**Südosteuropa - Studien · Band 51**

(eBook - Digi20-Retro)

Roland Schönfeld (Hrsg.)

# Transformation der Wirtschaftssysteme in Ostmitteleuropa

**Verlag Otto Sagner München · Berlin · Washington D.C.**

Digitalisiert im Rahmen der Kooperation mit dem DFG-Projekt „Digi20“ der Bayerischen Staatsbibliothek, München. OCR-Bearbeitung und Erstellung des eBooks durch den Verlag Otto Sagner:

**http://verlag.kubon-sagner.de**

© bei Verlag Otto Sagner. Eine Verwertung oder Weitergabe der Texte und Abbildungen, insbesondere durch Vervielfältigung, ist ohne vorherige schriftliche Genehmigung des Verlages unzulässig.

«Verlag Otto Sagner» ist ein Imprint der Kubon & Sagner GmbH.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371

# SÜDOSTEUROPA-STUDIEN

herausgegeben im Auftrag der Südosteuropa-Gesellschaft
von Walter Althammer

Band 51

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371

# Transformation der Wirtschaftssysteme in Ostmitteleuropa
# Transforming Economic Systems in East Central Europe

Herausgegeben von Roland Schönfeld

Südosteuropa-Gesellschaft

München 1993

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371

Bayerische
Staatsbibliothek
München

Die Deutsche Bibliothek – CIP-Einheitsaufnahme

**Transformation der Wirtschaftssysteme in Ostmitteleuropa =**
Transforming Economic Systems in East Central Europe/
Südosteuropa-Gesellschaft. Hrsg. von Roland Schönfeld. –
München: Südosteuropa-Ges., 1993
(Südosteuropa-Studien; 51)
ISBN 3-925450-38-6
NE: Schönfeld, Roland [Hrsg.]; Südosteuropa-Gesellschaft
<Deutschland>; PT; GT

© 1993 by Südosteuropa-Gesellschaft, 8000 München
Alle Rechte vorbehalten
Gesamtherstelltung: Schoder Druck GmbH & Co. KG, Gersthofen

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371



# INHALTSVERZEICHNIS
# CONTENTS

ROLAND SCHÖNFELD
**Vorwort/Foreword** . . . . . . . . . . . . . . . . . . . . . . . . . . 8/9

I. Policy Goals

DAVID STARK
**Path Dependence and Privatization. Strategies in East Central Europe** . . 11

KAZIMIERZ Z. POZNANSKI
**Property Rights and Civil Liberties: Evolutionary Perspective on Transition in Eastern Europe and the Soviet Union** . . . . . . . . . . . . . . . . . 41

LÁSZLÓ BRUSZT
**Transformative Politics: Social Costs and Social Peace in East Central Europe** . . . . . . . . . . . 61

II. Strategies of Transition

DAVID BARTLETT
**The Political Economy of Privatization: Property Reform and Democracy in Hungary** . . . . . . . . . . . . . . . 77

JANUSZ M. DABROWSKI, MICHAEL FEDEROWICZ, ANTHONY LEVITAS
**The State Enterprises in the Process of Market Creation in Poland** . . . . . 111

ZHIYUAN CUI
**Recessionary Bias of Polish Stabilization in 1990: Perspectives from the Economics of Incomplete Markets** . . . . . . . . . 125

JAN SZOMBURG
**Polish Privatization Strategy: Evolution and Features** . . . . . . . . . . . 135

FRANZ-LOTHAR ALTMANN
**The Transformation of Property Rights in Czechoslovakia** . . . . . . . . . 155

ROLAND SCHÖNFELD
**Transformation and Privatization in East Germany: Strategies and Experience** . . . . . . . . . . . . . . . . . . . . . . . . 159

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


## III. Lessons

MARIE LAVIGNE
**Denationalization and Reprivatization in the East, West and South: Are Comparisons of Experiences Relevant?** . . . . . . . . . . . . . . . . . 173

IVAN T. BEREND
**The Role of Non-Economic and External Factors in East Central European Economic Transformation** . . . . . . . . . . . . . . 185

WERNER GUMPEL
**The Mentality Problem in the Transition Process from Centrally Planned Economy to Market Economy** . . . . . . . . . . . 191

PETER MURRELL
**Conservative Political Philosophy and the Strategy of Economic Transition** . 199

Autorenverzeichnis/List of Authors . . . . . . . . . . . . . . . . . . . . . . 211

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371



# VORWORT

Im Juni 1991 veranstaltete die Südosteuropa-Gesellschaft gemeinsam mit dem Joint Committee on Eastern Europe des American Council of Learned Societies (ACLS), New York, und dem Südost-Institut in der Carl Friedrich von Siemens Stiftung in München-Nymphenburg ein wissenschaftliches Symposion zum Thema „Transformation der Wirtschaftssysteme in Ostmitteleuropa", das Wissenschaftler aus Australien, Belgien, Frankreich, Österreich, Polen, der Tschechoslowakei, Ungarn, den USA sowie West- und Ostdeutschland zusammenführte. Diese Experten der Wirtschafts- und Gesellschaftssysteme und der Entwicklungsbedingungen in Ost- und Südosteuropa untersuchten die politischen, wirtschaftlichen und sozialen Institutionen, die auf den Trümmern des Staatssozialismus errichtet oder wiedererrichtet werden müssen. In ihrer Analyse der institutionellen Voraussetzungen für die Schaffung funktionierender Marktwirtschaften zeigten sie auch die Grenzen und Lücken der verfügbaren Transformationstheorien auf.

Die in diesem Band gesammelten Beiträge wurden für die Konferenz vorbereitet und von den Autoren unter Berücksichtigung der Diskussion überarbeitet. Ich möchte bei dieser Gelegenheit Herrn Professor David Stark, Cornell University, für die Vorbereitung und Durchführung des Symposions herzlich danken. Unser besonderer Dank gilt auch Herrn Dr. Jason Parker, ACLS, der als Mitveranstalter diesen anregenden und erfreulichen Gedankenaustausch ermöglicht hat. Zu danken ist nicht zuletzt der Carl Friedrich von Siemens Stiftung für die erneute, großartige Gastfreundschaft.

München, im Oktober 1992 — Roland Schönfeld

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


# FOREWORD

In June 1991, a conference on "Transforming Economic Systems in East-Central Europe" was held in Munich by the Südosteuropa-Gesellschaft and the Joint Committee on Eastern Europe of the American Council of Learned Societies (ACLS), New York, gathering scholars from Austria, Australia, Belgium, Czechoslovakia, France, Hungary, Poland, the USA as well as West- and East Germany. Those specialists, familiar with the systems, conditions and developments of Eastern Europe, examined the political, economic and social institutions that must be constructed or reconstructed on the ruins of state socialism. In analyzing the institutional prerequisites for the creation of market economies, they showed the limitations and deficiencies of the transformation theories available.

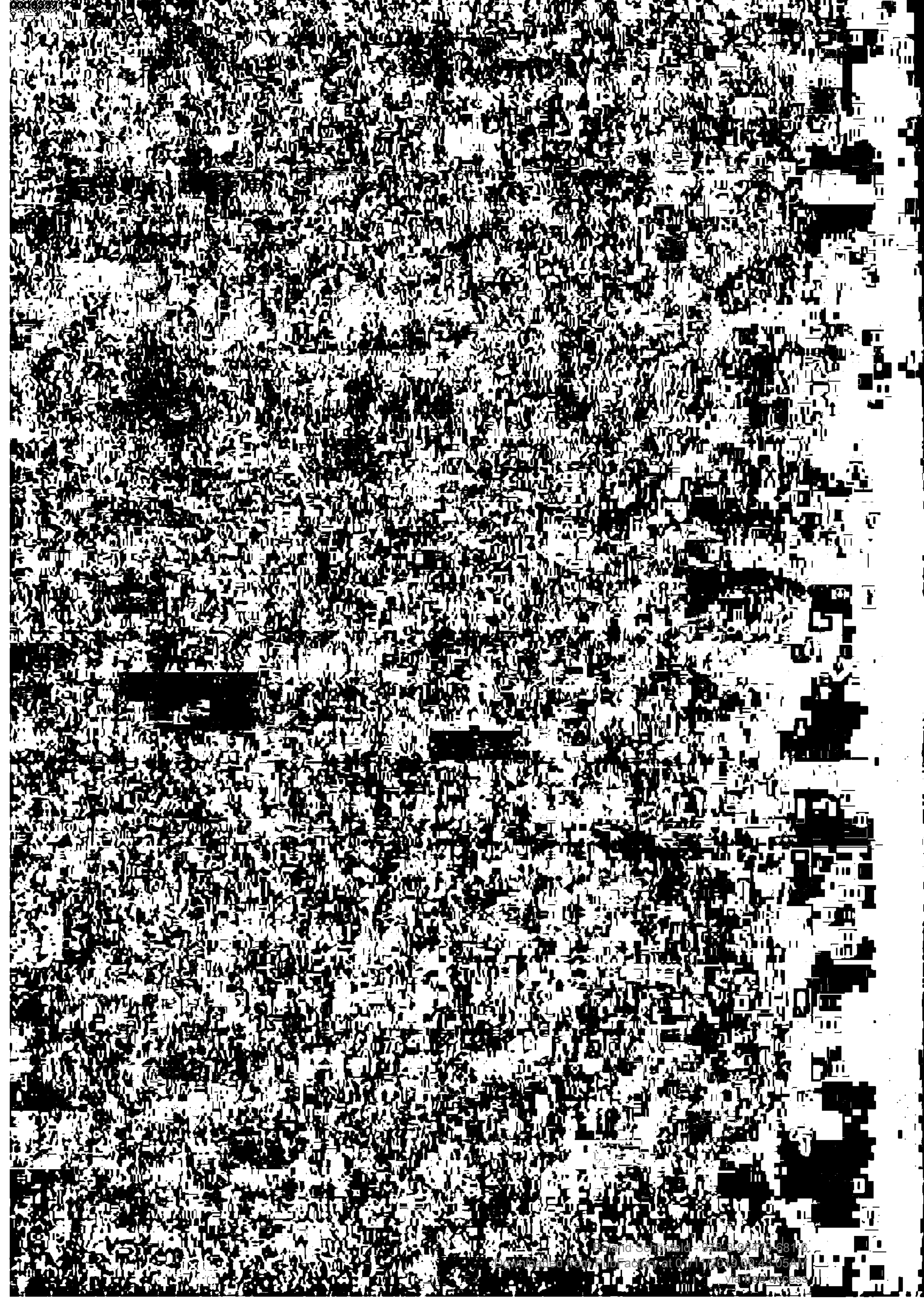
The papers collected in the volume had been prepared for the conference and the authors were given the time to include the result of our lively discussion. I would like to take this opportunity to thank Professor David Stark, Cornell University, for his help in preparing and organizing this conference. Our thanks to Dr. Jason Parker, ACLS, for co-sponsoring the conference and thus making this stimulating and enjoyable intellectual exchange between European and American scholars as well as this publication possible, and last but not least, the Carl Friedrich von Siemens Stiftung for offering again their beautiful conference facilities.

Munich, in October 1992 — Roland Schönfeld

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

# Policy Goals

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access



Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371



*David Stark*

# Path Dependence and Privatization Strategies in East Central Europe*

## Introduction: Capitalism by Design?

Across the ruins of Communism, a clear breeze blows from the West. Like the "fresh winds" that had been hailed from the East across the ruins of war more than four decades earlier, it promises prosperity through sacrifice. Like the old vision with its road maps to the promised land, this new vision comes with packaged formulas for applying economic science to the grand project of institutional reconstruction. In 1991, no less than in 1948, devastation is seen as mandating boldness of action but also as presenting an opportunity: the collapse of the old order issues the imperative for ambitious experiments while offering the occasion to build anew, this time, with a fresh start to create capitalism by design.

As the juxtaposition of postwar Bolshevism and post-Cold War designer capitalism suggests, this paper is highly skeptical about analyses that approach the economic transition in East Central Europe as a problem to be solved by the rationalist design of economic institutions. Three sets of reasons inform this skepticism.

First, proposals for all-encompassing institutional change according to comprehensive blueprints suffer from an inadequate comparison of socialist and capitalist economic systems.[1] Misled by the obviously superior efficiency and performance of capitalist institutions, such proposals mistakenly draw the conclusion that these institutions can be replicated according to instructions, whereas the deeper and more pertinent comparative lesson is that the failure of socialism rested precisely in the attempt to organize all economic processes according to a grand design. The notion that the more rational institutions can be implemented by conscious design thus duplicates the rationalist fallacy evidenced during the introduction of socialism with, for example, the Leninist notion that property relations could be changed overnight by administrative decree. Moreover, the premise that efficient institutions can be drafted at the systemic level ignores, as Peter Murrell acutely observes, the actual operations of existing capitalisms.[2] The origins of capitalism in the West were not by blueprint, its development has not been directed by conscious design, and, as recent research in evolutionary economics and organizational ecology has demonstrated, its processes

---

* Research for this paper was supported by grants from the National Science Foundation. My thanks to László Bruszt, Valerie Bunce, Janusz Dabrowski, István Gábor, Péter Gedeon, Peter Katzenstein, János Lukács, Gerald McDermott, Peter Murrell, Victor Nee, László Neumann, Andrzej Rychard, Jan Szomburg, Marton Tardos, Eva Voszka, and especially Monique Djokic Stark for helpful criticisms and suggestions at various stages of researching and writing this paper.

[1] See, for example, Olivier Blanchard, Rudiger Dornbusch, Paul Krugman, Richard Layard, and Lawrence Summers, *Reform in Eastern Europe* (Cambridge, MA, 1991).

[2] Peter Murrell, "Conservative Political Philosophy and the Strategy of Economic Transition," in this volume.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


for selecting technologies and organizational forms are governed more by routine than by rational choice.[3]

The second reason to be skeptical about cookbook capitalism is that the systems designers and international advisory commissions who fly into the region with little knowledge of its history tend to approach the problem of "the transition" exclusively through the lenses of their own general models. Through such a gaze, differences among the countries in the region are merely differences in degree (the timing and rapidity of collapse, the strength of elite commitment to reform, the speed of introducing new policies, and the like). As a consequence, their analyses of developments in the region are the simple measurements of the degree to which a particular strategy conforms to or departs from a given therapist's prescriptions. Contrary to such views, we should instead regard East Central Europe as undergoing a plurality of transitions in a dual sense: across the region, we are seeing a multiplicity of distinctive strategies; within any given country, we find not one transition but many occurring in different domains – political economic, and social – and the temporality of these processes are often asynchronous and their articulation seldom harmonious.[4] Most important, because their models of economies are abstracted from the social institutions in which societies (and hence economies) are reproduced, analyses that begin with blueprints ignore the ways in which actual policy makers are shaped and constrained by the citizens of the newly emergent democracies of East Central Europe. Capitalism cannot be introduced by design in a region where the lessons of forty years of experimentation by a rational hand have made the citizenry cautious about big experiments. A new social order cannot be created by dictation – at least not where citizens themselves want a voice in determining the new institutions. And these voices will be loudest where economic transformations are, as they must be in East Central Europe, painful and difficult. That is, attempts to reduce production costs and lower transaction costs can only be successful where society is willing to bear the transition costs.[5]

Because the actions of policy makers will be shaped by their perceptions of society's tolerance of these transition costs, we would do better to analyze the resources at

[3] See especially Michael T. Hannan and John H. Freeman, *Organizational Ecology* (Cambridge, MA, 1989); Richard Nelson and Sidney Winter, *An Evolutionary Theory of Economic Change* (Cambridge, MA, 1982); Paul David, "Understanding the Economics of QWERTY: The Necessity of History," in *Economic History and the Modern Historian,* edited by W. Parker (London, 1986), pp. 30-49; and Brian W. Arthur, "Competing Technologies and Lock-in by Historical Events: The Dynamics of Allocation under Increasing Returns," *Economic Journal,* 99 (1989), pp. 116-131.

[4] Sensitivity to these differences is obscured by the very events that brought so much attention to the region. "1989" was a double conjunture – both in the near simultaneity of events across the countries of the region and in the rapid acceleration and increasingly reciprocal effects of changes across political, economic, and social domains. But "1989" will stand in the way of understanding developments in the region if we take it as a universal beginning or culmination. That is, we must begin to disaggregate "the transition," perhaps even dispense with it as a concept, and undertake the difficult research work of understanding how changes in the different countries and in the different domains have very different temporalities. Changes in social institutions, for example, are not simply slower but might well have been taking place much before more easily observable political developments. If pace and timing differ across domains, we should also not assume that changes within them necessarily move in the same directions.

[5] László Bruszt, "Transformative Politics: Social Costs and Social Peace in East Central Europe." *East European Politics and Societies,* vol. 6, no.1 (1992): 55–72.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


their disposal for securing support for burdensome measures instead of focusing exclusively on their recipes for change. Such resources are not likely to be evenly distributed across the countries in the region. Even more important, these resources are not simply material, financial, or economic, but are above all political, as they entail the historically shaped patterns of mediation between state and society that differ qualitatively from country to country. In such a view, social change is not a process either directed from above or initiated from below but a result of interactions in which the designs of transformation are themselves transformed, shaped, and modified in response to, and even in anticipation of, the actions of subordinate social groups.[6] By attending to these interactions, our examination shifts from preoccupation with the "one best way" to manage the transition scientifically to a more comparative analytic strategy deliberately attuned to diverse institutional configurations differing among the countries not in degree but in kind.

The third reason for skepticism about analyses that begin with blueprints is that they often take the "collapse of communism" to indicate the existence of an institutional void. Indeed, this myth of "starting from scratch" explains some of the academic fascination with the region and the hasty proliferation of marching orders to create capitalism in six steps or sixty. But the devastation and destruction wrought by Communism and the explosive rapidity of the demise of its party-states have not left an institutional vacuum. My concern here is not with some lingering traces of socialist ideology or with the reconstructive surgery that gives new anatomies to the old nomenklatura but with the institutional legacies of the transitions themselves. To extend the metaphor of collapse: It is in the ruins that these societies will find the materials with which to build a new order; therefore, differences in how the pieces fell apart will have consequences for how political and economic institutions can be reconstructed in the current period.[7] In short, it is the differing paths of extrication from state socialism that shape the possibilities of transformation in the subsequent stage.

The analysis below thus takes as its point of departure a proposition that is implausible only on first acquaintance – the economic transformations currently attempted in East Central Europe will be marked by "path dependence". The hypothesis is unlikely from the vantage of the drafting board where the designer sketches new institutions on a tabula rasa: Why should we expect continuities where departures are imperative? The true strength of the concept of path dependence, however, is precisely its analytic power in explaining outcomes where strategic actors are deliberately searching for departures from long-established routines and attempting to restructure the

---

[6] Unlike the designer's schemes in which the actions and preferences of subordinate social groups are a hindrance to the speedy enactment of the prescribed formulas (or at most take only a reactive role at the voting booth to approve or remove programs and parties), in the perspective adopted here the institutionalized interactions between state and society play a formative role in shaping actual strategies.

[7] I take this to be the key analytic insight of Theda Skocpol's *States and Social Revolutions* (Cambridge, England, 1979). See László Bruszt and David Stark, "Remaking the Political Field in Hungary: From the Politics of Confrontation to the Politics of Competition," in Ivo Banac, *Eastern Europe in Revolution* (Ithaca, NY, 1992), pp. 13-55.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


rules of the game.[8] Actors who seek to move in new directions find that their choices are constrained by the existing set of institutional resources. Institutions limit the field of action, they preclude some directions, they constrain certain courses. But institutions also favor the perception and selection of some strategies over others.[9] Actors who seek to introduce change require resources to overcome obstacles to change. This exploitation of existing institutionalized resources is a principal component of the apparent paradox that even (and especially) instances of transformation are marked by path dependence.

Such a view does not preclude the possibilities of changes that are far-reaching and dramatic. But it departs emphatically from those all too prevalent approaches that argue that economic development requires a rapid, radical, extensive (and even exhaustive) replacement of the current institutions, habits, and routines of the former centrally planned economies by an entirely new set of institutions and mentalities. Such wholesale replacement is rejected not because of some illusions or nostalgia for socialism but from an appreciation of the evolutionary character of capitalism (point one above). And if the massive social engineering that would be required to effect it is undesirable, it is also unlikely (point two).[10] It is for these reasons that I argue that the structural innovations that will bring about dynamic transformations are more likely to entail processes of complex reconfigurations of institutional elements rather than their immediate replacement.

From this perspective, we become more circumspect about such notions as "the transition to capitalism" or "the transition to a market economy" – alert to the possibility that behind such seemingly descriptive terms are teleological constructs in which concepts are driven by hypothesized end-states. Presentist history finds its counterpart here in futurist transitology. Thus, in place of transition (with the emphasis on destination) we analyze transformations (with the emphasis on actual proces-

---

8 As my emphasis on paths of extrication in the paragraphs above should indicate, by "path dependence" I am not referring to some processes whereby the societies of Eastern Europe are seen to return to the natural "historical trajectories" of the interwar period from which they had temporarily deviated (see, for example, the argument of Ivan Szelenyi in *Socialist Entrepreneurs* (Madison, 1988)). Unlike these notions of already existing roads or the concept of trajectory in which one can calculate destination from knowledge of initial direction and thrust, the concept of path dependence is not that of a vector.

9 My conception of institutions as embodied routines and my emphasis on practices instead of preferences and on predispositions instead of rational calculations draws on the work of Pierre Bourdieu, especially *The Logic of Practice* (Stanford, 1990). For a similar conception of institutions as not simply constraining but as enabling, see Paul DiMaggio and Walter Powell's introductory essay in *The New Institutionalism in Organizational Analysis* (Chicago, 1991), pp. 1-38.

10 The pertinent lesson of state socialism is that large-scale social engineering might so badly tear the social fabric that its damage will take decades to repair and that a totalizing institutional uncertainty will preclude the longer-term calculations so central to the efficient functioning of economic institutions. That is, the greater the scope of an experiment, the greater the risk of catastrophe. (See Murrell, in this volume.) My intention here is not to denigrate institutional design. Institutional designs do matter and can be for the better, especially if they are delimited in scope to solve particular problems of governance and coordination for specific sectors or localities (rather than as global solutions to the problems of an entire economy). In place of grand experiments, we should hope for more, not less "designs" – partial solutions to limited problems in which transformation becomes a process undertaken by a multiplicity of dispersed agents at many institutional sites.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


ses) in which the introduction of new elements takes place most typically in combination with adaptations, rearrangements, permutations, and reconfigurations of already existing institutional forms.

This paper examines these transformative processes through a comparative analysis of strategies of privatization in the four East Central European economies: Czechoslovakia, Hungary, Poland, and the former East German territories. The purpose of such a four-way comparison is not to construct some essentialist model of privatization against which the respective cases differ only in degree but to produce a comparative framework in which the specificity of each case will be revealed through its simultaneous mutual contrast with the other cases.[11] The comparative study of East European capitalisms is best launched not by taking its point of comparison in a general model of capitalism nor even of the plural models of existing capitalisms (in which the East European cases are various approximations of West European counterparts) but by an analysis in which the specific content of the analytic categories is developed through a relational comparison of the East European cases themselves.[12] The privatization programs of the region offer an opportunity to adopt such a methodological strategy. Despite broad and pervasive similarities in the systemic problems encountered, there are significant differences in the privatization programs that typify transformative processes across the four national cases. In the concluding section, these differences in the first phases of transformation are traced to differences in the earlier stages of extrication. We shall see that these privatization programs are not derived from master blueprints but are shaped by the specific institutional resources that are the legacies of the path of exit from state socialism. Seen from this vantage point, transformative processes taking place in contemporary East-Central Europe resemble less architectural design than bricolage, construction by using whatever comes to hand.

## Specifying the Dimensions of the East European Variant(s)

"Privatization" in this paper refers to the process of transferring ownership rights of productive assets held by the state. Although in the contemporary East European context such transfer is conventionally seen as the principal means of creating a private sector in an economy dominated by a public sector, the two processes should not be confused or conflated. First, transferring ownership from state to private hands is unlikely to be sufficient to create a dynamic private market economy.[13] Second, such

[11] For the use of a similar comparative methodology see David Stark, "Rethinking Internal Labor Markets: New Insights from a Comparative Perspective," *American Sociological Review,* 51:4 (August 1986), pp. 492-504; and David Stark, "Bending the Bars of the Iron Cage: Bureaucratization and Informalization under Capitalism and Socialism," *Sociological Forum,* 4:4 (1990), pp. 637-664.

[12] This is the major limitation of Ellen Comisso's interesting argument in "Political Coalitions, Economic Choices," *Journal of International Affairs,* 45:1 (Summer 1991), pp. 1-29. For Comisso, the "options" available to the economies of Eastern Europe are given by the array of existing West European national economies, e.g., the "French model," the "Swedish model," "modified Thatcherism," etc.

[13] David Stark, "Privatization in Hungary: From Plan to Market or from Plan to Clan?" *East European Politics and Societies,* 4:3 (Fall 1990), pp. 351-392.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


a marketized private sector might be more effectively produced by measures to stimulate the start-up of new ventures and expansion of existing units in the nascent private sector (formerly, the second economy) than by transforming state assets into private assets.[14] Nonetheless, each of the new governments in the region looks to privatization, i.e., ownership transfer, as the fundamental step toward the creation of a market economy. This paper brackets the question of that causal relationship and focuses on the variation in privatization strategies across the cases. How do the ways these new governments differ in their policies for transferring ownership of the assets of state enterprises? While acknowledging similarities among the cases, it identifies the distinctive privatization programs that typify each new government's strategy of privatization during its initial period in office.

For a typology to portray these differences, I propose three dimensions reflecting three central questions that must be addressed by any program of privatization: (1) How are the state's assets evaluated? (2) Who can acquire these assets? and (3) With what resources are ownership rights acquired? In the following section I specify the categories of these dimensions for the East Central European variant(s) of privatization strategies.[15] We then analyze the country cases and identify those programs exemplifying the various combinations of methods of asset evaluation, identities of participants, and resources for participation in privatization.

## Valuation of Assets

The polarities of this dimension are straightforward. At one pole, assets of the large public enterprises are evaluated by administrative means. At the extreme we would find a single agency responsible, as part of the state bureaucracy, for every aspect of the privatization process. That bureaucratic agency would assess the economic viability of firms, selecting some for foreclosure and others for privatization, and would seek out buyers for those designated to be privatized. Although bureaucratic agents might solicit economic assessments of market performance when conducting these evaluations, actual decisions would be made on the basis of administrative measures rather than spontaneous market mechanisms. The other pole is already anticipated in our presentation of the first: valuation would take place directly through market mechanisms. Here policy makers do not see markets only as an outcome of privatization but also as a means of privatization. At the extreme we would find spot market transactions in the form of public auctions where auctioneers could, as with the sale of

[14] János Kornai, *The Road to a Free Economy* (New York, 1990); and Stark, "Privatization."

[15] Rather than explicating these dimensions as a strictly logical deductive exercise, the analytic categories are given content in terms of the specific historical and social setting that is contemporary East Central Europe. The Weberian notion of historically grounded concepts should be familiar to most sociologists. My method here is antithetical to the hollow antinomies of "deduction versus induction" or "theory versus historicism" resuscitated in the recent rational choice literature, e.g., Edgar Kiser and Michael Hechter, "The Role of General Theory in Comparative-Historical Sociology," *American Journal of Sociology*, 97:1 (July 1991), pp. 1-30.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


farm implements, announce a figure at which bidding could begin; but the final selling price would be determined by the competitive bidding.

The two poles, however, do not entirely capture the complexity of this dimension, for in between are some mechanisms of price formation and valuation that can be conceptualized either as combinations of bureaucratic measures and market mechanisms or as alternatives to them. Examples of such hybrid or alternative mechanisms would be relational contracting (in which state agencies contract the task of privatization to consulting firms based on their international reputation or in anticipation of long-term associations in which agency and firm would share information through channels not easily expressed in market terms), or *bargaining* (a loose term denoting patterns in which price setting is strongly influenced by network connections that differ from purely market transactions or political considerations that differ from purely administrative criteria).[16]

## Actors Targeted to Acquire Assets

In constructing a strategy of privatization, the new governments of these emergent democracies can present privatization as a process that will increase the wealth of the nation. Firms will be more accountable, more likely to economize on costs, and more oriented toward effective and efficient performance, they can argue, when property rights are exercised by private owners instead of state bureaucrats. But if privatization will increase the national income, it will also increase private wealth. Regardless of how they choose to portray private gain as contributing to the public good, governments that undertake privatization on a scale so potentially vast as that in contemporary East Central Europe (where over 85 percent of productive assets are state property) must address questions of distributive justice.[17]

We are thus interested in the question of whether these new governments will attempt to forge an explicit link between the economic objectives of privatization and the new civic principles of the emergent democratic polities. Specifically, is citizen-

---

[16] On relational contracting and other forms of coordination between firms that lie between (or outside) the dichotomy of markets and hierarchies, see Oliver Williamson, *The Economic Institutions of Capitalism: Firms, Markets, and Relational Contracting* (New York, 1985); and Rogers Hollingsworth and Wolfgang Streeck, "Countries and Sectors: Concluding Remarks on Performance, Convergence, and Competitiveness," in Rogers Hollingsworth, Philippe Schmitter, and Wolfgang Streeck, eds., *Comparing Capitalist Economies: Variations in the Governance of Industrial Sectors* (New York, 1992).

[17] Strategies of justification thus lie at the core of strategies of privatization. Although I raise these issues explicitly in this subsection, processes of justification are an important aspect of each of our three dimensions. My intention here is not to unmask them as after-the-fact ideologies or false rationalizations mystifying some underlying injustice but to see how the specific work of justification can vary from case to case as shaped by the broader transformative politics. On strategies of justification in the transitional period on the shop floor, see David Stark, "La valeur du travail et sa rétribution en Hongrie," *Actes de la recherche en sciences sociales,* 85 (November 1990), pp. 3-19 (available in English as "Work, Worth and Justice in the Hungarian Mixed Economy," Working Papers on Central and Eastern Europe, Center for European Studies, Harvard University, 1990, no. 5). For an ambitious theory of justifications, see Luc Boltanski and Laurent Thevenot, *La justification: Les economies de la grandeur* (Paris, 1991).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


ship (that most fundamental civic principle with its attendant concept of the abstract equality of the citizen) invoked as a principle for distributing property rights? At issue is not whether individuals are explicitly targeted in their capacity as citizens to be recipients of property rights in the privatization of the assets of the large public enterprises.

Whereas some governments will utilize civic principles to target citizens as recipients of the state's former assets, others will utilize purely economic principles to target corporations. In this latter case, although private persons might participate in some programs of privatization (in agriculture, in the "small privatizations" of retail shops and restaurants, for example), the fundamental strategy of the privatization of the large state enterprises will be based on distributing property rights to incorporated units. In short, privatization strategies will differ according to whether the state specifically seeks to involve civic persons (citizens) as participants or, alternatively, eschews civic principles in favor of designing large-scale privatization around legal-economic persons (corporations).

## Resources Utilized to Acquire Ownership Rights

Privatization strategies can also vary according to the kinds of resources that are utilized (we might say converted) to acquire ownership rights. Monetary or financial resources are the obvious first category along this dimension. But, in addition to being differentiated according to their financial holdings or monetary savings, actors in the transitional societies of East Central Europe also differ according to the powers and capacities invested in their positions. In fact, the prohibition of private property in productive assets meant that the stratification systems of state socialist societies were organized more around differences in positions than in wealth. Thus, at the very moment when these economies embark on privatization, they must deal with a continuing legacy of the stratification system of state socialism: society is not greatly differentiated according to wealth in a system where advantages accrued to positions.

Thus, our third dimension contrasts those privatization schemes and strategies that are organized primarily around the utilization of monetary (including credit or other financial) resources with those in which the participating agents capitalize on their positional resources.

The concept of position and that of "positional property," of course, carry connotations of office holding.[18] We also start from that Weberian conception, but we will find it useful as well to extend the application of the concept from office holding to a broader set of organizational posts and locational positions. We should stress that our attention to positions should not be interpreted as a narrow preoccupation with the

[18] We think obviously here of the work of Pierre Bourdieu on different forms of "capital" in modern societies. See, for example, his "Forms of Capital" in John G. Richardson, ed., *Handbook of Theory and Research for the Sociology of Education* (New York, 1986), pp. 241-258. On positional property and its conversion in the Chinese setting, see Victor Nee, "Social Inequalities in Reforming State Socialism: Between Redistribution and Markets in China," *American Sociological Review*, 56 (1991), pp. 267-282.

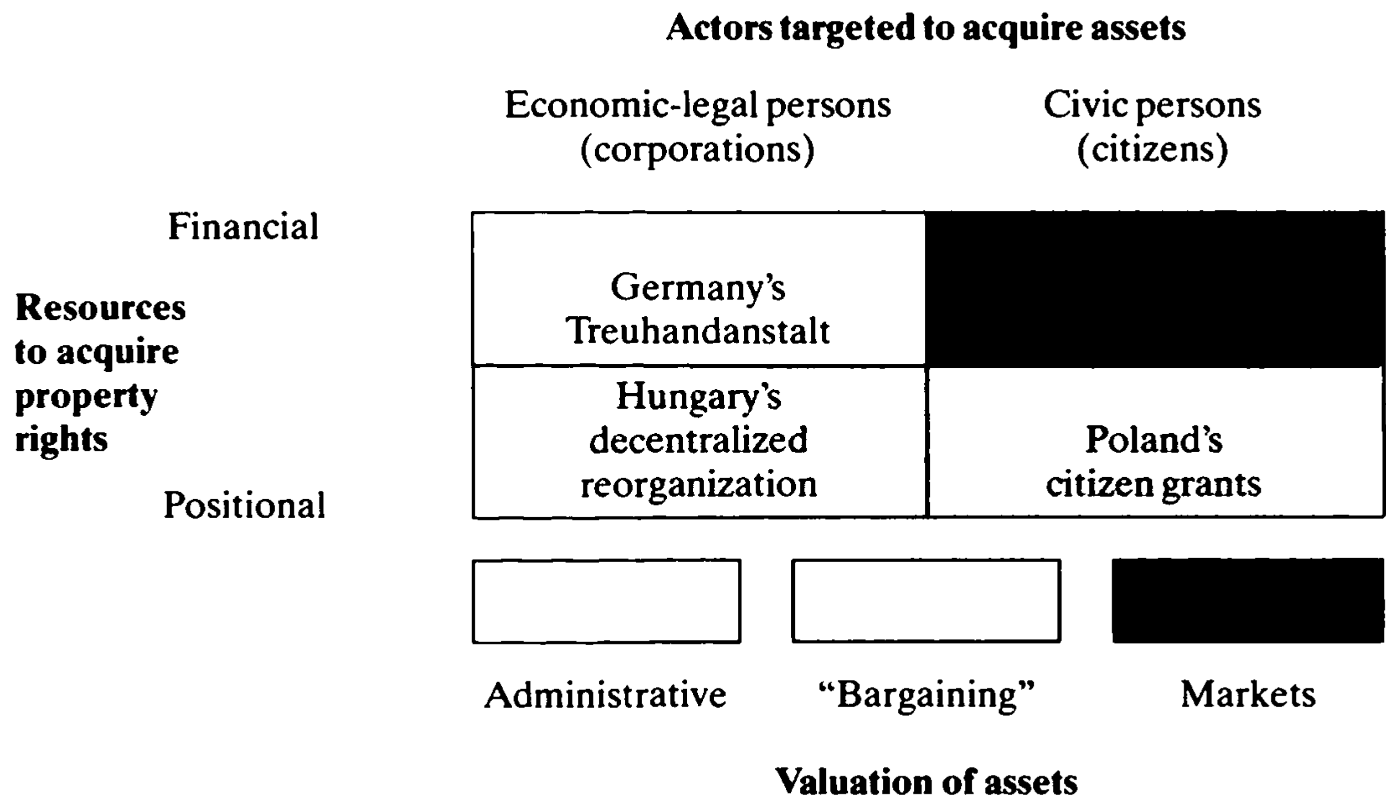
Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

p0063371


fate of those who held political positions in the old order and whether and how they are converting their political capital into economic capital.[19] Our concern here is more with economic job holding than with political office holding. Some privatization strategies will be structured in such a way that the occupants of certain positions will be able to utilize that occupancy for advantage in acquiring property rights. Managers, for example, might be able to utilize positional resources to gain effective ownership rights. Similarly, privatization strategies that place importance on employee ownership plans are instances of inclusion/exclusion in which ownership rights are acquired through positional resources.

Our three dimensions are cross-classified in Figure 1 to yield a preliminary typology of privatization strategies in East Central Europe. The dimensions referring to actors targeted to acquire assets and resources to acquire ownership rights form a two-by-two table. The remaining dimension referring to the method of evaluating assets is represented through shading ("administrative" lightest and "markets" darkest with "bargaining" in between). Also located on Figure 1 are those strategies for privatizing large public enterprises that most closely exemplify four of the possible combinations of the categories along the three dimensions.

Figure 1.
*A typology of privatization strategies in East Central Europe.*




[19] The old political capital suffered a massive devaluation and, in the current period, the publication of memoirs is one of the few remaining avenues of such direct conversion. In fact, there are good reasons to expect that in the current period monetary rather than positional resources will be more important as an avenue to ownership for those former apparatchiks whose earlier assets were exclusively political (that is, whose political capital had not already been combined with certain forms of cultural capital to yield economic positions in the managerial ranks).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


To avoid possible misunderstandings in interpreting this typology, we should state at the outset how we have delimited its object of study. First, the typology addresses questions of the privatization of large public enterprises. That is, we have not included here the multitude of schemes for privatizing retail trade, catering establishments, and agricultural cooperatives.[20] Second, our decision rule for placing country cases within the typology was to find cases that exemplify particular intersections of its dimensions. Our task here is to identify distinctive traits rather than produce an exhaustive description of the full range of privatization programs in each country. Thus, location of a particular country case in a given cell of the typology is not meant to capture all aspects about its course of privatization.[21] Third, our typology focuses on the strategies of policy makers in approximately the first year of the newly elected governments. How these strategies will be reshaped in the course of interactions with the relevant social actors must be the subject of a separate, and later, investigation.

## Distinctive Features of the Country Cases:

### *Germany's Treuhandanstalt*

Our discussion of the typology of privatization strategies represented in Figure 1 begins with the position denoting the administrative evaluation of assets favoring corporate actors utilizing predominantly monetized resources. No privatization strategy better exemplifies this particular combination of elements than the institution of Germany's Treuhandanstalt. Charged with the task of performing *triage* on the wounded enterprises of the formerly East German economy, the Treuhandanstalt or Trust has singlehandedly carried out functions that are performed elsewhere in the region by diverse governmental units scattered across the ministries of Industry, Planning, Finance, Labor, and Privatization. Following the monetary union of the two Germanies in July 1990 and their unification on October 3, 1990, the Treuhandanstalt became the world's largest industrial holding with a staff of 2,500 to privatize and monitor the operations of the former East German state enterprises employing more than

[20] A more comprehensive examination would also necessarily have to address the disposition of real estate and the question of the reprivatization of property. Restitution or compensation of former owners is an important question with significant implications for the timing, pace, and methods for privatizing the large public enterprises. In particular, uncertainties about reprivatization can pose serious obstacles that inhibit potential buyers and delay privatization in the state sector.

[21] For example, our location of "Hungary's decentralized reorganization" in the lower left-hand cell indicates that policy makers there have, to date, designed ownership restructuring around corporate owners, through bargaining processes, favoring positional resources. It does not imply, for example, that financial/monetary resources are not mobilizable in Hungary nor that positional resources are not mobilizable in Germany. Similarly, the use of citizen vouchers in Poland and Czechoslovakia does not exclude incorporated actors from participation in privatization in those economies – although it is interesting to note that the governments of Germany and Hungary have, thus far, excluded the principle of citizenship from their strategies for privatization.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

p0063371


3 million wage earners.[22] By May of 1991, the Trust had privatized 1,670 firms out of the approximately 7,000 that had been operating in the former East German lands, taking its largest strides in the branches of energy, food stuffs, construction, trade, and tourism. Ninety percent of these properties were sold to West Germans (primarily corporations), five percent were purchased by foreign (that is, non-German) capital, and five percent are now held by their former managers. In preparation for further privatizations, the Treuhand also split up 316 *Kombinat* (mega-conglomerates in the old socialist economy) into 8,500 smaller firms involving some 45,000 plants.[23]

This aggressive posture of attacking a problem by means of a strong bureaucratic agency with an almost unquestioned mandate to impose radical, sweeping, and rapid restructuring is the defining feature of the German privatization strategy. But if the German state has moved with greater speed and determination than other Central European governments in the first stage of privatization, there are indications that its greatest difficulties still lie ahead. Recent developments indicate that these obstacles will not be met with an even quickened pace and stronger administrative measures but that the difficulties facing the Treuhand will retard its speed and lead to modifications of its methods. The irony of the East German case to date has been that the very strength of the West German economy that was presumed to yield a more smooth transition (relative to its neighbors) has proven in the initial stage to be also a source of problems. In particular, the dramatic surge of demand for consumer goods in the newly incorporated lands was met in the first instance by expansion of output by West German firms. Thus, if it indeed might be the case that the "wealthy brother" will save the situation by buying firms in the long run, in the short run he began by selling goods to his desiring and poorer siblings. Uncompetitive on the world market, unable to sell goods on the West German market, and now uncompetitive on their own territory, the former East German enterprises saw their markets evaporate within weeks. With no orders and no work, millions of employees in these failing enterprises have been receiving a scarcely disguised unemployment compensation in the form of "short-time work" in which they remain on the payroll with little or nothing to do at their place of employment.[24]

For some of the intellectuals who attempt to shape German public opinion, the most attractive solution to this problem is massive migration. "Everyone who is wil-

---

[22] *The World Bank/CECSE,* 2:5 (May 1991), p. 3.

[23] For an excellent description of the work of the Treuhand in its first months of operation and a balanced analysis of the difficult problems facing it in the near future, see Roland Schönfeld, "Privatization in East Germany: Strategies and Experience" (paper presented at the Conference on Transforming Economic Systems in East-Central Europe, Munich, June 1991).

[24] Such short-time work was originally scheduled to expire on June 30, 1991, prompting some estimates that there would be 3.5 to 4 million unemployed (as high as 45 percent of previously active earners in 1989) by the end of the summer of 1991. See Schönfeld, "Privatization." These worst nightmares were not realized, in part, because short-time work was extended beyond that deadline. By late 1991, high-level Treuhand officials acknowledged an effective unemployment rate of about 30 percent. See Horst Kern and Charles F. Sabel, "Between Pillar and Post: Reflections on the Treuhand's Uncertainty About What To Say Next" (paper presented at the Conference on the *Treuhandanstalt,* Harvard University, November 1991; and comments by Treuhand officials at that conference).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

ling to work hard can find a job here in our prosperity," they can be heard to say. But even if such westward migration could absorb a significant proportion of those seeking work, the consequences might prove not only catastrophic to the social fabric but also devastating to the local economies they leave behind. Massive migration, even on a scale far lower than some policy makers have in mind, could lead to a massive devaluation of the human capital of the economy of the former East German lands. Such devaluation would be triggered not simply by the aggregate loss of highly skilled individuals but also by the destruction of the work teams in which those skills had previously been utilized. Not as a direct outcome of foresight and planning but as an unintended consequence of the macroeconomic mismanagement of state socialism, the organization of work in the micro sphere of the redistributive enterprise had evolved into a forced autonomy and a distorted flexibility.[25] At the level of the shop floor, work teams developed, indeed were forced to develop, patterns of adaptation to adjust quickly and flexibly to supply shortages and other irrationalities of central mismanagement. Such adaptations should not be idealized – they were constrained and distorted – but they had evolved into work units in which the human capital of the teams was more than the sum of its individual parts. In such a case, the departure of two or three from a team of a dozen can cripple its functioning and shatter a small but potentially significant resource that might otherwise be a basis for reconstructing a failed economy. In short, migration stimulated by the close proximity to prosperity on the same national territory might alleviate unemployment but it might also erode organizational capacities and retard the development of a dynamic economy in the former East German lands.

Unemployment and severe economic crisis will have important consequences for the further work of the Treuhandanstalt. As the situation inside the Eastern enterprises rapidly deteriorates, it will prove increasingly difficult to find buyers for them. Meanwhile, as unemployment explodes to unprecedented proportions, pressures will mount to slow the pace of liquidation. Firms that can be neither sold nor shut down (and we can expect that they will number in the thousands) will remain under the bureaucratic authority of the Treuhand, and that state agency will be forced to intervene directly in reorganizing these properties using subsidies to keep them afloat in the meantime.[26] But we can further expect relentless pressures on the Trust to demonstrate that it remains committed to a determined course of privatization. After all, its mandate was for sweeping and rapid privatization – federal politicians and other governmental officials will not look favorably on an agency that resorts to subsidizing instead of privatizing, and bureaucratic superiors will frown at subordinates in the agency whose quarterly record of completed privatizations falls below the norm. From the combination of these factors, we can expect that the Treuhandanstalt will increasingly look to the current managers as a potential pool of new owners for the failed but recuperable smaller units that have already been (or soon will be) broken

[25] Stark, "Rethinking," and János Lukács, "Organizational Flexibility, Internal Labor Market, and Internal Subcontracting, Hungarian Style," in Rudolf Andorka and László Bertalan, eds., *Economy and Society in Hungary* (Budapest, 1986), pp. 15-34.

[26] Schönfeld, "Privatization"; and Kern and Sable, "Pillar and Post."

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


off from the large state enterprises. In this scenario, the evaluation of assets is likely to take place increasingly through bargaining between the agency and enterprises with managers utilizing positional resources to exercise new and expanded property rights. A recent study indicates that this process has already begun, and restructuring has become the critical task of the Treuhand. To organize the market for potential buyers, firms must first be reorganized.[27] The Kombinate are too big to sell all of a piece; and the parts that can be broken off and sold by themselves are too small to make a difference. Restructuring thus often entails the simultaneous disaggregation of several large enterprises and the strategic recombination of these newly available constitutive parts (from across different enterprises) to create new ventures.

### *Czechoslovakia's Voucher-Auction Program*

In strong contrast to the decidedly statist orientation of the German privatization strategy, the Czechoslovak strategy is an exemplary case of evaluating assets directly by the market, involving participation on the basis of citizenship, and utilizing monetary resources. In fact, this particular combination of categories along our three dimensions is represented in a single institutional innovation in the Czechoslovak strategy – the use of citizen vouchers in public auctions of shares of the large state enterprises.

The program that the Czechoslovak economic authorities are proposing will involve the distribution of over fifty percent of the equity of more than a thousand large public enterprises through a citizenship voucher scheme. Each Czechoslovak citizen over eighteen years of age will receive vouchers equal to a thousand "investment points." These investment points can be exchanged for shares in the enterprises designated for privatization through the voucher program. But, if every citizen receives these vouchers as a matter of right, only those who pay a registration fee of a thousand korunas will be able to use the vouchers in the public auctions.[28] To indicate that the equity shares obtained through the voucher program are emphatically not a free gift from the state, to signal that there will be risk involved, and to filter out citizens with no serious interest in share ownership, the Czechoslovak officials have designed a voucher scheme that combines citizenship participation and monetary resources.

The actual process of exchanging vouchers for shares is fairly complex (and the Czechoslovak authorities are undertaking a major program to educate the public about its basic principles and its logistical intricacies). The first round of the voucher-auction is scheduled to begin on May 26, 1992. By that time the Ministries of Privatization will have designated the enterprises whose equity will be distributed through auction.[29] For each enterprise, the Ministries will post an initial asking price for the

---

[27] Kern and Sabel, "Pillar and Post."

[28] Presumably to increase participation rates, the registration fee has been reduced from initial proposals that called for 2,000 korunas (equivalent to about half the average monthly earnings of industrial employees).

[29] By late 1991, the Ministry had received 3,588 privatization projects from some 900 enterprises. Some 2,800 of these projects were in conformity with the requirements of the voucher scheme. I am grateful to Gerald McDermott for providing these figures.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


shares of that particular firm. To understand the principles of the auction, it is important to note that this "price" is not expressed in monetary units but in terms of investment points. Basically, the state announces the number of investment points at which it is willing to exchange a share of a given enterprise. A single share of a blue-chip company, for example, might begin at an initial level of two hundred investment points; a share of a firm with a less prominent record or less promising future prospects, on the other hand, might be posted at only ten investment points. In the first round of the auction, then, one citizen might decide to place all of his one thousand investment points on five shares of the blue-chip company; another could indicate his willingness to exchange all of his one thousand points for one hundred shares in the less promising venture; and a third could diversify his "portfolio" of investment points across firms with differing initial asking prices.

Equally important in understanding the principle of asset evaluation represented in the voucher-auction, it should be stressed that the auction is conceived as an iterative process occurring in multiple rounds. That is, although the economists in the Czech and Slovak Ministries of Privatization must conduct a rough and ready evaluation of the performance of firms to set the initial price of shares in the first round of bidding, the final price in investment points in the simulated market of the voucher-auction (and, more importantly, the later price of shares bought and sold on an actual market) will be determined by the supply and demand for these shares. What Vaclav Klaus and his team in the Ministry of Finance seem to have in mind is a kind of Walrasian auctioneer.[30] The auctioneer (actually a computerized network) accepts offers to buy shares of a given enterprise at a certain asking price in investment points. Unlike a commodities exchange (or the typical auction we might know from an estate sale or of objects of art) the bidder-citizens are not, strictly speaking, bidding up the price in a given round. At the end of the first round, the auctioneer identifies those shares for which demand exceeded supply as well as those in which the reverse was the case. (To take a hypothetical case, the number of citizens willing to expend two hundred of their investment points for a share in the blue-chip corporation exceeded the number of shares being issued for that enterprise, or vice versa.) As the seller, the state can then accept offers from that round, or adjust prices upwards or downwards for the next round to be held two weeks later. The auction proceeds for three of four rounds with the state accepting offers or revising prices. One concept currently in circulation among the designers of the voucher-auction program is that the state should accept offers where the demand for shares of a particular enterprise is lower than their supply (the number of shares for each firm in the auction is fixed) and revise prices upwards for those shares where demand exceeds supply.

This is not the place to elaborate all the technical and political complexities of the voucher-auction. What percentage of assets will the state retain even for the auctioned firms and how will this influence the bidding process? What are the likely consequences of different decision rules about when the state should accept offers or when to revise "prices" upwards or downwards? What if the overall participation rate is so

---

[30] We might also observe that the auction that Klaus is proposing has some resemblance to the schemes of Oscar Lange for setting prices through a simulated market within a socialist economy.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


low that virtually all shares are undersubscribed?[31] Our attention here is instead addressed to the major principles that underscore the voucher-auction as an important feature of the Czechoslovak strategy of privatization.

First, and most important, the Czechoslovak leadership appears committed to using a simulated market to rapidly achieve an actually functioning equity market in the shares of a significant proportion of the former state enterprises.[32] The question of whether "investment points" reflect the real value, even a true relative value, of shares is quite beside the point since the purpose of the voucher-auction is to get shares in private hands where they can be actually bought and sold.[33] According to the designers of the auction, it is in such a market (where speculators are not to be disparaged but encouraged) that the real evaluation of assets will take place.[34] It is for this reason, rather than primarily because of the registration fee, that we locate the Czechoslovak privatization strategy in that cell representing the intersection of market evaluation and monetary assets.[35]

Second, with the establishment of a capital market organized around the stock exchange stimulated by the voucher-auction program, the Czechoslovak economy appears to be heading in the direction of raising investment funds through markets (typical of the Anglo-American system) rather than through the Japanese or German system in which banks play a more central role in monitoring and directing the performance of their creditor firms (for a contrast, see the Polish case below).

Third, the Czechoslovak leadership appears prepared to accept relatively dispersed ownership in the initial stage of its privatization program in hopes that later trans-

---

[31] According to public opinion polls at the beginning of 1991, interest in participating in the voucher-auction program was very low. See Franz-Lothar Altmann, "Privatization in Czechoslovakia" (paper presented at the Conference on Transforming Economic Systems in East Central Europe, Munich, June 1991). For an excellent account of the economic landscape in which the Czechoslovak privatization programs are occurring, see Gerald A. McDermott and Michal Mejtrik, "The Role of Small Firms in the Industrial Development and Transformation of Czechoslovakia," *Small Business Economics*, 4 (1992), pp. 51-72.

[32] The Czechoslovak leadership, moreover, appears prepared to accept relatively high transaction costs (the voucher-auction will be complicated and costly) in the distribution of shares in its privatization strategy in anticipation that these one-time transition costs will quickly reduce overall transaction costs in the newly privatized economy.

[33] To the problem that the citizenry might not have information about the market the Czech strategists also seem to have a market solution in mind; investors who take risks will want better information and the demand for information will stimulate some to get into the business of gathering and selling information. The simulated market, they believe, will help to set in motion the secondary institutions (brokerage houses, market analysis, etc.) required for smoothly functioning capital markets.

[34] Prominent among the Czechoslovak citizens who will have money to speculate on the stock exchange that is to be the product of the voucher-auction will be former Communist officials and black-marketeers. The cynicism of the architects of the Czech privatization strategy is undisguised: "It's sure there is dirty money here," said Tomas Jezek, Czech Minister of Privatization. "But the best method for cleaning the money is to let them invest it." *New York Times*, January 27, 1991, p. 10.

[35] The architects of the Czechoslovak voucher-auction programs hope that a simulated market will stimulate a market. There is an element of learning by doing built into the program. By playing the voucher market (and this is really playing a game), at least some groups of citizens get accustomed to "buying and selling" and might be drawn into really playing the market. (For a very different conception, see the Polish case below, which highlights the distinctiveness of the Czech case.) The question of whether the institutions of a stock exchange can be created in such a manner, of course, remains to be tested.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


actions in the actual capital market will yield relatively rapid concentration of ownership in mid-level enterprises. Several design features currently being discussed (the combination of offering the shares of some firms at initial low asking "prices" and accepting offers where the supply of shares exceeds demand) suggest that the Czechoslovaks are hopeful that some enterprising individuals will quickly buy up these relatively cheap shares and gain controlling interest in these firms. Such a scenario would most likely be accompanied by continuing dispersed ownership in the most highly prized enterprises where the economic leadership presumably has more confidence in the enterprises' managerial talent and is therefore more willing to tolerate the managerial control that comes with highly diffused shareholding.[36] These same features also suggest that the Czechoslovak leadership is aware of the likelihood of resistance to the voucher-auction on the part of managers of the enterprises designated for auction and is designing some features of the program in attempts to neutralize or mitigate this resistance. At the bottom end, firms whose shares find no buyers might be more easily liquidated after a strong vote of "no confidence" by the citizen "investors." At the top, economic officials can point to the likelihood of diffused shareholding in the blue-chip companies to persuade their managers (precisely the ones with the most bargaining power) that the auction is not against their interests and should not be resisted.[37] For that broad range of enterprises in between, the Czech ministers can probably count on resistance from managers, but they seem to hope that relatively quick concentration of ownership will bring these firms under control of the new owners.

### *Poland's Universal Citizen Grants and Employee Shareholding*

The story of Poland's privatization strategy begins in Gdánsk, the birthplace of the first and, for a time, the largest independent trade union in Eastern Europe. But Solidarity and the most famous offspring of the Lenin shipyards who is now the president of the Polish Republic are only half the story. Not without historical irony yet not entirely by coincidence, Gdánsk was also the birthplace of Polish neo-liberalism. During the mid-1980s, while the intellectuals of Warsaw and Budapest debated in urban coffeehouses, a group of young private businessmen and young provincial intellectuals in Gdánsk formed a Liberal Club and at its meetings began reading and discussing major theoretical statements on property rights. From the practical experiences of these entrepreneurs and the circle of intellectuals close to them arose the Liberal Congress, a small but extraordinarily influential party that has produced Jan Krzysz-

[36] For those enterprises at the very bottom of the list (where citizens were not willing to exchange points for shares) the state will, of course, face the difficult decision of whether to close them or to continue operating them under state management.

[37] Anticipation of managerial resistance would lead us to expect that there should be active bargaining between ministries and enterprises in the initial asset evaluation determining the initial asking "price" in the first round of the auction. Such an observation does not threaten our typology since that initial asset evaluation is only a preliminary one to set in motion the auction (and the later market for shares) in which the effective and determinate asset evaluation will take place.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371



tof Bielecki, the former Prime Minister and a disproportionate share of cabinet ministers in the government formed after the election of President Walesa.

Privatization in Poland, of course, did not begin under the leadership of Walesa's Polish liberals but instead under Jaruzelski's Polish Communists. During the power vacuum of 1989, an untold number of apparatchiks landed comfortably ("not perestroikists but parachutists," went the expression) as the new owners of promising units carved out of the former state enterprises. The liberals thus came to office (first with Finance Minister Balcerowicz and later with Bielecki's larger retinue) in a period in which the scandals of such "nomenklatura capitalism" could be heard in public circles, narrow and wide. Property reform was clearly on the agenda; and the Mazowiecki government announced a program of clean privatization, with the promise of attracting foreign investors and a series of large public offerings along the British model at its centerpiece. But foreign investors were slow and few (looking more to Hungary and, for different reasons, to Eastern Germany) and the public offerings made little dent in the state-owned assets of the large socialist enterprises. In fact, the major achievement of the first year of the Ministry of Property Transformation (a few unrepresentative foreign buyouts aside) was privatization through liquidation – a dubious achievement, given the stated aims of the Ministry, since the assets of 159 of these 160 so-called privatizations were leased to the managers and employees of the liquidated firms.[38]

After the election in which he had promised "acceleration," President Walesa turned to Janusz Lewandowski, the new Minister of Property Transformation from Gdánsk, asking him to elaborate and concretize the sweeping program for "mass privatization" that Lewandowski had proposed years earlier together with his Gdánsk compatriot, Jan Szomburg (currently, Director of the Research Center for Marketization and Property Reform).[39] The young transformers confronted two obstacles. First, from the other side of the Gdánsk story, they faced the Workers' Councils, reactivated after 1989, who saw property transformation as their opportunity to solidify employee ownership.[40] Second, they faced the enormous problem that domestic savings could cover only a fraction of the assets of the large state enterprises. On this subject Lewandowski had been heard to comment before accepting his new position

---

[38] See Jan Szomburg, "Poland's Privatization Strategy" (paper presented at the Conference on Transforming Economic Systems in East Central Europe, Munich, June 1991). For an overview of the ambitious goals but limited achievements of the early privatization efforts in Poland, see Tomasz Gruszecki, "Privatisation in Poland in 1990," *Communist Economies and Economic Transformation*, 3:2 (1991), pp. 141-154.

[39] Lewandowski and Szomburg had proposed a stock distribution plan as early as 1988. See their "Uwlaszczenie jako fundament reformy spoleczno-gospodarczej" (Property change as a fundamental aspect of socioeconomic reform) in *Propozyce Przekształcen Polskiej Gospodarki* (Warsaw, 1989), pp. 63-81. A similar program of mass privatization was later elaborated by David Lipton and Jeffrey Sachs, "Privatization in Eastern Europe: The Case of Poland," *Brookings Papers* (1990), pp. 293-341.

[40] Ownership claims coming from the Workers' Councils spring in some places from strong bargaining positions while in others from weakness. For an excellent analysis of reorganization at the level of enterprises that cautions against any global statements about the activities of "workers," "trade unions," or "management," see Janusz Dabrowski, Michal Federowicz, and Anthony Levitas, "Stabilization and State Enterprise Adjustment: The Political Economy of State Firms After Five Months of Fiscal Discipline," Working Papers on Central and Eastern Europe, Harvard University, 1990.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


that "privatization is when someone who doesn't know who the real owner is and doesn't know what it's really worth sells something to someone who doesn't have any money."[41]

The program of mass privatization formally announced in June 1991 calls for the property transformation of some four hundred Polish enterprises in the first stage of its operation. Contained within the program is a major peace offering to the Workers' Councils: employees in the privatized firms will receive gratis 10 percent of the shares of their companies. That is, lacking savings and credit, employees will be able to use their positional resources as job-holders to gain an ownership stake in their enterprises.[42]

At the center of the mass privatization program, however, stands a universal citizenship grant in the form of share vouchers issued to every Polish citizen. In marked contrast to the Czechoslovak program, no registration fee is required to participate. By this signal, and through all its rhetoric, the Polish government seems eager to send the message that this is emphatically a free gift from the state.

Unlike the Czechoslovak schemes, moreover, the Polish citizen will not exchange his vouchers directly for shares in a privatized enterprise. Instead, the vouchers will be exchanged for shares in one or another "asset manager" who will, in turn, exchange the vouchers for shares in the transformed enterprises that it chooses (or is assigned) to manage. Current proposals call for this role to be played by experienced foreign companies, perhaps as few as ten in number. These asset managers, large holdings of many of the largest firms, should not be confused with the managers of pension funds or mutual funds with which they bear only superficial resemblance. According to the intentions of the program's designers, these asset managers will not influence firms indirectly by buying and selling shares on the market but, instead, exercise authority through active and aggressive property management directly involved in formulating the policies and business strategies of the firms under their ownership control.[43] Thus, in place of the Czechoslovaks' imitation of Anglo-American practices, the Poles seem to be looking to models in Germany and Japan.[44]

Several other features of the Polish program of mass privatization complete the contrast to the Czech voucher schemes. According to Polish officials and experts, the situation in the immediately foreseeable future is not likely to be developed enough to establish an "open-ended" program in which citizens are free to withdraw shares and change asset managers. Presumably to avoid inflation, citizens will be initially limited to collecting dividends from the results of the voucher-asset manager program. That is, for an indeterminate period (but certainly lasting for several years) citizens

---

[41] Szomburg, "Privatization Strategy."

[42] Debated but not yet resolved is the question of whether Workers' Councils will be disbanded in all transformed enterprises. If so, workers would be asked, in effect, to exchange a set of implicit organizational rights inherited from the transition period for a set of explicit ownership rights in the new period of transformation. The question will not be answered without much bargaining.

[43] See, for example, Janusz Lewandowski and Jan Szomburg, "The Strategy of Privatization" (paper presented at the Research Centre for Marketization and Property Reform, Gdansk, October 1990).

[44] The distinction between "credit based" and "capital market based" (roughly, banks versus a stock exchange) is presented in John Zysman, *Government, Markets, and Growth* (Ithaca, 1983).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371



cannot capitalize their shares by turning them in for their nominal value. The system is further "closed-ended" by prohibiting citizens from changing to a different asset manager. Because they will not be exposed to the discipline of disappointed shareholders who seek higher dividends elsewhere, the mass privatization program will include a complex incentive program for the executives of the limited number of asset managing companies. The hopes, meanwhile, are that the managers of the former state enterprises will now be under the firm discipline of the foreign asset managers. Obviously more concerned than the Czechs about the consequences of dispersed shareholding, the Poles are hoping to target citizens as "owners" while using the universal citizenship grant as a vehicle to achieve extraordinarily concentrated corporate control.

Thus, with its unrestricted access, the Polish voucher program is more inclusive than the Czechoslovak schemes. Yet its citizens' participation is almost entirely passive. What can the Polish citizen do with his share? He cannot capitalize it, nor can he withdraw that share from his current asset manager and deposit it with another. In exchange for his passivity he gets a dividend, and that alone.

But why then have a voucher program at all? the answer lies in the goals of the Polish program to yield aggressive property management to foreign companies within the constraints of a politicized citizenry. No Polish politician or official could propose an outright give-away of Polish firms to foreign asset managers, and, strictly speaking, this is not what they will do. In a legal and political sense, they will have given the ownership to the Polish citizenry and the stewardship of the citizen-owned assets will rest in the hands of presumably competent managers. The Polish voucher program will not be "popular capitalism" in the sense of millions of small active investors with an interest in the ups and downs of the market. Instead, its designers hope to increase the chances that a capitalism with quite concentrated effective ownership can be made popular with the Polish citizenry.[45]

### *Hungary's Institutional Cross-Ownership*

The fourth cell in our typology is exemplified by Hungary – characterized by the combination of bargained evaluation of assets, corporate owners, and positional resources. Although Hungary's centralized State Property Agency (SPA) has a strong legislative mandate (and a firmly established bureaucratic office) to supervise and control

---

[45] By late 1991, Poland's program of mass privatization showed signs of unravelling. The 400 firms scheduled for the voucher program had been reduced to 230, and the program was under attack from all quarters. See Ben Slay, "Privatization and De-Monopolization in Poland," unpublished manuscript, Research Institute, Radio Free Europe/Radio Liberty, November 1991. If citizen vouchers recede in importance, we should expect that the locus of privatization/reorganization will shift even more to the level of firms and localities and especially to the Workers Councils – one of the most important institutional legacies in the economic realm of Poland's extrication from state socialism. For an excellent analysis of decentralized reorganization in Poland, see Janusz M. Dabrowski, Michal Federowicz, and Anthony Levitas, "Polish State Enterprises and the Properties of Performance: Stabilization, Marketization, Privatization," *Politics and Society*, 19:4 (1991), pp. 403-437.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


all aspects of the privatization process directly, asset evaluation in Hungary is not conducted through administrative means as in Germany. And although the shares of Hungarian firms can be sold on an embryonic stock exchange, the evaluation of assets, unlike the proposals for auctions in Czechoslovakia, is not primarily performed by market mechanisms. As a case that is in between the polarities of administrative and market evaluation, it is represented in Figure 1 as "bargaining," yet this residual or negative definition fails to convey the more precise institutional character of asset evaluation performed by the Hungarian authorities. In the spontaneous and controlled transformation of property rights that is occurring through decentralized processes initiated by the large public enterprises, bargaining is indeed the prevalent modality. But within the State Property Agency itself, and especially for the very largest firms designated by that agency to be sold to foreign investors in hard currency transactions to reduce the state deficit, the mechanism of asset evaluation would be more accurately characterized as relational contracting.

Within months after taking office in the spring of 1990, Hungary's coalition government under Prime Minister Jozsef Antall of the leading party, the Hungarian Democratic Forum, responded to the criticisms of the opposition parties by adopting the opposition's call for the "Privatization of privatization." The central feature of this measure was a dramatic increase in the role of international investment banks and leading consulting firms in the privatization of the large state enterprises. When it nominated a list of twenty enterprises to be sold in the first round of privatization, the State Property Agency also announced an open invitation to investment banks and consulting firms to place proposals with the agency indicating, in general terms, how they would evaluate assets, arrange credit, and find a buyer for a given enterprise. That is, the agency put up for tender the rights to manage the restructuring of a particular company. The investment and consulting firms that won this competition would be compensated with a percentage of the final selling price. In an important sense, the SPA was not directly selling enterprises but instead selling the rights to lead and manage their privatization.

Dozens of consulting firms and investment banks responded to these tenders as whole rooms in the Property Agency were stacked high with proposals from floor to shoulder height. Among them, several of the most internationally prominent firms (Salomon, Goldman Sachs, Barclays, Price Waterhouse, Coopers and Lybrand, and others) had submitted prospectuses for eight or even more of the tenders. Each thought that, if selected on its merits, the firm would be leading several of the reorganizations. But when the SPA announced its decisions only three weeks later, it became obvious that its assignment of the tenders was based less on careful reading of the proposals than toward the aim of maximizing the number of cooperating partners in the first round: the twenty enterprises slated for privatization were distributed among twenty different leading banks and consulting firms.

In more recent months it is becoming clear that these organizations are forming the core of a relatively stable set of participants involved in an ongoing relationship with the Agency. In assigning tenders (and even in selecting enterprises to be restructured) in subsequent privatizations, the SPA is working closely with the international partners with whom it has had positive experiences in the first round. Invitations are not entirely open; in some cases the Agency approaches only a few international firms to

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


sound them out about plans for this or that enterprise. And, although we have no documentary evidence, we should not rule out the possibility that effective decisions are being made before the announcement of a competitive bidding for the rights to manage a particular restructuring. When making contracts in these cases, both sides are calculating not simply in terms of the immediate contract at issue but in terms of past performance and in anticipation of future exchanges. Our purpose here is not to denounce a too cozy relationship between the Property Agency and the communities of international banking and consulting. On the contrary, these practices have an economic rationale: relational contracting provides a mechanism in which both parties can gain more information than through more restricted market transactions. On the side of the SPA, such relational contracting lowers transaction costs (for example, the administrative costs of handling an overabundance of bids, or the costs in time and resources in working with too many partners) and can yield more extensive and better information (about capital markets, about international investors, about the marketing and production strategies of foreign companies, and the like) than might be obtained when contracts are made through open competition on a strictly case-by-case basis.[46]

We would seriously fail to understand the process of privatization in Hungary, however, if we focused our attention too narrowly on the State Property Agency – for although the SPA has the legal authority to supervise privatization, the predominant processes restructuring the ownership rights of the large public enterprises is not taking place at its initiative. Instead, the prevalent form of transformation in Hungary should be characterized as the decentralized reorganization of property. Simplifying from a more complicated web of transactions and a wider network of connections, the basic course of such reorganization can be outlined as follows: Under the pressure of enormous debt, declining sales, and threats of bankruptcy or (in the cases of more prosperous enterprises) to forestall takeovers or to attempt to increase autonomy from state ministries, directors of many large public enterprises are taking advantage of several important pieces of legislation that allow state enterprises to establish joint stock companies (RTs) and limited liability companies (KFTs). To be clear, in the typical cases of such reorganizations the state enterprise is not itself transformed into a joint stock enterprise; rather, the managers of the enterprise are breaking up the organization (along divisional, factory, departmental, or even workshop lines) into numerous corporations.[47] As newly incorporated entities with legal identities, these

[46] To the legitimate objection that such an arrangement should be designated as a "market" because it bears strong resemblance to the organization of some capital markets in developed economies, we have three replies. First, see below on the continuing nature of these contracts. Second, the observation might lead some researchers to further explore features of "relational contracting" in such capital markets in Western economies. (Such research is already ongoing. See, for example, the extraordinary analysis of networks in investment banking by Joel Podolny, Ph.D. dissertation, Department of Sociology, Harvard University, 1991.) Third, for the purposes of our typology, this institutional arrangement (so prevalent in the Hungarian case) deserves some distinctive terminology to set it apart from the use of spot markets (auctions) in the Czech case.

[47] Such a restructuring would require preparation of a comprehensive transformation program, under the guidelines of the 1989 Law on Transformation, with the direct involvement of the State Property Agency.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


new units are nominally independent – registered separately, with their own boards of directors and separate balance sheets. The more interesting question is, of course, who owns the shares of these new units? An examination of the computerized records of the Budapest Court of Registry indicates that the controlling shares (in overwhelming proportions) of the corporate satellites launched around the large public enterprises are held by the state enterprises themselves.[48] For this reason, I prefer to use the term VKFT (in Hungarian, *vállalati-KFT,* or enterprise limited liability company) to denote their semi-autonomous organizational status and to indicate their continuity with an organizational innovation of internal subcontracting (the VGMK) that had appeared in the earlier stage of transition.[49]

Property shares in these satellite organizations are not limited, however, to the founding enterprise. The typical cases involve patterns of more mixed ownership. Top and mid-level managers, professional and other staff, and (more rarely) highly skilled workers can be found on the lists of founding partners. But their shares are not large and should not be taken as evidence of "managerial buyouts." More important than private persons is the participation in share ownership in a given corporate unit by other joint stock companies and limited liability companies – sometimes by other VKFTs in a similar orbit around the same enterprise, more frequently by joint stock companies or VKFTs spinning around some other enterprise with lines of purchase or supply to the corporate unit.[50] Most important among the outside owners are banks. In many cases, the establishment of VKFTs and other corporate forms is triggered by enterprise debt, and in the reorganization the creditors, whether commercial banks (whose shares as joint stock companies are still predominantly state-owned) or other credit institutions (also state-owned), exchange debt for equity.

---

[48] I am grateful to László Neumann and Eva Voszka for providing me with these data.

[49] The term VKFT is not my invention but comes from workers I interviewed (in collaboration with János Lukács) in January 1990 during field work in several Hungarian factories. With that acronym these workers were alluding to an earlier hybrid organizational form, the VGMK (enterprise work partnership), involved in a primarily internal system of subcontracting. Although they were free to make contracts and had significant autonomy in organizing production and allocating their "entrepreneurial fees," in the VGMK form the ownership of fixed assets remained in the hands of the parent enterprise. With the term VKFT these workers were denoting the semi-autonomous character of the new limited liability companies spinning around the enterprise. On the VGMK as a hybrid organizational form and precursor of new mixed property forms, see David Stark, "Coexisting Organizational Forms in Hungary's Emerging Mixed Economy," in Victor Nee and David Stark, eds., *Remaking the Economic Institutions of Socialism: China and Eastern Europe* (Stanford, 1989). For an application of the concept of hybrid property forms to the Chinese economy, see Victor Nee, "Organizational Dynamics of Market Transition: Hybrid Forms, Property Rights, and Mixed Economy in China," *Administrative Quarterly,* 37:1 (March 1992).

[50] See especially the important study by Eva Voszka, *Tulajdon – reform (Property reform)* (Budapest, 1991), and also her "From Twilight to Twilight" (paper presented at the Congress of Hungarian Sociology, Budapest, June 1991). For an excellent case study of such reorganization, see Eva Voszka, "Rope Walking: Ganz Danubius Ship and Crane Factory Transformed into a Company," *Acta Oeconomica,* 43:1-2 (1990), pp. 285-302; see also Mária Móro, "Az állami vállalatok (ál) privatizációja" (Pseudo privatization of state enterprises), *Közgazdasági Szemle,* 38:6 (1990), pp. 565-584.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


What then is the fastest growing new ownership form in the Hungarian economy?[51] The terminology is cumbersome but it reflects the complex, institutionally intertwined, character of property transformation in Hungary: a limited liability owned by other limited liability companies owned by joint stock companies, banks, and large public enterprises owned by the state.

Has the decentralized reorganization of property rights taken place beyond the control and outside the purview of the governmental agents responsible for privatization? Consistent with its campaign rhetoric in the elections for Parliament, the new Hungarian government, upon taking office in May 1990, adopted a deliberate strategy that promised to slow down privatization and to provide for its centralized management.[52] But within months, the State Property Agency seems to have realized that it has neither the capacity nor the ability to oversee the privatization of thousands of state enterprises directly. Toleration (bordering on encouragement) of decentralized reorganization appears to be its current posture. This statement should not imply that the Property Agency is unaware of the particular character of these reorganizations. Each corporate spin-off of the kind described above involving assets valued above thirty million forints (approximately $400,000) or a series of such spin-offs that represents in the aggregate more than fifty percent of the assets of the state enterprise must be approved by the Agency. Although not virtually automatic, the approval rate of such proposals is extraordinarily high.[53] This high rate of approval suggests that negotiations with the Property Agency precede the submission of a proposal for reorganization. Moreover, case studies and summary reports of corporate reorganizations indicate that the dominant modality of asset evaluation in these cases is unquestionably "bargaining."[54] Whether at the level between the state enterprise and its affiliated corporations or between the enterprise and the state agency, actors exploit every available means of bargaining power.

In which direction will corporate reorganization evolve? Any answer would be premature but the alternatives can be clearly stated. In the first scenario, the current ambiguities in the distribution of property rights will be clarified in favor of the managers of these enterprises. That is, decentralized reorganization will lead to a further concentration of managerial control.[55] In the second scenario, decentralized reorga-

[51] In the past eighteen months the creation of new economic units has increased by two-and-one-half times, but the number of corporations has grown by seventeen times (Voszka, "Rope Walking"). If we preferred to measure by capitalization instead of counting units, the new semi-autonomous corporate forms would be even more preponderant.

[52] In this phase, as Eva Voszka succinctly describes, on issues of privatization the government was much more preoccupied with the question of who should be the seller rather than who should be the new owner. Voszka, "Rope Walking."

[53] After consulting with the leading Hungarian experts in this field, our best estimates are that only about ten percent of such proposals are rejected at the level of the SPA. According to the best available data, the official rate of approval of corporate reorganization is seventy percent. But most practitioners in the field acknowledge that many rejected proposals are approved after minor technical changes (or, on occasion, with no revision).

[54] Voszka, "Rope Walking"; Móro, "Pseudo privatization"; and László Neumann, "Labour Conflicts of Privatization in Hungary," Institute for Labour Studies, Budapest, 1991.

[55] This first scenario envisages a further extension of patterns of institutional cross-ownership and suggests a research agenda to investigate patterns of interlocking directorates in the Hungarian economy.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


nization sets the stage for a later round of genuine privatization. That is, although senior management might have broken up enterprises with the aim of buffering the firm from inevitable bankruptcies or increasing their autonomy from state authorities, the establishment of even semi-independent corporate forms might create inviting opportunities for takeover by foreign firms or indigenous private entrepreneurs with limited means to acquire properties when they were more closely bound within the large state enterprises.[56] In the third scenario, decentralized reorganization is but the first phase of a reconsolidation of state ownership.[57] This outcome might be only seemingly paradoxical. State elites may be willing to tolerate corporate reorganization (even on a wide scale and together with some genuine privatization of the smaller units[58]) provided that the controlling shares remain in institutional hands over which the state can continue to exercise control.[59]

Whatever the outcome, we can observe in the meantime that predominant form of the transformation of property relations in Hungary is the outcome of bargaining about asset evaluation and takes the form of institutional cross-ownership in which enterprise managers use their resources as office-holders to extend their effective exercise of property rights. For these reasons, Hungary exemplifies that cell in our typology representing the intersection of bargaining, corporate owners, and positional resources.

---

[56] In this scenario, the debt for equity exchange so prevalent in the first round of reorganization could play an important part in the second. The overwhelming problem of enterprise debt (owed to banks, as well as in the disguised form of inter-enterprise debt as firms increasingly delay paying their suppliers in the state sector) is resulting in problems of solvency in the banking sector. There are recent indications that at least some banks are beginning to act like owners – demanding dividends from the KFTs and RTs affiliated with the state enterprises. Where profits are low to nonexistent, some state enterprises may be forced to sell some of their affiliated units to pay such dividends. But the prospects for privatizing these units to domestic entrepreneurs are far from encouraging. From where will they receive the capital to make such investments? The same financial crisis that triggers the sales also places restrictions on credit.

[57] In such a scenario, the relationship between enterprises and the state would take the form of bargaining and would reflect the continuity of ambiguous property relations in Hungarian state enterprises from the 1968 reforms to the present. But there would be discontinuities as well: in place of the earlier "plan bargaining" and the later "regulatory bargaining," under decentralized reorganization and reconsolidation of state ownership the new relationship would be characterized as dividend bargaining. For a discussion of the continuities and discontinuities in these bargaining relations, see Erzsébet Szalai, "A hatalom metamorfózia?" (Metamorphosis of power?) *Valóság*, 6 (1991), pp. 1-26.

[58] Encouraging, but limiting, such privatization would be consistent with a policy choice that sought to rationalize the state's ownership role (trimming down the size of its assets) while consolidating its ability to intervene in the economy as an (indirect) owner.

[59] In this case, as in all the scenarios, the question of who controls the banks is of fundamental importance. The dismissal in June 1991 of three bank presidents following a sharp dispute over the bank's dividend policies indicates that the state is attempting to use its authority in appointing senior banking officials to control the shares in state enterprises held by the banks. It remains to be seen how the state's influence over banks will be changed by the new banking law that took effect on December 1, 1991. Under that legislation, only banks or other financial institutions may hold more than 25 percent of the shares of a bank. The state has until 1995 to reduce its direct ownership of shares in commercial banks.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371



**Paths of Extrication and Patterns of Transformation**

The typology of privatization strategies and the discussion of the country cases presented above was to provide a preliminary analytic framework that might stimulate more systematic comparisons of these cases. The eventual outcome of these strategies will be shaped by the continued tug and pull of politics and the interaction of the state and various social groups in these societies. But whatever these outcomes, it is not too early to observe that the privatization strategies in East Central Europe are beginning from four quite distinctive starting points.

How can we explain these differences? In my view, an explanation of these distinctive strategies of privatization must begin by taking into account their distinctive paths of extrication from state socialism – reunification in Germany, capitulation in Czechoslovakia, compromise in Poland, and electoral competition in Hungary.[60] These diverse paths of extrication, and the preceding differences in social structure and political organization that brought them about, have had the consequence that the current political institutions and forms of interest intermediation between state and society differ significantly across our four cases. The collapse of Communism in East Germany resulted in the colonization of its new political institutions during incorporation into the powerful state of the German Federal Republic. The capitulation of Communist authorities in Czechoslovakia after decades of suppressing almost all institutions of civil society resulted in the rapid restructuring of its political institutions with relatively few remnants remaining from the earlier period.[61] Communism did not collapse in Hungary and Poland; its demise was negotiated in both countries. Faced with a powerful, indeed mono-organizational, opposition with deep roots in society, Poland's Communists attempted a compromise solution. And the legacies of this path of extrication, with its institutional guarantees for Jaruzelski and company, remain even today in the still-compromised parliament and a strong presidency together with a nationwide, though weakening, workers' movement. Hungary's reform Communist, by contrast, attempted to salvage some of their power by entering into direct electoral competition with a seemingly weak political opposition. That political opposition, of course, is now in the government and the Parliament, but the legacy of Hungary's peculiar path remains. In the nearly two years since its roundtable negotiations, Hungary has seen the rapid flourishing of political parties without roots in society, its weak labor movement become further fragmented, and its enterprise managers (as the best-organized social group during the previous decade) become the most powerful social actor in the society.

Thus, it is the relationship between different types of democracy and different types of capitalism, rather than the abstractions of democracy and capitalism, that

---

[60] For an elaboration of these concepts, see László Bruszt and David Stark, "Remaking the Political Field in Hungary: From the Politics of Confrontation to the Politics of Competition," in Ivo Banac, ed., *Eastern Europe in Revolution* (Ithaca, 1992), pp. 13-55.

[61] Czechoslovakia's current trade unions, for example, bear relatively little resemblance to the pre-1989 unions – in contrast to Hungary, where the old official union remains the largest (if tired) trade union federation, and to Poland, where both Solidarity and the OPZZ are the continued legacy of the 1980s. See Bruszt, "Transformative Politics."

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


holds the clue to explaining differences in contemporary Eastern Europe.[62] The diverse paths of extrication from state socialism yield distinctive patterns across a triangle formed by the state, the market, and the society. It is in terms of these patterns, all too briefly, that we conclude our discussion of privatization strategies in East Central Europe.

With their political incorporation into the German Federal Republic, the citizens of the former East German territories found their futures charted by a political leadership with a strong commitment to thorough marketization. But together with an abiding confidence in the market, this political leadership has profound confidence in the state. This trust, moreover, is accompanied by a deep, and almost indiscriminate, distrust of East German society. Forty years of communism, according to the German leadership, have produced a terrible human tragedy – the personality structures, habits, dispositions, expectations, and mentalities of the citizens of the new lands make them unfit and incapable of managing their affairs. It is not their fault, but they are no longer trustworthy. They must be remolded and reeducated not simply in industrial skills but with new mentalities. Those too old or too thoroughly spoiled by old habits and inclinations must be prevented from obstructing the new course; in the yet undamaged youth of the Eastern lands lies good fortune.[63] It follows that the German leadership will use the state to transform the economy and reconstruct the society.

The Czechoslovak leaders also have profound confidence in the market. Unlike the Germans, they lack a strong state; yet unlike the Poles, they are not faced with deeply rooted institutions in civil society that might negate their leadership. From this it follows that the Czechoslovak political leadership is pursuing a course of attempting to use the market to transform the economy. So deep is their confidence in the market that they will use it to privatize the economy. Citizen vouchers in Czechoslovakia are not an ideological means to win support through some extra-economic means but are instead the institutional vehicle to achieve the directly economic goals that will provide the basis for short-term and longer-term social support. It would be entirely misleading, therefore, to interpret the Czechoslovak leadership's use of a civic principle as an indication of their deep and abiding commitment to equality. In fact, if they do indeed proceed with the auctioning of the assets of the large public enterprises at the pace and scope being proposed, that scheme is likely to give rise to a relatively rapid differentiation of wealth – because some individuals (not without certain risk, of course) will be able to acquire properties at truly bargain basement prices.

---

[62] Bruszt, "Transformative Politics." On the concepts of different types of capitalism and different types of democracy, see the insightful work of Philippe Schmitter, "Modes of Sectoral Governance: A Typology," unpublished manuscript, Stanford University; and Terry Karl and Philippe Schmitter, "Modes of Transition in Latin America, Southern and Eastern Europe," *International Social Science Journal*, 128 (March 1991), pp. 269-284.

[63] The reader who suspects exaggeration here would benefit from reading, for example, Werner Gumpel's "The Mentality Problem in the Transition Process from Centrally Planned Economy to Market Economy" (paper presented at the Conference on Transforming Economic Systems in East Central Europe, Munich, June 1991). I have paraphrased Professor Gumpel in the passage above. To quote him directly: "These people must be made to unlearn most of what they were brought up with."

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


Hungary, by contrast, is in many ways the opposite of the Czechoslovak case. There we find a state elite that is profoundly ambivalent about the market, so much so, that we can say that it distrusts the market. But at the same time, this is a state elite that is highly uncertain about society's trust in its leadership. The current government was popularly and legitimately elected. It enjoys legitimacy but that legitimacy does not convey confidence that the burdens that will necessarily accompany marketization will be accepted by the population. Nor could the likely replacement government formed from parties of the same political elite anticipate greater confidence. Lacking intermediary institutions (such as strong and cohesive trade unions) with whom it could publicly negotiate, that elite has very few means to know where the limits of society's tolerance might be. Thus, it avoids taking decisive steps in fear of society's reaction. And all the while, it engages in a cyclical process of here tightening, there loosening the reins on the galloping enterprise managers.

If the German state leadership trusts the state to remake the society, the Czechoslovaks trust the market to remake the economy, and the current Hungarian leadership distrusts the market while being distrusted by the society, Poland is that case where to keep the trust of society the state must win society's faith in the market. Like the Czechoslovak voucher program, the Polish citizenship vouchers are intended to perform an economic function of promoting privatization where domestic savings are too little to cover the value of the assets. But unlike the Czechoslovak program, the Polish strategy of appealing to the civic principle is not simply auxiliary to, or instrumental for, an economic logic. Whereas in Czechoslovakia the voucher system is a means of achieving a market that is seen as self-legitimating, in Poland, the citizen voucher system is a means of legitimating the market.

## Conclusion: A Market Economy or Modern Capitalism?

These programs will inevitably be modified as the work of the transformers is transformed by the societies of East Central Europe. The resulting process will resemble innovative adaptations that combine seemingly discrepant elements, bricolage, more than architectural design. We should not be surprised, however, if the blueprints of foreign experts continue to figure in the transformative process. Although the grand designs of cookbook capitalism will not be utilized faithfully as guidelines for action, they will, nonetheless, be useful resources. This hypothesis stems from a view of contemporary East-Central European politicians and policy makers as located between their populations who must bear the transition costs, on one side, and, on the other, international agencies and foreign governments that are the potential providers of capital, aid, and access to Western markets.

Master blueprints are not substitutes for stabilization measures, but which East European finance minister would dare enter into negotiations with international lending institutions (the World Bank, the IMF, the European Bank for Reconstruction and Development, and the like) without one? With the diffusion of grand models from one economy to the next we should expect, however, that formulas for external

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


legitimation will be "decoupled" from actual practices.[64] At the same time, we should note the possibility that politicians might present their own policy preferences as mandated by international agencies. ("The IMF made me do it.") The question of who is legitimating what and by which means is much more complicated than a matter of powerful international agencies dictating to East European politicians who have no choice but compliance.

Will this bricolage result in market economies? Definitive prognosis is, of course, premature. But functioning markets are more likely to come from trials and errors that can be corrected, and new opportunities are more likely to be perceived and exploited when transformative processes are decentralized than by grand experiments that are centrally imposed on society.

The more important questions is whether the most far-reaching marketization of all aspects of economic life should be the policy goal in contemporary East Central Europe. Advocates of such a goal suffer from two analytic shortcomings: (1) they mistake one possible means as the end itself and (2) they operate in a theoretical universe in which the dichotomies of state or market exhaust the range of viable coordinating mechanisms in modern economies. But (to take the first point) surely the goal of marketization has been, among other ends, to modernize the production processes and improve the international competitiveness of these damaged economies. Yet (moving to the second point), as various currents of thinking in political economy recently indicate, there are sectors in which the most competitive forms of economic coordination are neither market nor statist but new forms whose alternative operations we are only beginning to understand and identify (with such preliminary labels as "networks," "alliances," "inter-firm agreements," and the like).[65] An exclusive policy of all-encompassing marketization across all sectors would therefore pose a new obstacle and not a means to international competitiveness.

Such a tragedy is likely so long as the policy debate in the transitions from state socialism is dominated by those who mistake the triumph of capitalism as the triumph

[64] The rapidity with which some packages of innovation have become institutionalized (that is, come to be taken for granted) has been extraordinary. No one was shocked, for example, when Yeltsin announced shock therapy for the Russian economy. On diffusion across national boundaries, see David Strang and John W. Meyer, "Institutional Conditions for Diffusion" (paper presented at the Workshop on New Institutional Theory, Department of Sociology, Cornell University, November 1991). On the decoupling of formal structures celebrating institutionalized myths from actual organizational practices, see especially John W. Meyer and Brian Rowan, "Institutionalized Organizations: Formal Structure as Myth and Ceremony," in Walter W. Powell and Paul J. DiMaggio, eds., *The New Institutionalism in Organizational Analysis* (Chicago, 1991), pp. 41-62.

[65] See especially the research presented in Rogers Hollingsworth, Philippe Schmitter, and Wolfgang Streeck, eds., *Comparing Capitalist Economies: Variations in the Governance of Industrial Sectors* (New York, 1992); Schmitter, "Modes"; Robert Boyer, "The Transformations of Modern Capitalism in Light of the Regulation Approach and Other Theories of Political Economy" (paper presented at the Conference on Comparative Governance of Economic Sectors, Bellagio, June 1989); and Walter Powell, "Neither Market nor Hierarchy: Network Forms of Organization," in B. Staw and L.L. Cummings, eds., *Research in Organizational Behavior* (Greenwich, CT, 1990), pp. 295-336. The key analytic move in this new literature is to shift from the preoccupation with micro- or macro-phenomena to a meso-level focus on sectors. These studies suggest an exciting agenda for similar meso-analysis of sectors and localities in contemporary Eastern Europe.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371



of the market and look only to the "market revolutions" of Reagan and Thatcher when the real victories went to the industrial reorganizations in Germany and Japan that were neither market nor hierarchical. But modern capitalist economies should not be reduced to only one of their constitutive parts: markets are but one of a multiplicity of coexisting coordinating mechanisms in modern capitalism.[66]

Transformative schemes that rely on an exclusive coordinating mechanism do not so much emulate existing capitalism as echo the implementation of state socialism and, like it, carry the danger of sacrificing dynamic efficiency and flexibility that depend on diversity of organization forms.[67]

---

[66] On the multiple meanings of the term "market," see the excellent paper by Robert Boyer, "Markets within Alternative Coordinating Mechanisms: History, Theory, and Policy in the Light of the Nineties" (paper presented at the Conference on the Comparative Governance of Sectors, Bigorio, Switzerland, April 1991).

[67] Michael T. Hannan and John Freeman, *Organizational Ecology* (Cambridge, MA, 1989), especially p. 3; and David Stark, "Coexisting Organizational Forms," especially p. 168.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371



*Kazimierz Z. Poznanski*

# Property Rights and Civil Liberties: Evolutionary Perspective on Transition in Eastern Europe and the Soviet Union

With the collapse of Communism, Eastern Europe and the former Soviet Union are both creating some version of capitalism – not yet defined – and rebuilding bridges to the capitalist world as well. There are coherent reform programs already in place to facilitate the process in such countries as East Germany, Hungary, and Poland, but in many others the programs are still amorphous. While there remains quite a bit of confusion, the process looks to be irreversible.

The transition away from state socialism unquestionably carries certain high risks, more the product of poor judgment than of objective obstacles. The Communist utopia was abandoned only to be replaced by other great illusions, so that again states put great trust in untested "projects" and believe in quick cures. It is as if the sad experiences of the "collectivist dream" were not enough to ground these nations in down-to-earth realism.

## Restoration of Effective Markets

The Communist economy is discredited so badly for its inefficiency (but less for its social "benefits") that almost all social groups want it replaced with its antithesis, some form of capitalist market, and it is only a question of time before markets are fully established. What is less clear is how long it is going to take for such a transition to be completed, and the related issue of whether states can accelerate the pace of the process in any way.

### *Market Anxiety*

The recent opening of this area for massive economic reforms has caused a heating up of the long-lasting debate between gradualists calling for a prudent approach and radicals arguing for an all-out assault on inherited structures. Basic arguments have not changed in any substantive way, but state preferences have shifted anyway, so that while the reforms pursued by the Communist regimes were following a gradualist philosophy, the post-Communist leaders are generally attracted to radical shock therapy.[1]

[1] D. Lipton and J. Sachs, "Creating a Market Economy in Eastern Europe: The Case of Poland", *Brookings Papers on Economic Activity*, 1 (November 1990).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


Rejection of gradualism is not surprising, since the opponents of Communist party, and also reform-minded elements within it, have always seen that "style" as one of the sins, almost as bad as putting the system together in the first place. Communist reforms have been characterized by critics as a succession of inconclusive attempts, where too few steps were being taken to prevent the system from returning to the starting point (to no positive effect, but at the price of unnecessary temporary disruption of production routines at the enterprise level).

Anti-gradualism also reflects the perception that with the defeat of the Communist party/state, some building blocks for effective markets are already in place, including expanded autonomy for enterprises. In Poland, for instance, the once mighty Planning Commission – and an arm of the party – was turned into an analytical study center. The economic ministries (except for the Ministry of Finance) have also been deprived of most of their authority over enterprises. At the lower level, the party has ceased meddling in the affairs of state-owned enterprises since the cadres were banned from their premises.

Undoubtedly, this change represents a major step on the way towards creating markets, but markets do not mean just an absence of state direct controls over enterprises, a fact well understood by the current wave of reformers. Markets also require that resources, including capital, are clearly assigned to identifiable individual owners, since only then will efforts be made to maximize the current and future value of assets. Consequently, the focus of the current reforms is to turn state or ownerless capital stock over to private hands.

Such reforms in property rights are generally seen by the reformers as attainable in a short period of time. Thus, when the first non-communist government was formed in Poland at the end of 1989, its key financial planner, Balcerowicz, announced that it should take two years at the most for the bulk of state assets to be privatized. When the Soviets started talking more directly about privatization in 1990, they envisioned a similarly short timetable (see, for instance, the Shatalin program calling for the bulk of property transfer to be completed in less than three years).[2]

To divest quickly, however, the state cannot ask the full market value for assets, or even some modest fraction of it, since households in Eastern Europe and the Soviet Union have miniscule savings.[3] According to some estimates, it would take thirty or forty years for the populations of Poland or Hungary to afford to buy the state assets.[4] Moreover, these personal savings are very unequally distributed, with larger sums often coming from sources that the public may find questionable, so that relying on them involves some political risks.

Aware of the difficulty in attracting domestic buyers, the post-Communist governments seem to have found an easy way out – divesting assets at fire-sale prices. This policy has been endorsed in Hungary and Poland (and in former East Germany, where the price of stocks is less an issue than commitment to invest in refurbishing

---

[2] See E. Hewett, "The New Soviet Plan", *Foreign Affairs* (Winter 1990).

[3] This is particularly the case when privatization is preceded by elimination of excess cash, as effected in Poland in early 1990 through cuts in real wages (or as attempted in the Soviet Union in 1991 through cash confiscation that did not cut deeply into money holdings).

[4] See Z. Fedorowicz, "Objektywne uwarunkowania czy chciejstwo," *Zycie Gospodarcze*, 19 (1988).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

obsolete equipment). The problem with this approach is that it creates an image of corruption, or theft, in the eyes of those who, for some reason, cannot take part in the sell-out.

To cope with the issue of fairness, many new governments (with the important exception of East Germany and Hungary) have developed an ingenious idea of distributing shares to citizens through so-called vouchers.[5] For instance, this is to be the main vehicle for privatization announced in mid-1991 in Czechoslovakia, where all citizens, for a small fee, can receive vouchers to be freely turned into shares. In Poland at about the same time, with strong backing by Walesa, all adults had been promised vouchers, to be managed by holdings put in charge of the majority of large enterprises.[6]

## *Historical Parallels*

It might seem hard to judge realistically the feasibility of the transition from Communism to capitalism through such shortcuts as vouchers, because of the lack of comparable real-life examples. However, it might be a reason for concern that the particular approach to the rebuilding of capitalism adopted by some of the post-Communist states is, in many ways (with respect to methods and not content), reminiscent of property changes in the early days of Communist rule, to well-known negative effect.

What these two attempts appear to have in common is that they are blueprint reforms formulated by the ruling elite, programs based on some theoretical arguments about what a superior form of property structure is in the eyes of the leaders, rather than distilled or derived from collective experience.[7] The only important references to empirical evidence in support of these respective "grand" projects has come from the not necessarily applicable experience of other countries.

Similarities also include enormous trust by these two power elites in the fundamental importance of property rights, though directly related to very different ideological backgrounds. Early Communist reformers drew from Marx, who, in contrast to his contemporaries, made property the single most important category in his economics. This category had been mostly forgotten later on, and only now are property rights put right in the center of economic thinking by post-Communist reformers, fascinated instead with modern "property right" theories.[8]

---

[5] D. Stark, "Privatization in Hungary: From Plan to Market or from Plan to Clan", *East European Politics and Societies*, 4:3 (1990), provides a good description of various options for privatization. See also I. Grosfeld and P. Hare, "Privatization in Hungary, Poland, and Czechoslovakia", *CEPR Discussion Papers*, 544 (April 1990).

[6] A similar program was also adopted in Romania, where one third of state assets is to be given away and managed by special funds. Free distribution is also entertained in Mongolia (see A. Gelb, "Voucher System in Mongolia", *Transition*, 2:7 (July-August 1991), pp. 6–7.

[7] P. Murrell, "Evolution in Economics and in the Economic Reform of the Centrally Planned Economies." (Unpublished paper of the Department of Economics, University of Maryland, College Park, MD, 1991.)

[8] E. g., A. Alchian and M. Demsetz, "The Property Right Paradigm", *Journal of Economic History*, 33 (1973).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


The analogies go even deeper, since, similar to current denationalization, the Communists did not allow themselves enough time for their programs to mature. Elimination of private ownership was introduced countrywide with little preparation and very short deadlines. When these programs stumbled on some obstacle, rather than scale them down, Communist rulers would concentrate more energy on crushing the barriers. Faced with lack of budgetary funds for full or partial compensation, for example, they decided to confiscate property in a matter of months.

These parallels also include great politicization – both property changes seem to be largely driven by political calculations rather than purely economic ones. The Communist rulers were newcomers, unknown quantities that needed to gather support from societies as the post-Communist leaders do now. Fictitious appropriation of property to the people seemed to offer such a tool then as the real passage of rights does now. This was particularly the case because the initial years of building the Communist system were expected to require austerity, and the same is true of the current radical reforms to undo that system.

It follows from the above that the truly important lesson from the Communist past is not the one that the present reformers have adopted, namely, that gradualism does not work. In fact – forgetting that the system was ill conceived from the very beginning – the cautious approach to reforms could have been actually a virtue. Really relevant today is the experience of the formative years of state socialism rather than that of mature age, which is that radical change by states is a recipe for failure of great proportions.

### *Market Ethos*

The same lesson could be drawn from liberal economic theory – including the Austrian school with von Hayek – that is now in great esteem among reformers. The reading of this theory has so far been one-sided, however, as with the Austrians who are celebrated mostly for their unequivocal support of capitalist markets, presented as an "extended order" natural to human beings. In contrast, their warning against any efforts by states to force their ideas of proper ordering on society have not been appreciated yet.[9]

Liberal economic theory provides arguments on what represents the single truly effective economic regime – specifically, allocation through competitive markets – but also how such a structure is arrived at. In fact, these two aspects of the theory are not easily separable since such regimes can be generated only in one way, through markets. In other words, markets are not only a superior mechanism for allocation of resources but also the best vehicle for institution building.

In the market alternative for institution building, it is individuals who create a suitable framework for economic activities, allowed to bring in any ideas that they wish, based on their personal experience or preferences. The greater the number of ideas, the higher the probability of finding appropriate arrangements, since social institu-

---

[9] An important exception is V. Klaus and T. Jezek, "Social Criticism, False Liberalism, and Recent Changes in Czechoslovakia", *East European Politics and Societies*, 5:1 (1991).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


tions are extremely complex – this is why relying on one source, such as the autonomously acting state, carries a high risk of causing harm to the economy.

Individuals do not have to be compelled by the state to develop proper institutions, as they do not have to be coerced into a search for optimum production programs. Individuals have strong inner motivation to develop institutions, since institutions are solutions to a certain class of problems they face in real life. In brief, the motive for individuals is to lower transaction costs related to their production activities (that is, costs of gathering and processing all information needed to conclude a contract on purchase of inputs and/or sale of outputs).[10]

In such a market-type building process, institutions are selected for application not according to whether they appeal to the state – following some political agenda or abstract formulas – but by following verdicts of a truly competitive test, very much like products that are judged in terms of their price and utility. As in the market for goods, where exchange is completed when parties voluntarily agree on conditions of sale/purchase, institutions are accepted in this kind of competition voluntarily by the users, that is, those who play by some prescribed rules.

Since institutions in this type of process are set up by individuals for a purpose, it means that each particular order is developed by a specific type of agent sharing a certain ethos. In the case of the capitalist market, the focus of this discussion, these specific actors are the market agents – those who accept competition, however defined, as the only rule of the game. In other words, those are the agents driven by the so-called market ethos, an unusual combination of two behavioral ingredients – greed and decency.[11]

This is an unusual combination, since it involves a balance of two very different and conflicting motives of individual action.[12]The market ethos is a mixture of the unconstrained desire for individual enrichment – greed – with the constraining predisposition for the general well being – decency. Similarly in the political realm, the hunger for freedom is only one foundation of a democratic ethos, the other one being so-called civility, that is, respect for the rights of others and adherence to proceduralism in political life.[13]

In defense of liberal capitalism, Kolakowski argues that greed is good, and he is basically right. This sounds like an unacceptable statement only if one misses the point that greed provides a powerful engine that makes individuals relentlessly try something, strive for more and more, and calculate carefully. Still, greed is not good alone, since it also inevitably leads to such pathologies as plunder, extortion, or exploita-

---

[10] D. North, *Institutions, Institutional Change, and Economic Performance* (New York, 1990); O. Williamson, *Markets and Hierarchies* (New York, 1973); and A. Alchian and H. Demsetz, "Production, Information Costs, and Economic Organization", *American Economic Review*, 62 (December 1972).

[11] See K. Poznanski, "Property Rights Perspective on Changes in Eastern Europe and Soviet Economies." (Unpublished paper presented at a conference in Milan, December 1990.)

[12] This focus on ethos is very much in the Weberian tradition and not in the Marxian one. While Weber (see M. Weber, *Economy and Society* (Berkeley, 1978, original edition, 1921)) stresses the importance of heritage and dispositions by individuals, Marx considers assets (i. e., property) and opportunities as decisive factors determining individual behavior.

[13] E. Shill, "The Virtue of Civil Society", *Government and Opposition*, 20:1 (Winter 1991).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


tion, all undercutting the aggregate effect to individual actions and ultimately the system that provides a stage for them.

To form such a market ethos is difficult and time-consuming. No doubt greed can be let loose quickly since it reflects natural instincts, animalistic forces. The restraining norms cannot be put in place as quickly, however, because they represent tradition – in fact, they require a rather long time to be formed. Such norms become "second nature" only through a very laborious process, since it takes an enormous number of trials and errors for individuals finally to accept them (though their questioning probably never stops completely).

### *Slow Process*

While the longstanding presence under Communist rule of a second economy – legal and illegal activities outside of the state domain – causes some economists to believe that market ethos is strong enough to entrust capital to private ventures, this is hardly the case. This observation might be applicable to Hungary, and to a lesser degree to Poland, but definitely not to other countries of Eastern Europe, nor to the former Soviet Union, where legalization of private activities was resisted for a particularly long time.

It is also questionable how suitable all the experiences learned in the second economy are for the current transition to effective markets, since it mostly helped to release greed, not decency.[14] Submerged in the large state-run economy, this sector thrived largely on speculation--exploitation of monopolistic rents allowed by imperfections of state allocation. Survival of enterprises in the private sector depended more on personal connections and bribing state officials than on a struggle for cost minimization and consumer satisfaction.[15]

Importantly, this bias in the ethos of the second sector in the Communist past represents only one facet of a larger phenomenon of the great impoverishment of responsible ethics in Communist societies. Sociologists working on Eastern Europe and the Soviet Union have documented empirically this universal pattern – going beyond the private sector or even the whole economic realm – of what they call excessive individualism or disintegrative selfishness (typically linked to atomization of society).[16]

The initial phase of transition to capitalism has invited even more drastic forms of the selfish pursuit of interest. The stakes became higher because of increased number

---

[14] The market in which individuals exchange valuables for money is still not the way of life for large segments of these societies, or, in other words, it is not yet a principal force integrating people; see K. Polanyi, *Primitive, Archaic and Modern Economics* (Boston, 1968). This is largely because, during the period of Communist restrictions on individual activities, people had largely unlearned the competitive rules of the game.

[15] See J. Kornai, "The Affinity of Ownership and Coordination Mechanism", *Economic Perspectives*, 4:3 (1990).

[16] See, for instance, M. Marody, "From Social Ideal to Real World: Clash Between New Possibilities and Old Habits", in K. Poznanski, ed., *Constructing Capitalism: The Reemergence of Civil Society and Liberal Economy in the Post-Communist World* (Boulder, CO, 1992).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

of niches for speculative profits caused by imperfections of newly passed laws and more policy mistakes by inexperienced bureaucrats. In addition, enforcement of the law has been at least temporarily weakened by elimination of some Communist agencies (for example, "economic police" in Poland) and by the considerable demoralization of many others.

It is a real paradox of the Communist breakup that while the defeat was widely seen by some major opposition forces as a crusade for moral revival, or restoration of traditional ethics, the fallout of this collapse has brought even further damage to responsible norms. Since the tendency for society to perceive reality in "moral" terms has not subsided, the near future may thus witness other acts of defiance in the name of "high" morals, this time aimed at the post-Communist bureaucracies.

This brings me to the conclusion that the economies of Eastern Europe and the Soviet Union are a long distance away from operating effective markets, ones that are organic. The alternative to this variant of institution building is for the states to get heavily involved, but such efforts only result in "creating" defective, pathological markets. While such defective regimes do not have to prevent effective markets from eventually being put in place, they do delay the process and thus "create" more problems than they solve.[17]

*Dual Economy*

Since the emergence of a healthy private economy has to be slow, so must be the contraction of the public sector. In other words, in their transition to capitalism, Eastern Europe and the Soviet Union will have to move through a lengthy phase of dual economy.[18] In such an economy, the outgoing state sphere of production can be characterized by what is called in the theory of development the "traditional" sector, with the incoming private segment falling then into the category of a "modern" sector.

What this implies is that during that critical stage, the state has to operate parallel economic arrangements for enterprises based on the traditional mode of operation and for those already liberalized. In addition, different instruments have to be applied to state-owned and private (and other non-state) enterprises respectively. Such use of various tax schedules, profit arrangements, wage systems, credit schemes, and other financial tools, of course, puts special demands on the state apparatus.[19]

The duality presents the state with the practical question of whether the public and private sectors should be treated equally in terms of the tightness of various state instruments, given quite obvious differences in respective productivities of those sec-

---

[17] J. Schumpeter, *Capitalism, Socialism, and Democracy* (New York, 1942, 3rd edition) distinguishes the transition in a state of maturity, which implies that resistance will be weak, and one in a state of immaturity when new political forces "gain control of the central organs . . . while nevertheless, both things and souls are as yet unprepared . . . so that the resulting arrangement is bound to break down." (pp. 221–23)

[18] J. Kornai, *The Road to a Free Economy* (New York, 1990).

[19] R. McKinnon, "Financial Control in the Transition from Classical Socialism to a Market Economy." (Conference paper, 1991)

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


tors. One possible response is for the state not to disfavor any of these sectors on the grounds that if the private sector is to be allowed – for reasons mentioned earlier – to grow organically, so too must the public sector be permitted to contract in a spontaneous way.

Another response is to use financial instruments to suppress the public sector for the sake of speeding expansion of the private economy. This is the approach that seems to be favored by many post-Communist governments, a reflection of their view of the state sector as a liability. The tendency is not only to discontinue direct ties quickly – commands and instructions – between the central bureaucracy and state-owned enterprises but also to deprive them of financial assistance they had gotten used to in the past. At the same time, the private sector is given great attention and offered numerous incentives.

An example of such differentiation between the two sectors is Poland, where the deflationary policy of late 1989 has been applied to state industry more aggressively than to the private sector. For instance, state-owned enterprises have been subjected to extremely steep taxes on excess wage increases(that is, going beyond state-determined limits), while the private ones have not. The private sector has also been exempted from the very controversial tax on capital stock called dividend, since, obviously, the state does not own assets in private enterprises.

The private sector has been favored not only by explicit state preferences but also by the fact that it is more difficult for the state to execute financial obligations from private enterprises. Given the weakness of the internal revenue service, enterprises in the private sector could have easily avoided many due payments, a privilege not accorded bank-controlled state enterprises. Moreover, the private sector may more easily escape duties on imports since customs are so porous (and avoid turnover taxes that represent another element of effective tariffs).

This highly differentiated approach showed in the 1990 economic figures and in the 1991 data as well. The deflationary policy – probably excessively harsh – drove much of the state sector industry to the brink of disaster. Its total output dropped by 23 percent in 1990 and kept falling through most of 1991, causing a sharp increase in unemployment. At the same time, the private sector grew – in 1990 its output increased by 8 percent – and added many jobs as well (though mostly outside of industry).

Such an overall decline in industry would have alarmed almost any government, but in Poland it has been largely ignored or downplayed. Thus, the recession has been officially presented as caused in large part by a fall in "unwanted" production goods being too costly, or their having no buyers. The recession has been described as beneficial also because it supposedly has helped in speeding up privatization of state assets by bringing the value of capital in the public sector down (a fact already discovered by some worker collectives interested in leveraged buyouts).

### *Replacement Strategy*

While the claim is frequently made that the current transition from state socialism to liberal capitalism has no relevant precedent, this is not necessarily true.[20] There is at

---

[20] E. g., S. Edwards, "Stabilization in Latin America: Lessons for East Europe." *Unpublished paper at the Department of Economics,* UCLA 1991.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


least one important case that is applicable, namely, that of China, since China has traveled farther down the road of building markets than almost any country of Eastern Europe or the Soviet Union.

Since 1978 Chinese Communists have allowed parallel markets to exist, that is, those regulated by the state through hierarchical plans and those free of control for above plan-quota quantities, with each segment operating separate prices. By now most consumer goods – including food – are subject to market regulation and, since 1983–84, markets for investment goods have been largely freed of state allocations (for instance, about three-fourths of machine tools for metals sold outside of the state quota system in 1989).

Even more impressive has been the opening of the economy to the world market, so that, for instance, more than half of exports in 1989 were conducted outside of the state directives. In the same year more than half of imports were financed through currency acquired at auctions, and most of the state allocations were priced at rates the same as those recorded in the auctions. This degree of internal convertibility was not matched by either Eastern Europe or the Soviet Union at the time and still remains one of the highest.

China has also developed a market for securities, again more than any East European economy and the former Soviet Union. In Eastern Europe, only Hungary has some signs of a bond market, but it is limited by comparison with China, where, for instance, there is now a thriving secondary market for bonds. In 1991 two very active stock markets – open to foreigners – operated in China, while Eastern Europe was only experimenting with the stock exchange (for example, Poland, with less than half a dozen enterprises irregularly trading their shares in that year).

This transition to markets in China has taken place with no articulated reform program and even less a specific timetable. Simply, initial changes have been leading to consecutive changes when the former proved fruitful but limited and the latter promised further improvement. Thus, for instance, when obligatory bonds proved no longer attractive, the state allowed for broad trade in bonds. Short-term leases for land were extended on a few occasions and finally even inheritance rights were made into law.

Significantly, effective markets have been created for most of the economy without wide privatization of state assets. In agriculture, land remains state-owned, though its use is in the hands of households. In industry, very few enterprises have been sold or given away to private hands, and there is no serious discussion of what scheme to adopt in order to privatize state capital (except for a brief period a few years ago, mostly in response to ideas brought in by foreign advisers).

Even though the non-state sector has not been buying into the public sector, the ownership structure has changed in China very substantially, far beyond what East Europeans have managed to achieve so far. Thus, while non-state enterprises accounted for one-fifth of output in 1978, they represented almost half of output in 1990. This shift has come about simply because the non-state sector has been allowed to grow at a rate a few times higher than the state sector (for example, in 1990, the state sector increased its output by 3 percent, but the collective grew by 9 percent and private production by 21 percent).[21]

[21] N. Lardy, "Redefining U.S.-China Economic Relations." *NBASR* Analysis No. 5 (1991).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


*Transition Costs*

What is intriguing about China's way of introducing capitalism is that this process has been taking place without political reforms of comparable scale. In fact, except for another reinterpretation of the meaning of "true" Communism – allowing profit-making and individual enrichment – politics has not really changed. Even more surprising is that capitalist transition has been proceeding with minor economic costs, since it directly challenges the conventional view that any major reform initially produces considerable net loss.

True, inflation has accelerated after the removal of state price setting for much of the production, but prices have been growing at a modest, mostly single-digit rate (one important exception being the surge in 1988 to 18 percent, quickly extinguished after application of "tight" money policy by the state). Income diversity has intensified, but not through putting scores of workers out of a job, and – with the overall rapid increase in individual consumption – retreat from rigid egalitarianism has not caused major social tensions.

These gains in personal consumption have been possible because of enormous acceleration in the rate of output growth, not only in agriculture but also in industry – almost twofold production growth during the decade from 1980 to 1989. Even more phenomenal has been the export expansion (that is, tenfold increase in value in the same period). Moreover, the economy has been able to generate trade surpluses – particularly with the United States – and thus allow for accumulation of considerable currency reserves.

This contrasts sharply with the recent performance of Eastern Europe and the former Soviet Union on their way to capitalism. Most of those countries have experienced an abrupt increase in the inflation rate, often exceeding the Chinese record. For instance, in 1990 inflation doubled in Hungary to reach 29 percent and it also doubled in Poland to 584 percent. Differentiation of income has widened significantly, in part because of rapidly spreading unemployment in the regions with few job opportunities (for example, in rural Poland, often reporting double digit rates in mid-1991).

Unlike in China, production has uniformly declined in industrial sectors but often in agriculture as well. At the end of 1989 these countries were heading for a recession, in 1990 they had gotten into one, and it has extended through 1991 (for example, net material product fell by 11 percent in Eastern Europe and by 4 percent in the Soviet Union in 1990). With few exceptions, notably that of Poland and Hungary, exports have suffered great losses and external balances have worsened as well (for instance, volume of exports from both Eastern Europe and the Soviet Union fell by more than 12 percent in 1990, with 46 percent decline in Romania).

That China has done so much better economically than Eastern Europe and the Soviet Union seem to be doing lately might not be related to the fact that China is pursuing an evolutionary path while the latter are "storming" with reforms.[22] However,

---

[22] R. McKinnon similarly states that "capitalism is best grown from modest beginnings in small-scale enterprises that provide a sorting mechanism for successful and unsuccessful entrepreneurs", in McKinnon, "Transition", p. 12.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

p0063371


this might not be just a coincidence but rather a proof that the costs of transition are high when the economic order is altered abruptly, or even when state intentions are to change everything radically. It is telling that among East Europeans, Hungary, with a long tradition of market-type reforms and a relatively cautious approach now, has also suffered the lowest losses.

## Return to Working Democracy

If restoration of effective markets cannot materialize right away, the question whether democracy can be established any faster has to be raised. If one accepts the prevalent conception that democracy and markets make each other stronger, and even more the popular contention that markets are a precondition of and thus precede democracy, the answer is no. If, however, the above theorems are rejected as overly broad generalizations or simply as incorrect, one has to search for an answer by examining the political scene alone.

### *General Perceptions*

Both the leaders and the public throughout most of the region are convinced, by and large, that installing democracy is not going to take long, a feeling that seems largely to reflect the collective "experience" with the Communist collapse. Societies are informed less by theories than by memories, particularly of some late spectacular events, and the recent attitudes toward introducing democratic politics in Eastern Europe and the Soviet Union seem to prove this general point well.

It is hard not to be impressed with the sudden withdrawal of the Communist party structures (for example, expeditious liquidation of some parties, relinquishing of party property, and disappearance of party media organs) throughout 1989–91 in a large part of the region. These structures were correctly blamed for restricting political freedoms in the past, so that their quick removal leads many to believe that now democratic politics is back or at least at hand – as if the absence of something meant the presence of its opposite.

The collapse is seen as so total that not only were its institutions – enforcing authoritarian politics – pulled down, but with them certain attitudes, such as yielding to authority, propensity to secrecy, and contempt for dissent vanished as well. Of course, for this to be true, the members and supporters of the party/state – accounting for a significant portion of the population up to the final moments – would have had to be through, or only steps away from, such conversion.

Moreover, the collapse of the Communist system is very often viewed as proof that the quest for political freedoms is a natural, inalienable need of human beings – one that can prevail even under the most unfavorable conditions, like those created by the Communist parties in the Soviet Union and Eastern Europe. The hope is that the same natural forces will continue to work for the sake of further transformation of the political landscape into one most suitable for exercise of liberties.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


These high expectations are further reinforced by the frequent perception that the forces responsible for the removal of the Communist parties had demonstrated great restraint in dealing with their opponents (a fact that has made them so much less revolutionary). This self-restraint suggests to many that people in those countries are already prepared for democracy built on respect for an opponent, preference for negotiations, and time for differences of opinion to subside.

A further source of confidence in the ability to set up working democracy is the impression that Communism was displaced not by individual efforts but rather through organized ones – such as the independent unions in Poland that at some point numbered one-half of the adult population, or mass demonstrations extended through a few weeks in the former East Germany – and that by and large this popular activism was of a grass-roots nature, both features usually equated with democratic politics.

### *Political Reality*

This sense of rapid democratization is another illusion, even in Hungary, the country that has made the greatest progress in pluralization of its political life. Here, the 1990 parliamentary elections produced well defined parties, often recreations of pre-war ancestors, but political participation has been very low, as demonstrated in particular by the follow-up local elections with an average turnout of one-third. The public continues to reject politics on moral grounds or because of apathy, so the current Hungarian system is one of elite rule.[23]

In Poland, the polarization into party politics had already begun in 1990 through splits within the social movement, that is, the independent unions. Great power has been given to the presidential office, however, not taken advantage of by Jaruzelski but employed by his successor, Walesa, elected in 1990. The principal mechanisms are not parliamentary decisions but accords between major political elites, as in the case of the 1989 roundtable, or the formation of Bielecki's government in 1991.

The Czechoslovak political scene is overrun by a rather heterogeneous conglomerate political movement headed mostly by urban intellectuals acting as a symbol both of the resistance to late Communism and of national unity. As in Poland, however, the social movement has been splitting lately into proponents of a radical shift to classical capitalism (that is, Klaus) and Havel's milder social democrats (unlike in Poland, none of these emerging factions defining itself politically vis-à-vis the Church).

In Bulgaria and Romania, authoritarian politics continues with converted Communist parties dominating the political scene, though this time facing vocal, legal opposition forces. Opposition politicians are often intimidated or harassed, as during the Romanian elections in 1991, and the former Communist party, now relabeled socialist, is antagonizing workers and intellectuals as much as in the Communist past (for example, miners brutally breaking up demonstrations in Bucharest in mid-1990).

[23] B. Racz, "Political Pluralization in Hungary: The 1990 Elections", *Soviet Studies*, 43:1 (1991), describes the political situation in the country as pre-democratic with parties "formed from above by often self-appointed elites." (p. 130)

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


At the risk of some oversimplification, the Soviet political scene in 1991 can be described as representing authoritarianism as well. National movements, as in the most independent of such new states as the Baltics, have, for instance, been denying autonomy to minorities (for example, the Poles in Lithuania). The so-called democratic forces, as in Russia, are controlled by powerful individuals, rather than by representative assemblies. Finally, in many Asian republics, Communist parties have survived as the only influential political force.

Generally speaking, the region is dominated by political forces – mass parties and movements – that represent conglomerates of political interests rather than homogeneous group interests. Rulers generally govern in the name of higher interests, be it moral renewal or economic reform (as is clearly the case with the consecutive non-Communist governments in Poland). These are thus mostly "mission" regimes and not yet the genuinely representative ones that invite fully democratic politics.

### *Pre-Communist Past*

These patterns of slow, inconsistent emergence of democratic politics suggest that the antidemocratic fallout of the Communist period is more serious than the typical view would hold. Moreover, since the decay of the party/state structure has not really created rapid development of democratic politics, it might be that some remaining barriers to the rule of many actually have some roots in the pre-Communist times as well, and one should not be surprised by this.

The Communist system, in fact, did not represent a complete departure from the past but carried along some elements of the pre-Communist reality, not simply because total change is never possible but also because the pre-Communist past did not represent a complete reverse image of the Communist order. The point is that the dictatorship of the proletariat was not built on the ruins of working democracies but rather on the remnants of what can be described as various forms of authoritarian politics.[24]

The only country where political democracy functioned continuously before the last war was Czechoslovakia. In other parts of Eastern Europe, democratic politics was never really in place – as, for example, in Hungary, which was run by a land-based oligarchy with strong conservative overtones.[25] Bulgaria did not enjoy democracy either, while Romania and Poland began the interwar period with open elections and multiparty systems but, in less than a decade, they introduced semi-autocratic regimes.[26]

---

[24] E. g., Bulgaria from Great Britain. See A. Janos, *Politics and Paradigms: Changing Theories of Change in Social Science* (Stanford, 1986).

[25] G. Stokes, "The Social Origins of East European Politics", *Eastern European Politics and Societies*, 1:1 (1987).

[26] See J. Rothchild, *Return to Diversity: A Political History of East Central Europe Since World War II* (New York, 1989).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


Czechoslovakia developed a democratic structure since it was the only country in the region with a well advanced urban industrial sector and prosperous agriculture. Elsewhere, the urban-rural conflicts were intense and tore apart consensus politics, as, for instance, in Bulgaria with its radical peasant movement. Ethnic hostilities in almost all these countries were causing further deep divisions, as in Poland, with its Ukrainian minority, and so were border disputes, a case in point being war-defeated Hungary claiming some Romanian territory.

The war years between 1939 and 1945 resulted in the destruction – or suspension – of the remaining democratic elements both in such German-occupied countries as Poland and among such German allies as Hungary and Croatia. Political rights in the occupied countries were practically eliminated, and certain minorities, most notably the Jews, were placed outside the law by Germans. In the allied countries, power was in the hands of various kinds of fascist regimes with little respect for political freedoms and repressive towards minorities as well.[27]

*Skewed Structure*

There is yet one more "past" that might have had some negative impact on the pace of building democratic politics – the recent collapse of the Communist system itself. In fact, the impact of this final act has not been uniformly positive, at least in some immediate outcomes. Among these negative legacies is, in particular, the fact that the collapse left a weak state faced with a strong society, a situation that according to political theory is not conducive to democratic politics.[28]

Thus, during the early period of Communist rule, the party was also the state, so that a strong party meant a strong state, while society was weak, as in any totalitarian or authoritarian structure.[29] In the later phase, the party/state continued to be strong, despite erosion of official ideology and increased political tolerance. The state became weak only with the actual collapse of the system, since with the disappearance of the party structures, the fabric of the state had to be damaged as well (a good case in point being Poland and the post-putsch Soviet Union).

The state apparatus has not yet recovered from the recent loss of power, though appearances of strength are frequent. One critical reason is that post-Communist elites entered into state decision-making with little or no preparation. Positions in public administration today are often filled with former opposition activists trained in debates within small private enclaves and with intellectuals running away from underpaid jobs (for example, writers, artists, and academics). They slowly gain experience by learning on the job.

---

[27] See J. Gross, "Social Consequences of War: Preliminaries to the Study of Communist Regimes in East Central Europe", *Eastern European Politics and Societies,* 3:2 (Spring 1989).

[28] G. Ekiert, "Transition from State Socialism in East Central Europe", Social Science Research Council *States and Social Structures Newsletter* (Winter 1990).

[29] A strong state is one that can force society into concessions and a strong society is one capable of getting concessions from the state. For a more elaborate discussion, see J. Migdal, *Strong States and Weak Societies: State-Society Relations and State Capabilities in the Third World* (Princeton, 1988), who defines strong states as those that can pursue their task by penetration of society, raising revenues, etc.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

p0063371


Moreover, state offices often do not offer sufficient opportunities to attract talented public servants and even less to keep them for long. Intense political infighting makes state posts vulnerable to personnel changes, while official pay is not particularly high, reflecting both fiscal conservatism aimed at curing inflation and public resistance to income differentials. Moreover, the image of state bureaucracy remains greatly tarnished and officials have to subject themselves to intense scrutiny of their ethics demonstrated by their behavior.

Not only do the states remain weak, but the societies continue to be strong and evidence of that strength is abundant, particularly in such countries as Romania. Here, many important political outcomes lately have been decided in the streets, such as the governmental changes in late 1991 caused by thousands of miners first hijacking trains to reach the capital and then storming governmental buildings to demand price freezes and higher wages (the miners helped the same government of the National Salvation Front in mid-1990 when it was besieged by urban protesters).

In Poland, so far, society has refrained from violence, but pressure on post-Communist governments has been extremely powerful and often channeled through extra-democratic channels. Since the demotion of the last Communist regime, strike alerts, hunger strikes, and occupation strikes have been practically continuous, declining in numerical terms only briefly, to escalate again, causing, for instance, sudden reversals in state policies, relaxation of credit conditions and imposition of higher tariffs to satisfy farmers being just two examples.

### *Strange Outcomes*

This imbalance between state and society is not only detrimental to politics, but it also has a negative impact on economics. While the post-Communist states are weak, they act as if they had great strength, as in the case of the privatization of the state sector. Not surprisingly, the outcomes of state actions are either close to nonexistent or they produce results opposite to those intended, and the ongoing privatization process offers continuing abundant evidence of that.

For instance, while so many ambitious privatization programs have been announced, the pace of divesting public assets has been very slow, with the possible exception of Hungary (where foreign investors have been particularly active). Everywhere else in Eastern Europe only a fraction has been sold or dispersed so far. In Poland, for instance, less than five percent of state enterprises were privatized during 1990 and 1991, and most of them rather small-scale units.[30]

While efforts have been made to assure that privatization proceeds in an orderly way, the reality has been just the opposite. Thus, in all these countries, separate central agencies were created and empowered with great authority. Mass privatization of state assets has turned out to be too heavy a burden for the newly established bureaucratic bodies, however, so that almost by default lower levels of administration have gained great influence in the process.

---

[30] J. Sachs, "*Accelerating Privatization in Eastern Europe: The Case of Poland.*" (Unpublished paper of the Department of Economics, Harvard University, 1991.)

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


The declared purpose of finding new owners is to put capital to more efficient uses, but disposal of public assets has often become instead an arena for purely political struggles. For instance, in the Soviet Union, property reform has turned into a power game in which appropriation of assets serves republics in their fight to capture authority from federal bureaucracy. But it also helps some territorial units within republics (autonomous regions or cities, for instance) to shift authority toward themselves.

States have been trying to regulate access to public capital, so that in Poland, for instance, the decision was made in 1990 to prevent workers from taking over their enterprises. This was an abrupt shift in the economic platform of the former opposition forces, aimed at avoiding the ills of Yugoslavia's labor-managed model, which is now blamed for suppressing incentives for maximization of capital value. Contrary to these intentions, the large part of privatized enterprises went to workers and managers through leveraged buyouts.[31]

To assure fairness in the disposition of assets, some states have contemplated free or low-fee vouchers. At least in Poland, despite strong support from central figures in the government of Bielecki, the whole program has been stalled through most of 1991. The idea of vouchers did not find enough votes in the parliament, and only a few out of a myriad of parties have offered to back it. Most important, the potential benefactors, adult citizens, did not express much enthusiasm about the program either.

In the spirit of fairness, some post-Communist bureaucracies have made efforts to eliminate "nomenklatura" enterprises, strongly objected to by the general public. Such actions, as in Hungary and also in Poland, have been timid at best and, in fact, new forms of "political capitalism" – where political influence is exploited for economic benefits – have been allowed to emerge and, instead of curtailing "nomenklatura" enterprises, the newly formed elite widely engages in the same practices.[32]

In many countries, strong sentiments against providing easy access to privatized assets to foreigners have arisen, among them in Poland. Consequently, the 1990 law allowed only 10 percent of assets in any individual enterprise to be offered to foreigners (the limit to be increased only by the government if it is determined to be justified). However, the common practice has become to hire foreign investment banks to evaluate these capital assets and arrange sale of shares, all for a payment (service fee plus success bonuses) sometimes equivalent to one-quarter of the established face value.[33]

Finally, privatization has been expected to provide financial revenues sufficient to repair budgetary deficits inherited from the late Communist governments. So far, as

---

[31] In contrast, Hungary succeeded in excluding workers from gaining broad access to public capital. D. Bartlett, "The Political Economy of Privatization: Property Reform and Democracy in Hungary" (unpublished paper, Vanderbilt University, Department of Political Science, 1991) points to "the virtual political disenfranchisement of the Hungarian working class" (p. 7) as a factor behind this exclusion.

[32] For instance, the Polish government of Bielecki in 1991, under the presidency of Walesa broke its election promise and allowed high level officials to also manage their own businesses or serve on the boards of private enterprises.

[33] According to Sachs, "Accelerating Privatization", p. 12, the valuation fee charged by the banks for five enterprises that were first privatized in 1991, plus related bonuses, "probably constituted 25 percent of the value of these companies."

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


in Poland, proceeds have provided only a minimal relief, since the sell-off has been slow and at prices depressed greatly by the recession. Moreover, the hasty and confusing privatization efforts have increased uncertainty among enterprises over their legal future, resulting in contraction of production that in turn has reduced the tax base for the state.

### *Demobilization Options*

To facilitate democratic politics, but also to limit counterproductive economic interventions, the current balance of power has to be tilted in favor of the state.[34] What that means, in practical terms, is that some form of societal demobilization is needed to reduce demands on the state and make various critical groups of influence less volatile. While quite a few options for demobilization are available, none of them seem to offer a quick and easy way out.

Given the long history of aggressive nationalist movements in the region, one obvious option is to call for individuals to restrain themselves for the sake of some "general interest" – be it territorial integrity, preservation of heritage, or economic revival. In fact, nationalist sentiments are rather high at the moment, but relying on these emotions is a double-edged solution since while shifting power to the state, it undercuts individualism, an indispensable ingredient of democratic politics.

It must also be remembered that nationalism can be helpful primarily, or only, in societies that are fairly homogeneous. Otherwise, the nationalism of one ethnic group fuels the nationalism of another, reducing the governability of the country. In the Soviet Union, but also in Yugoslavia, the faltering Communist elite has turned to nationalism, thereby gaining some legitimacy but at the same time causing dangerous divisions along republican lines (greatly responsible for the violent clashes between neighboring Serbs and Croats in 1991 and 1992).

Another approach is to throw society into the market game of survival by quickly removing such welfare safeguards as job protection and state subsidies. The hardships of daily struggle might demobilize society politically, providing that people would refrain from using power to promote their welfare. This is, however, exactly what was learned during the closing phase of Communism, as clearly was the case in Poland (and as quickly is becoming a reality in the former Soviet Union, where a similar type of labor movement is establishing itself).

Demobilization through economic hardship is additionally complicated by the fact that these societies, already exhausted by their suffering under the Communist regimes, are asking workers to make wage sacrifices and at a later date threatening them with unemployment as well. By resorting to similar measures, though not executed directly but rather through market discipline, the post-Communist leaders risk being associated with the Communists and thus jeopardizing their legitimacy.

To avoid misunderstanding, rebuilding a strong state is not necessarily inconsistent with the concept of organic, evolutionary development. Organic does not mean

---

[34] See interesting comments, J. Staniszkis, "Main Paradoxes of the Democratic Change in Eastern Europe and the Soviet Union", in Poznanski, *Constructing Capitalism*.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


state-free, at least not within the intellectual tradition of liberal economists such as von Hayek.[35] His arguments for organic change should not be equated with the traditional laissez-faire doctrine, but rather should be seen as calling for a limited state with a reasonable social agenda, that is, guaranteeing minimum wage and assisting individuals in providing for some common hazards.[36]

The state is not disruptive of spontaneous processes as long as it follows the "rule of law" – rather than bend the law according to its needs at a given time, characteristic of such a prerogative state as the Communist one. State interventions are also compatible with the evolutionary, or organic, process when they do not prevent the individual from pursuing his independent plans by focusing its actions on the areas where it has a comparative advantage and by being credible – and thus increase the effectiveness of state actions too.

## Conclusions

The great paradox of the transition is that the utopian communist project of the past has been rejected only to be replaced, at least for the moment, with great illusions. It is as if the disappointing experience with utopia building by the Communist party/state was not sufficient to ground these nations in realism. False hopes again make the states believe that the time is right for radical "projects," and societies again allow states to act very much on their own.

The Communist system was not brought down by revolution but only diluted through evolutionary forces, so that many elements of the past are still very much present. Mistrust in politics, shortage of market ethos, underformalization, or weak law are just a few of the legacies of the past that make transition to liberal capitalism very difficult. Under those circumstances, state efforts to radicalize transition are likely to backfire and possibly even turn the region again into a "crisis zone" – to use a phrase coined by Berend, where regress is caused in the name of progress.

Warnings against state efforts to construct liberal capitalism too quickly come from unfinished transitions like that of recent China. But it also comes from the many available reconstructions of capitalist origin elsewhere, all stressing the spontaneous, evolutionary nature of the market-building process. This is definitely the conclusion from the theory of capitalist development formulated by Schumpeter.[37] It also comes from another classical account, Polanyi's study of the "great transformation" of capitalism.[38] (But Marx never had this in mind.)[39]

One critical feature of evolutionary change is that it does not follow any preconceived blueprint or – using Hayek's terminology – social plan, but rather comes about through random efforts, springing from various needs and stresses faced by individual

[35] F. von Hayek, *The Road to Serfdom* (Chicago, 1934).

[36] Ibid, pp. 119–22. Importantly, von Hayek does not even mind state involvement in countercyclical actions either.

[37] J. Schumpeter, *The Theory of Economic Development* (Cambridge, MA, 1934).

[38] K. Polanyi, *The Great Transformation: The Political and Economic Origins of Our Times* (Boston, 1944).

[39] Good discussion by A. Brewer, *Marxist Theories of Imperialism: A Critical Survey* (London, 1980).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

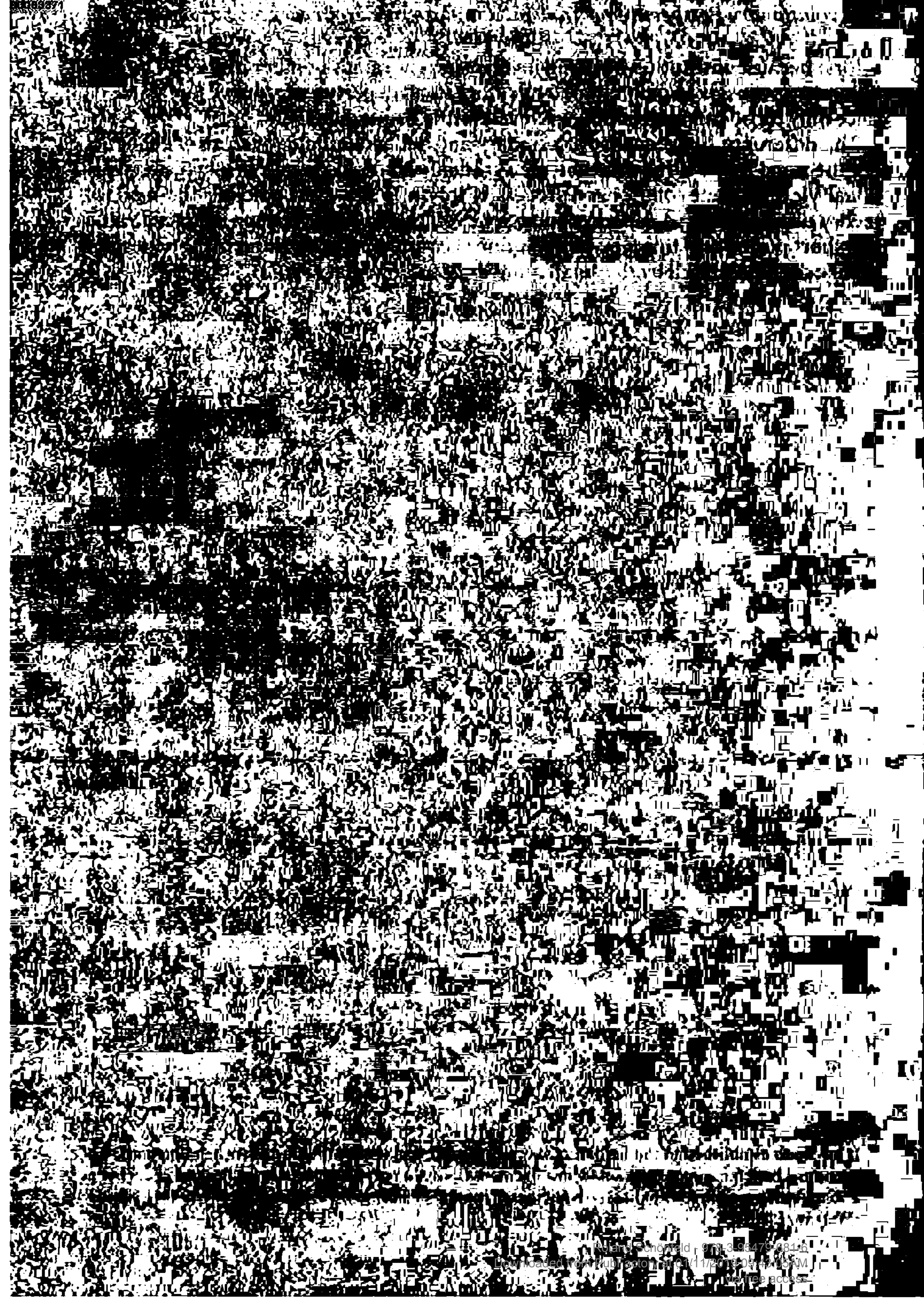
·:063371


actors, because institution building involves an enormous number of trials. The evolutionary process is also dominated by rather small departures from existing "states", since only those can be rectified without causing major damage.[40]

The difference between an evolutionary and nonevolutionary pattern of change is not the same as the difference between gradual and rapid change. While the conventional view of the evolutionary process is that it is slow and gradual, the modern theory distinguishes so-called "punctuary evolution", where change is concentrated in a short period and this type of evolution is considered to be a dominant pattern of change, demonstrated by the small number of intermediate forms.

[40] It has been established in the field of economics of technical change that the overwhelming portion of economic benefits comes from small improvements that not only allow large breakthrough changes but also make it possible to exploit all advantages of them. See Poznanski, *Innovations in Market Economy* (Warsaw, 1980).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access



Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371



*László Bruszt*

# Transformative Politics: Social Costs and Social Peace in East Central Europe*

## Marketization and Democracy

The various approaches to the political dilemmas of economic transformation in East-Central Europe are based on three uncontested assumptions and one highly debated question. The three uncontested assumptions are: (1) marketization will lower transaction costs in these economies, (2) privatization will lower production costs and increase the performance of these economies, (3) marketization and privatization will have high transitional social costs. The contested question is whether these societies will accept these cost – simultaneously a question of the assumed level of tolerance of these societies and the capacities of the newly installed democratic regimes to solve social conflicts related to the economic transformation.

Those who answer this question negatively do so by raising doubts about the compatibility of the social costs of economic transformation and the newly created rules of democratic politics. For them, the transitional social costs are too high and the worst-off will resist the changes, using the newly installed democratic rules to block the economic transformation and/or to undermine democratic governance. The arguments in this approach are based either on the legacies of the past regimes in economic and social structures, or simply on the contradictions of the logic of economic change and democratic governance. The "structuralist" argument runs basically as follows: due to the peculiarities of the interests of the social actors, determined by the inherited social structures and cultures, they (usually the workers in the more concrete arguments) will resist economic transformation. Those social groups that would support both economic transformation and democratic consolidation, based on their structurally determined interests, are absent.[1] The existing social groups have interests that contradict the logic of marketization.[2] The formalist version of this argument offers a set of interrelated paradoxes: (a) the consolidation of democracy requires marketization, (b) marketization of these economies is impossible without democracy, (c) democracy does not allow for marketization, (d) if there will be marketiza-

* Research for this paper was supported by grants from the National Science Foundation. My thanks to David Stark and Monique Djokic Stark for their helpful criticisms and suggestions on earlier drafts of the paper.

[1] The more concrete arguments here refer to the lack of a new "moneyed" middle class of owners.

[2] The most sophisticated arguments of this sort can be seen in George Schöpflin, "Central and Eastern Europe over the Last Year: New Trends, Old Structures," in *RFE Report on Eastern Europe*, February 15, 1991, pp. 26-28; and David Ost, "Shaping a New Politics in Poland" (paper presented at the conference on Transition from State Socialism in East Central Europe, Center for European Studies, Harvard University, Cambridge, March 15-17, 1991).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


tion, it will undermine democracy, (e) the lack of marketization will also undermine democracy.[3]

The affirmative answer to the same question is based also on the same two factors, arguing that there are ways to minimize the social costs of transformation and to gain society's tolerance of these costs.[4] According to the most elaborate study using this approach, people would support radical programs with high transitional social costs if they were confident in the future.[5] In the view of Adam Przeworski, the most likely successful road to a market economy is not the one that minimizes social costs but the radical one that is able to move ahead with economic transformation and simultaneously generate popular support. The political conditions favorable for economic transformation can either be created through centralizing political decisions and neutralizing or marginalizing those forces that could resist the transformation. Or they can be created by generating social support for, or at least passive tolerance of, the economic changes through different types of inclusive politics that increase the range of democratic institutions and political actors included in the decision-making process on reforms.

According to Przeworski, this road is certainly not a linear one. Economic reform can erode its social basis and reforms can go in cycles. The basic question is whether the periods of moving ahead will result in a critical mass of changes, upon which the next reforms can go even further. On the other hand, both the centralizing and the decentralizing strategies of generating favorable political conditions for economic change have their own limitations; and similarly to the stop-and-go process of economic transformation, politicians will vacillate between demobilizing resistance to the changes and mobilizing social support for transformative politics.

To amplify the "compatibility thesis" of Przeworski, I analyze the strategies of transformative politics of the four East Central European countries during the first year after the completion of the initial stage of transition to democracy. First I will present a simple analytic framework for describing the differences in the strategies chosen and the courses of action taken and, moving then from description to explanation, I will argue that we need to move a step beyond the proposals of Przeworski. While accepting his arguments in general, I will argue that a deeper analysis of transformative politics must examine the differences in the structural and institutional legacies of these regimes; linking the modalities in transformative politics to the differences in the paths taken before and during the transition to democracy. Based on the differences in the pre-transition solutions to the dilemmas of harmonizing the requirements of economic growth and social peace, the institutional outcomes of previous struggles of state-socialist modernization, and the outcomes of the extrication, we

---

[3] See especially Claus Offe, "Privatisierung der Ökonomie als demokratisches Projekt? Paradoxen des 'politischen Kapitalismus' in Osteuropa" (paper presented at the Zentrum für Sozialpolitik Universität Bremen, March 1991); and Jon Elster, "The Necessity and Impossibility of Simultaneous Economic and Political Reform," University of Chicago, 1991, unpublished manuscript.

[4] See especially Adam Przeworski, *Democracy and the Market* (Cambridge, 1991), pp. 136-188; and Andrew Arato, "Revolution, Civil Society and Democracy," New School for Social Research, New York, 1990, unpublished manuscript.

[5] Przeworski, *Democracy and the Market.*

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


should expect differences in the constraining factors of the various strategies, in the strategies chosen, and in the courses of action taken.[6]

Since the countries have differing legacies in economic and social structures, we should expect differences in the level of the social costs of the transformative policies. Moreover, the institutional legacies differ and correspondingly we should expect individually distinct capacities on the side of the new regimes to channel conflict into the framework of democratic politics, and in general, to generate support for, and/or toleration of, the social costs of the economic changes.

This approach draws from the recent studies of the relationships between the types of political regimes and the success of economic transformations in other regions of the world. One of the main conclusions one should draw from these studies is that there is no general rule of the relationships of the two sets of factors, that is, democratic or authoritarian rule and economic transformation. Economic hardships are mediated by various preexisting institutional arrangements for managing political conflict and by divergent abilities of the political elites to maintain the support of the key groups in their societies.[7] It follows that the chances for survival of the same types of regimes, authoritarian or democratic, will differ. In some countries the resistance to the social costs of economic changes could lead to the collapse of both democratic and authoritarian regimes, under other regimes, whether democratic or authoritarian, political conditions would allow them to survive even a deeper crises.[8]

## Strategies and Legacies

In analyzing the changes in the courses of action taken in the first year after the inauguration of the first post-transition governments in the four Central European countries – Hungary, Czechoslovakia, Poland, and the eastern part of Germany – the framework I propose is organized around the two major aspects of transformative politics: (1) choices concerning the speed of transformation and hence of the timing of social costs and (2) the means of securing social support or toleration of these costs. The two major aspects are combined to create a two-dimensional space where we can then locate the initial choices of strategies among our four cases and chart subsequent changes in these strategies, and then analyze the linkages between the strategies and legacies.

---

[6] For example, one can accept, in principle, that the costs of the strategy of market-shock can be lower than the cost of the strategy of gradual change. But, based on the analysis of the above mentioned differences, we can also explain why certain countries will hardly even attempt to experiment with that strategy, why in others only the reformers will be shocked by the degree of popular resistance, and why, in a third country, the bitter pill strategy will be the one with a high level of temporary social support.

[7] See especially Stephan Haggard and Robert Kaufman, "Economic Adjustment and the Prospects for Democracy," 1991, unpublished manuscript.

[8] Haggard and Kaufman, "Economic Adjustment."

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


*Speed (The Timing of Social Costs)*

The two dimensions of transformative politics are interrelated, but their relationship is far from being direct.[9] Decisions about the speed of the economic changes always take into account assumptions about the level of tolerance of different social groups, the capacities of the different actors to organize resistance, and the capacities of the reformers to mobilize support, and/or neutralize resistance. On the other hand, these decisions are always also influenced by such pressures from within as the internal structural problems of the economy, and/or from without, in the form of the pressure from private creditors, international financial organizations, and the like. To put it differently, decisions about the speed of economic transformation are always interconnected with calculations of the different time frames of transformative politics. The latter is partly determined by the parliamentary business cycle, that is, on calculations by reformers to get visible economic improvement by the last year of their term, while holding the coalition of their supporting forces together during the hard times. Decisions concerning speed are also strongly influenced by the time given by the structural conditions of the economy, and also by the grace period given by external creditors. Finally, the time frame given by the different extra-parliamentary political actors, first of all trade unions, is of increasing importance.[10] The timing of social costs is therefore dependent on institutional specificities and the power relations between the political actors.

While the slow-gradual approach dilutes the social costs of the economic transformation in time, the fast-radical strategy attempts to concentrate them. The gradual path seeks to partition the costs associated with systemic change evenly among the various segments of society, while proponents of the radical strategy do not take the social inequalities thus created into account when calculating the net social cost of reform. The gradualist approach seeks incremental changes, accompanied by piecemeal monetary compensation to alleviate the gradually growing burden on the population, thereby seeking to placate them. In contrast, the radical strategy, or shock therapy approach, aims at minimizing the duration of this period of anesthetization within which the radical surgery altering the economic system is carried out, thereby minimizing the net cost.

---

[9] Concerning the relationship of the variables, also see Przeworski, *Democracy and the Market.*

[10] During the last year there were several general agreements between governments and trade unions in various Eastern European countries, in which usually wage-restraint and/or strike-stop was exchanged for the extension of trade union rights and some form of less than 100 percent wage indexation. In these agreements, trade unions on the average gave the green light for but 3 to 12 months in which the government may proceed unchecked with the transformation of the economy. Examples for the shorter one are the agreements made between the Bulgarian or Romanian trade unions and governments; for the longer, the example is the one struck between labor and government in Czechoslovakia.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

p0063371



## *Social Peace*

The strategy of maintaining the social peace is again related to the choice of economic strategy, for example, in the form of calculations about the capacity of the reformed economy to create for various social groups the potential to accommodate themselves, the capacity of the new institutions to mobilize resources, and the interrelated capacity of the state to centralize them in order to "buy the social peace."The choice of this strategy is shaped by calculations of the capacities of existing institutions to generate a minimal level of political support as well as by calculations about the resources of potential opponents and the like.

Strategies of maintaining social peace can oscillate between two extreme solutions: they can either rely on the coercive capacities of the state to suppress, marginalize, and/or neutralize resistance, sometimes combined with, centralized welfare-redistribution but usually not enough. Or, at the other extreme, the maintenance of social peace may be brought about through support, organized by the independent forces of civil society.[11] While these are the extremes of the potential strategies, the actual strategies may be located between the two poles of maintaining social peace based on the centralized means of "stick and carrot," or on "socializing the problems of the economy," by including the institutions of parliamentarism and the multitude of organizations of civil society into the decision-making process.[12]

On the one pole we will find different types of extreme centralizations of power, from strong presidentialism with a populist-type leader to a one-party government with strong exclusionary and suppressive policies. Moving in the direction of the other pole we will find the different types of extensions of the social and/or political basis of transformative politics: the extension of party coalitions, social pacts with parties and peak associations of labor and business, different types of corporatist arrangements, including trade unions, into the framing of transformative policies, and finally social movements supporting the politics of "there-is-no-alternative" on a moral basis.

## *The Choice of Strategy*

With these locations in mind, our task is now to connect the modalities of transformative politics to the different ideologies and legacies of the "transformers," focusing

---

[11] The two strategies can be related to two different theoretical arguments about approaches to the political preconditions of transformative politics. According to the first school of thought, only a strong, centralized state can transform the state-socialist economy, because of the peculiarities of social structure, i.e., there are no social groups that would be interested in capitalism, and the state has to create those structural groups that would then support transformation.

According to the second approach, the success of the transformative politics will depend on the strength of the civil society, because of the contradictory logics of transforming structures and maintaining social peace. An example for the first approach is Jadwiga Staniszkis, "Dilemmata der Demokratie in Osteuropa," in R. Deppe, et al, eds., *Demokratischer Umbruch in Osteuropa* (Frankfurt); an example for the second, Andrew Arato, "Revolution, Civil Society, and Democracy," New School for Social Research, New York, 1990, unpublished manuscript.

[12] This expression comes from our conversation with Alfred Stepan.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


first on the institutional legacies of the extrication. Our analysis begins with the choices of the initial strategies and the role played in those choices by differences in the ideologies of the newly elected political leaders. We then turn to the different institutional and structural legacies that constrain these strategies.

In the choice of the initial strategies an important role was played by the different ideologies of the newly elected leaders. These ideologies were organized around two poles: the conservative "social-market" ideology of the Hungarian governing coalition, and in a more moderate form, of the German government; on the other extreme the Thatcherite liberalist views of the Czechoslovak "transformers." Somewhere between the two lies the more pragmatic liberal approach of the Polish economic policy-makers. Behind these different ideologies we can discover different views about the role of the market, the state, and civil society in the process of economic transformation.

The cautious "social market" ideology of the Hungarians, while accepting a market economy as the final destination of transformative politics, does not trust the market as the dominant means of the economic transformation and places its trust more in the transformative capacities of the centralized state bureaucracy insulated from society.[13] The process of marketization, on the other hand, is seen by them as a dangerous experiment which can undermine social peace, and which has to be counterbalanced either by the welfare services of the centralized state or by a strategy of placing burdens on the society only gradually.

At the opposite pole we find the fast-statist ideology of the Thatcherite liberals in Czechoslovakia.[14] According to this view, the market is not only the outcome of the economic transformation but itself can serve as a means of bringing about the economic changes. Moreover, instead of undermining social peace, the process of marketization can be designed in such a way that will help to generate support for the changes.[15] "Social-market" ideology holds that it is the state's role to coordinate economic transformation, while the fast-statist strategy sees the neutralization of potential social resistance as the major role of the state.

Finally, the pragmatic liberals in Poland hold that while the market can be used as a means of economic stabilization and transformation, the process of economic transformation needs the support of society despite the burdens placed on it. In this view the central role of the state is to maintain society's support of the unavoidable changes.

The initial views of the new governments about the role of their societies in maintaining the social peace during the process of transformation were strongly influenced by the institutional legacies of the extrication. With the exception of Poland, the institutionalization of intermediaries and different civil society organizations started only after the transition to democracy, and the links were weak between the new power-holders and different social groups.

---

[13] See an example of the politics of privatization in the paper by David Stark, "Path Dependence and Privatization Strategies in East Central Europe," in this volume.

[14] Vaclav Klaus, the Finance Minister of the federal government and since January 1991 the Chairman of Civic Forum, is the leading representative of this ideology.

[15] See Stark, "Path Dependence and Privatization Strategies in East Central Europe," in this volume.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


In Hungary the early promise of free elections during the first stage of transition resulted in a fast transformation of the majority of the existing political groupings into parties. There remained some weak new independent trade unions and small groups of environmentalists, but the post-election political scene was clearly dominated by the six parliamentary parties. The negotiated transition in Hungary allowed for a much stronger continuity at the level of intermediary political organizations. The old unitary trade unions are still the strongest, and although their disintegration has been quick, they have generally splintered from within the formed new confederations.[16]

In Czechoslovakia the level of political organization was lower at the time of extrication than in Hungary, and the political scene was dominated by organizations which were mixtures of proto-parties and social movements. In Hungary the negotiated nature of the transition allowed for strong continuities at the level of the intermediary organizations, but in Czechoslovakia the capitulation of the old regime resulted in a discontinuity at this level. Here the six thousand strike committees, set up at the time of the preparation for the general strike during November 1989, have occupied the old Communist trade unions from within and created the strongest new trade union confederation in the region.[17] At the time of the formation of the initial strategy of economic change the trade unions were only in the first stages of formation.

In the former GDR, the organizations of the extremely weak political society were marginalized by the political organizations of the "western brother" and during and after the electoral campaign the "Eastern" political scene was "colonized" by the West German parties and political organizations.

The lack of well developed political societies in Hungary, Czechoslovakia, and the former GDR invited statist initial strategies, but in Poland the existence of the strongest social movement in the region (combined with the rapid deterioration of the economic situation) forced or allowed for a radical program of stabilization, based on large-scale social support.

These differences are reflected in the divergent views of the new rulers about the role to be played by the organizations of the civil society in maintaining the social peace. The Hungarian governing coalition cannot rely on the organizations of the society, the Czechoslovak reformers did not want to rely on the society, and the German government thought that social peace could be bought by the infusion of billions of Deutschmarks. Only the Polish reformers could rely, at least in the first critical phase of the economic stabilization, on the organized support of the society.

Finally, in the formation of the initial strategies, an important role was played by the different institutional and structural legacies inherited from the previous economic regimes. With the exception of Hungary, the experiments with economic reforms were at a low profile in the pre-transition period in these countries and the institu-

---

[16] The two independent confederations, created during the first stage of transition in 1989, are still weak, and together represent less than 10 percent of the active labor force. In the slow formation of the new trade unions, an important role is played also by the existence of the second economy and the economic strategies of the laborers, related to the second economy. While in Poland the working-class elite is busy in trade unions, e.g., the elite workers in Hungary are part-time entrepreneurs within or outside of the public enterprises.

[17] The united Czech and Slovak Confederation of Unions (CSKOS) contains about 80 percent of the active labor force.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


tions of the market economy were absent for the most part. Although in Poland there was an immediate pressure to stabilize the economic situation, in Czechoslovakia and the former GDR it was the lack of previous reforms that invited "tabula rasa" strategies, a fast departure from the old regimes. In Hungary, by contrast the new governing coalition succumbed to the temptation to continue the politics of gradual reform adopted by the previous governments with only slightly different methods. In the choice of the statist-gradualist strategy in Hungary an important role was played also by calculations related to the growth capacities of the largest second economy in Eastern Europe.[18] The expectation that a tight monetarist policy (combined with a gradual extension of market institutions and change in the property relations) would quickly result in the improvement of economic performance and thus to increase the capacity of the government to reduce indebtedness and finance the material compensations for the worst off was evident.

To sum up, alongside the differences in ideologies, the choice of the initial strategies was influenced in all cases except Poland by the initial weakness of the political societies in these countries. The choice of a radical strategy was prompted by pressure for rapid stabilization in Poland, but it was the lack of basic institutions of the market that invited the choice of fast strategies in Czechoslovakia and the former GDR. Finally, in the choice of the gradual-statist strategy in Hungary an important role was played by the existence of the institutional legacies of previous economic reforms.

## *The Constraints*

In each country, these initial strategies were met by different constraints shaped by specific institutional legacies of the past. Common to all has been that the erosion of the initial support was fast, with the pressure from below to "renegotiate" the terms of transformative politics increasing rapidly. This erosion of support, however, was not signalled in the same ways and did not always have the same effects since its expression and influence were mediated by specific institutional differences shaped by the differing paths of extrication.

In Hungary and the former GDR during the first period of the new governments street demonstration was the only way for the society to communicate with authorities.[19] Czechoslovakia showed a different pattern where a strike alert called by unions throughout November 1990 and later threats of a general strike were enough to con-

[18] About the limitations of this strategy, and the ambiguous evolutionary potential of the Hungarian second economy, see the excellent paper of István R. Gábor, "On the Road to Modernity or Shifting to a New Kind of Duality?" (paper presented at the conference on the transformation of Soviet-Type Societies, Institute für die Wissenschaften vom Menschen, Vienna, June 7-9, 1991).

[19] In Hungary, the first big warning came a few months after the elections, when cab drivers, with the visible support of the population, for three days blockaded the main roads, paralyzing the whole country, demanding the withdrawal of an increase of the price of gas and the abolition of a supplementary gas tax. Later public opinion surveys showed major support for the action and a rapid decline in the popularity of the governing parties. In the former GDR, large-scale street demonstrations were the ways people communicated to the government their dissatisfaction with its policies.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

10063371


vince the government that negotiations were needed.[20] In Poland, first the sporadic strikes of early summer 1990 and later the electoral support given to Tyminski were clear signs of the diminishing support of the people for the government.

It is important to note that the speed of the erosion of the support was not directly related to the speed (and thus the level of social costs) of the economic changes. In Poland, the fast economic stabilization program in its initial phase was tolerated by society much better and longer than the cautious gradual-statist strategy of the Hungarian government with a lower social costs. And in Czechoslovakia it was not the price increases that prompted trade unions to change their initially strongly pro-market slogans, but instead the attempt of the government's technocrats to disarm the trade unions by the introduction of a highly restrictive strike law that brought about the change in the unions' posture. Throughout the region the differences in the speed of the erosion of support were mainly related to the level of trust in the new political leaders and thus to the relationships that had emerged before and during the first stage of transition between political elites and society at large. Because there was no serious public debate about the major elements of the economic programs in any of the countries, people were unprepared for the hardships to come. But while the population in Poland had ten years to establish a strong identification with the Solidarity movement, in the other countries the initial identification with the new leaders was based mainly on their performance during the extrication and the electoral campaign.

### *Changes in the Course of Action*

There were attempts to turn to more inclusive strategies (that is, in the direction of the lower end of our space), with the exception of Poland, and there were attempts to increase political basis of the politics of transformation. But the specific institutional vehicles for attempting to secure such support differ. In Czechoslovakia, the institutional basis for the renegotiation of the terms of the economic strategy existed in the form of the strongest and most unified trade union in the region, while in the former GDR the old trade unions have disappeared and the "colonization" of the political field by the "Western brothers" has not yet allowed for the emergence of trusted intermediaries. In Hungary, the seven competing trade union confederations were too weak to negotiate in the name of labor.[21] As a result, the changes in the course of action in Hungary (and partly also in the former GDR) are more in the planning phase and the turn to more inclusive policies is constrained mainly by the lack of inter-

[20] It was hard for the new leaders in Czechoslovakia to forget that it is possible to carry out a general strike. It was the general strike warning in November 1989 that resulted in the final capitulation of the old Communist rulers.

[21] There exists in Hungary a corporatist institution for the mediation of conflicts between government and the representatives of business and labor, but the "National Council of Reconciliation" is mainly for the renegotiation of minimal wages. And while the government still hesitates to decide whether it has to divide, marginalize, or strengthen the trade unions, the struggle of the splinter organizations of the old trade unions for survival just adds to the increase of social tensions.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


mediaries. There are, however, some initiatives on the side of the political leaders in both countries that indicate the direction of the potential change in the strategies. In Hungary, the creation of the "Hungarian Moncloa Pact" was proposed in the middle of 1991 and, according to the original plans, would have brought together the six parliamentary parties to work out the conditions of the political support for the government's politics of economic transformation similar to the social pact made in Spain after the conclusion of the first free elections.[22] The idea of increasing the political basis of the government with a pact between the parties of the governing coalition and the parties in opposition failed because of disagreement on the political preconditions of such support. During the preparatory talks, the parties could agree only on one question, namely, that they have to solve the problem of the lack of intermediaries. They have agreed that trade union elections should be held to solve the problem of competing representative claims of the seven confederations and that the assets of the old confederation should be redistributed according to the outcomes of these elections.[23]

It is ironic that it was the Czechoslovak leadership, the most Thatcherite reformers of the region, who signed the first corporatist agreement on macroeconomic questions in Eastern Europe. The most important role in the change of the course of action of the government was played not by the resistance of the society to the general social burdens, but by the reaction of the trade unions to the attempt of the Thatcherite technocrats to neutralize potential social resistance by a restrictive legal regulation of strikes. Warning with the threat of a general strike was enough to change the strategy of the government. The compromise resulted in the extension of trade-union rights, in a liberal regulation of strikes, and the joining of the trade unions of the tripartite "Council of Social Accord" in which the unions accepted a maximum 12 percent drop in real wages for 1991.[24]

Poland's institutional legacy (that is, the unitary social movement functioning simultaneously as a trade union, as a government, and as a legislature) allowed for the fast program of stabilization in the initial period. Later, as the support for the politics of transformation eroded, the same legacy became a liability for the major political actors who have differed among themselves as to what could be saved from the old Solidarity movement but have agreed that the regeneration of social support (to continue economic transformation) and the prevention of a regime crisis (in the absence of an organized alternative to the Solidarity government) presupposed the separation of the different "Solidarities."

---

[22] Note one important difference from the Spanish Moncloa pact. While in Spain the trade unions were part of the negotiations, in Hungary the absence of the trade unions was the expressed preference of the designers of the negotiations.

[23] The same solution, with the same ideology, is used in Romania to solve the problem of competing trade unions. David Stark and I interviewed the Romanian Minister of Labor, who made the following argument for holding trade union elections in Romania: "We cannot negotiate with several confederations, competing with each other, unable to agree on a single question with each other. We need a partner."

[24] It was signed in January 1991 by the representatives of the three governments – Czech, Slovak, and Federal – and the representatives of employers' and trade unions. In the slowdown of the fast-statist strategy in Czechoslovakia, an important role was played also by the peculiar institutional outcome of the extrication, i.e., the consociational character of the federal state and parliament, which limits the use of exclusionary strategies based on simple parliamentary majority.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


The process of adaptation to the new situation was not the outcome of any conscious "political design" but instead the result of infighting within the unitary social movement that resulted in the formation of the first "post-Solidarity" parties, the division of the unitary movement into "Solidarities" along institutional lines.[25] There was also the institutionalization of the remnants of the charisma of the "leader" in the form of a strong president.[26] While the course of the transformative politics in Poland turned in the direction of the statist-fast direction after the presidential elections, the massive strike waves in May 1991 show the possibility of a new change in the course of transformative politics in the direction of a more inclusive politics, based either on agreements with the trade unions about the terms of the economic change or on post-election renegotiation of the transformative politics among the would-be parties in parliament.

## *The Art of the Impossible?*

The first year of transformative politics in East Central Europe was therefore also the last year when economic change was solely the "business" of economic experts and politicians – as it had been for forty years during the old regimes and as it was everywhere in the initial period of the changes immediately after the extrication. The short period is over in which popular support for the politics of economic transformation was based either on moral support or only on the popular mandate given by the first free elections. What has just started in the region is the renegotiation, or more precisely the negotiation, of the terms of economic transformation. While the direction of the arrows in Figure 1 indicate the possibility of that change, it does not say anything about the feasibility or the durability of the new, inclusionary policies. As the initial strategies differed because of differences in ideologies and different configurations of the legacies of these countries, the chances of the more inclusive strategies will be different. Hungary and GDR did not yet have those trusted intermediaries on which the extension of the political basis of the economic change can be based. In Poland, the intermediaries are there; yet until the creation of a new government with the popular mandate of free elections (and until the renegotiation of the relationships of government, president, and parliament), the chances of turning in the direction of negotiations are not great. Only in Czechoslovakia do we find general negotiations on the terms of economic change; but even there the fast increase in prices might yet undermine at any time the deal struck for the year 1991. While in Czechoslovakia we could observe the first successful coalition based on interest instead of trust, in the other countries the movement in that direction is slower. There is a general tendency, however, to depart from the initial situation in which the programs for economic change were based mainly on a non-existing class, that is, the class of new middle-class entrepreneurs.

---

[25] That is, the separation of the Solidarity Trade Union from the Solidarity government and legislature.

[26] Actually, the strengths of the president are due more to the weakness of the parliament, due to its questionable legitimacy, than to the strong latitudes of the president, and it is still up to the outcome of the first free elections, and the regulations afterwards, to decide about the long-term strength of this position inside the political regime.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

The strategies of the extension of the social basis of transformative policies are different, depending mainly on the differences in the balance of forces in the given country. In Hungary, for example, due to the weaknesses of organized labor, the first sign for an attempt for coalition formation was the stabilization and the strengthening of the positions of the state bureaucrats, and of the managers of the large public enterprises, vis-à-vis the workers. Due to a different balance of forces, in Poland the government until now did not touch upon the exemptionary participatory rights of the workers at the workplace level. Instead it attempts to include workers into marketization by a deal in which participatory rights would be exchanged partly for higher wages, partly for property rights.

The first year of transformative politics was also perhaps the last such year when economic change was blocked by the mutual weaknesses of states and societies. Communist states were weak; unable to change not only because of their limited sovereignties, overpoliticized bureaucracies, or decrepit ideologies, but also because of the fears of their own societies. That fear was all the bigger when they have faced disorganized societies, lacking political organizations, leaders, and opposition strategies. They did not know how people would react to programs of economic liberalization or stabilization. How could they know the limits of toleration of their societies or predict when people would start to march in the streets? In the last few years of Communist rule several economic programs have collapsed in Hungary and Poland in their initial stages due to the fear of the leaders of the sudden and uncontrollable reactions of the people. In both countries that fear was the biggest impetus for change: a partner was needed who was able "to sell" society the costs of economic transformation, a solid political basis to start with the programs of inevitable economic change.[27]

The first year of transformative politics thus validates, at least partly, those reformers within the old regimes who sought "partners for dialogue." The durability of statist strategies, both gradual and fast, was short everywhere, and those states were stronger, that is, able to continue to execute their economic policies most consistently where, due to the level of the political organization of the society, it was possible to organize at least the passive toleration of the social costs of the economic changes. While that fact supports the old argument about the need of a "partner" and the need of democracy to start economic transformation, the first year of transformative politics does not give us enough evidence yet to strongly support or refute the thesis about the (in)compatibility of democracy and the continuation of the economic reform. Even at this stage, though, we have enough evidence to slightly reformulate the basic dilemma presented in the introduction of this paper about the compatibility of marketization (economic transformation) and democracy. According to this reformulation, the dilemma is not that of the compatibility of democracy and marketization in general but that of different types of democracies and different types of marketizations, that is, different paths, not to a general market economy, but to new types of economies with different mixes of market and non-market elements.[28] While that reformu-

---

[27] See László Bruszt and David Stark, "Remaking the Political Field in Hungary: From the Politics of Confrontation to the Politics of Competition," Journal of International Affairs, 45:1 (June 1991), pp. 201-245.

[28] On the concepts of different types of capitalism and different types of democracy, see the insightful work of Philippe Schmitter, "Modes of Sectoral Governance: ATypology," Standord University, unpublished

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


lation does not negate the existence of the generic problem of transformative politics, it suggests that instead of studying that relationship at a general level we should study the different capacities of the different mixtures of democratic institutions and policies, the different types of coalitions, the different types of market and non-market solutions in the economy, and the theoretically seemingly impossible mixtures of different organizational principles.

Whether transformative politics is "the art of the possible" or "the art of the impossible" will be decided in the future. What we can observe now is the plurality of paths taken, problems faced and solved. To remain with the topic of this paper: the first one year of transformative politics brought with it six different mixtures of strategies in East-Central Europe. It saw the failure of several policies which were thought to be "the only" feasible solutions to this dilemma. It saw in Czechoslovakia the failure of the neo-liberal statist strategy which wanted to solve the generic dilemma of economic transformation by anesthetizing society, reduce not only its time of reaction by a planned shock therapy, but also its possibility of reaction, by disarming it. We could witness the erosion of the support for the sole civil society based fast marketization strategy in Poland. The last year has also proved in Hungary, that the gradual statist strategy of trying to minimize the political risks of economic change can be very risky, and lead to a fast erosion of the political support. Finally we have seen the failure of the "social peace can be bought" strategy in the former GDR. But we have also seen the creation of new mixtures: the fast-populist strategy in Poland based on the remnants of the charisma of the "leader," and the strange mix of neo-conservative-corporatist strategy in Czechoslovakia. Perhaps such unorthodox approaches to politics, the capacity to mix up the most different principles, might yet be the proof that transformative politics is, in the end, the art of the possible.

---

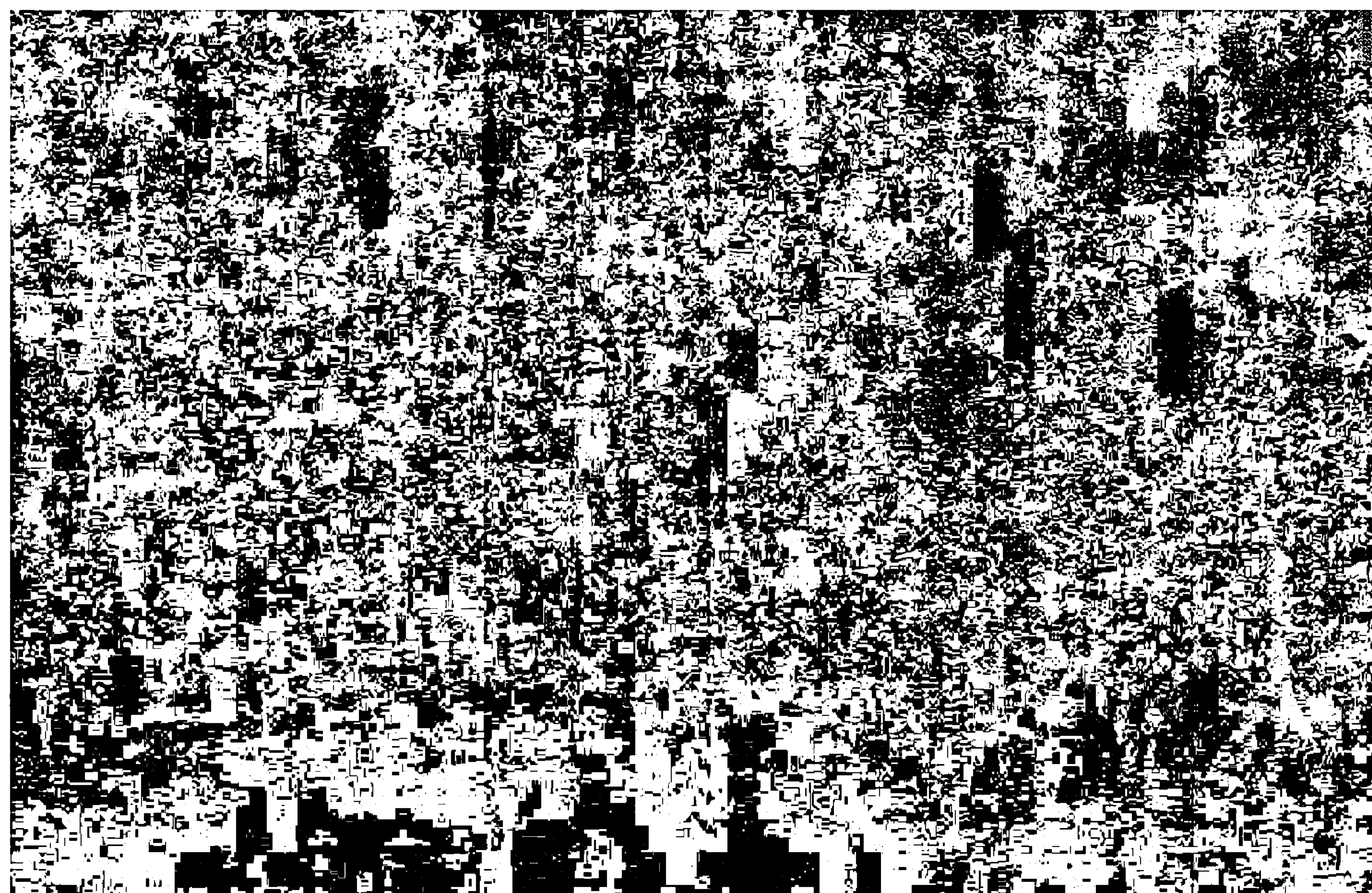
manuscript: and Terry Karl and Philippe Schmitter, "Modes of Transition and Types of Democracy in Latin America, Southern and Eastern Europe," Stanford University, International Social Science Journal, 128 (May 1991), pp. 269-284.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

# Strategies of Transition

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access



Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 08:43:05AM
via free access

00063371



*David Bartlett*

# The Political Economy of Privatization: Property Reform and Democracy in Hungary*

The central problem of political economy is the relationship between authority structure and ownership relations. Nowhere is that relationship of greater concern to policy-makers, or of greater interest to social scientists, than in Eastern Europe, where post-communist governments are grappling with the monumental task of privatization. Is it possible for countries undergoing transitions from authoritarianism to multiparty democracy to undertake radical reforms of ownership relations? In the East European context, does democratization facilitate or impede privatization?

It is useful to begin by considering how scholars have approached the links between authority structure and ownership relations in other regions of the world. Social scientists representing diverse methodological and normative perspectives have long noted the elective affinity between political democracy and private ownership of capital in the West. Investigations of the development of the early capitalist countries exhibit a notable degree of convergence of interpretation: Representative institutions served to advance the interests of incipient entrepreneurial groups. For example, Barrington Moore's analysis of the role of socioeconomic classes in post-feudal development places Great Britain, France, and the United States in the "bourgeois/democratic" route to modernity. In each case, a commercially minded bourgeoisie succeeded in defeating a conservative landed nobility and establishing a foundation for private capital accumulation and industrial development. Political democracy thus emerged as the principal means by which the early capitalists could protect private property rights.[1]

Douglass North and Barry Weingast, exemplars of the "institutional economics" approach to problems of growth and development, similarly emphasize the crucial role of representative democracy in enforcing the property rights which underlay early capitalist development. In the wake of the Glorious Revolution, the nascent English bourgeoisie utilized its dominant position in the Parliament to institute checks on the arbitrary confiscatory authority of the Crown. The assertion of Parliamentary prerogative over royal power was thus the essential condition for the protection of secure rights to private property, which in turn laid the legal, political, and economic foundations for the enclosure movement, the emergence of a capital market, and eventual industrialization.[2]

* I would like to thank the participants in the conference on "Transforming Economic Systems in East Central Europe" for their comments on an earlier draft of this paper. I also gratefully acknowledge grants provided by the JCEE, the Institute on Global Conflict and Cooperation of the University of California, and the University Research Council of Vanderbilt University, which made it possible for me to undertake the research for this paper.

[1] Barrington Moore, Jr., *Social Origins of Dictatorship and Democracy* (Boston, 1966).

[2] Douglass C. North and Barry R. Weingast, "Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England", *Journal of Economic History*, 49:4 (December 1989).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


The experiences of postwar Western Europe, North America, and Japan supply further evidence of an affinity between political democracy and private property. Several of the advanced industrialized democracies *did* retain or erect sizeable state sectors after World War II. But the privatization movement which swept Western Europe in the 1980s rendered those cases less anomalous. Indeed, divestitures of state-owned enterprises in Great Britain, France, and Austria reinforced the linkage between representative democracy and private ownership, as political authorities in those countries were motivated in part by the dissatisfaction of their respective electorates with the poor economic performance of the state sector in the 1970s and early 1980s.[3]

Recent developments in Latin America, Southern Europe, and Asia, where political liberalization has generally outstripped property reform, suggest that the close affinity between democracy and private ownership which characterizes the advanced industrialized countries is not likely to be duplicated elsewhere. Whereas representative political institutions promoted the interests of private capital in the early developing countries, they create certain obstacles to privatization in late developing countries undergoing transitions from authoritarianism.

In Turkey, the Ozal regime's privatization campaign met with the strenuous resistance of organized labor as well as state ministries responsible for overseeing nationalized industries. Argentina's powerful trade unions helped to thwart the Alfonsin government's privatization program in the mid- and late-1980s. In other cases, notably Brazil and the Philippines, newly democratized regimes have thus far proven unable to overcome opposition by local political patrons of state-owned enterprises, which have long served as media for patronage.[4]

Economic constraints reflecting the relative backwardness of these countries serve to augment the political obstacles to privatization. Thin capital markets and paucities of financial intermediaries frustrate attempts to divest state-owned enterprises by way of public issues of stock, and thereby hinder efforts to mobilize domestic support for privatization in the fashion of the "popular capitalism" campaign launched by the Thatcher government in Great Britain in the 1980s. These impediments to domestic capital formation in turn compel the authorities to look to foreign direct investment, whose role in the privatization process is likely to be circumscribed by domestic political factors as well as the uncertainty of foreign investors themselves. Meanwhile,

---

[3] For a discussion of the British case, see Yair Aharoni, "The United Kingdom: Transforming Attitudes," in Raymond Vernon, ed., *The Promise of Privatization: A Challenge for U.S. Policy* (New York, 1988), pp. 23–56. For analyses of the French and Austrian cases, see Michel Bauer, "The Politics of State-Directed Privatization: The Case of France, 1986-88," and Wolfgang Muller, "Privatizing in a Corporatist Economy: The Politics of Privatization in Austria," in John Vickers and Vincent Wright, eds., *The Politics of Privatization in Western Europe* (London, 1989), pp. 49–60, 101–116.

[4] For accounts of the Philippine and Brazilian cases, see respectively Stephen Haggard, "The Philippines: Picking Up After Marcos," and Ethan Kapstein, "Brazil: Continued State Dominance," in Vernon, ed., *Promise of Privatization*, pp. 91–148. For the Turkish case, see Roger Leeds, "Turkey: Rhetoric and Reality," in Vernon, ed., *Promise of Privatization*, pp. 149–178; and Ziya Onis, "Privatization and the Logic of Coalition Building: A Comparative Analysis of State Divestiture in Turkey and the United Kingdom," *Comparative Political Studies*, 24:2 (July 1991), pp. 231–253. For an overview of privatization policy in post-authoritarian Latin America, see Eliana Cardoso, "Privatization Fever in Latin America," *Challenge*, September/October 1991, pp. 35–41.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


the absence of a highly developed capital market prevents effective valuation of the assets of state enterprises targeted for divestiture. Combined with the strong dependence on foreign capital, this heightens public perceptions of undervaluation of national assets and weakens public support for the privatization program. The slow pace of privatization then leaves the political authorities with dwindling returns to the state budget, undermining their ability to soften the redistributive impact of privatization through direct transfer payments, public works programs, and other measures aimed at mollifying blue-collar labor and other domestic opponents.

And so for a number of developing countries, the transition to democracy has merely complicated the problem of property reform. Now faced with an electoral constraint, most of the post-authoritarian regimes have moved cautiously on divestiture of state-owned enterprises. It is noteworthy that the two foremost exceptions to this general trend are cases in which extensive privatization has taken place in domestic political circumstances least encumbered by pluralist democracy: Mexico, where the Salinas government has moved aggressively to privatize major state enterprises amidst the continued de facto political hegemony of the ruling PRI; and Chile, whose democratically elected government has benefitted from the groundwork laid by the radical privatization programs undertaken by the Pinochet dictatorship in the 1970s and late 1980s.[5]

Adam Przeworski, among others, has concluded from these cases that radical property reform may well prove impossible in countries where the transition to democracy has occurred by way of negotiations between the old authoritarian regime and opposition forces. The regime's voluntary assent to competitive elections is conditional on the creation of certain institutional guarantees of the interests of the economic actors with whom the regime is associated. A peaceful transition to democracy, in short, is only possible at the cost of forgoing a fundamental transformation of ownership relations.[6]

## Property and Democracy in Eastern Europe

Eastern Europe shares certain similarities with the Latin American, Southern European, and Asian cases. There, as elsewhere, privatization is likely to generate highly adverse socioeconomic consequences for sizeable groups, particularly low-skilled workers situated in loss-making state enterprises targeted for divestiture, whose grievances create opportunities for mobilization by trade unions, opposition parties, and other organizations now unleashed by political liberalization.

But in other respects, the challenges confronting the new democracies in Eastern Europe are unique. First, the post-communist regimes have inherited a political and ideological legacy (Marxism-Leninism) distinguished by a conspicuous hostility to private ownership, a factor not present in the right-wing authoritarian regimes of the

---

[5] Cardoso, "Privatization Fever in Latin America."

[6] Adam Przeworski, "Democracy as a Contingent Outcome of Conflicts", in Jon Elster and Rune Slagstad, eds., *Constitutionalism and Democracy* (London, 1988), pp. 59–80.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


Southern hemisphere. Second, the scale of the privatization programs contemplated by the successor governments in Eastern Europe well surpasses those of transitional countries in other regions, entailing not merely the diminution of large public sectors but the transformation of economies which were almost completely socialized after 1948. Finally, the economic circumstances in which East European privatization is taking place differ from those surrounding the other cases, involving not just the supplanting of *dirigist* policies with market mechanisms but the dismantling of Soviet-style central planning.

These distinctive factors suggest two contending scenarios for Eastern Europe. In one, democratization facilitates privatization. Socialist ownership of the means of production was the linchpin of the Communist regimes, and private ownership of capital was the key element missing in the various economic reform programs undertaken in the region during the post-Stalinist period. Thus, the defeat of the Communists in the recent elections served to remove the primary obstacle to privatization. And indeed, each of the democratically elected regimes in Eastern Europe quickly announced their intentions to implement sweeping privatization programs.

In the second scenario, democratization in Eastern Europe merely erects new obstacles to property reform. Electoral sensitivity to foreign capital penetration and undervaluation of assets which has complicated divestiture programs in Latin America and other developing regions is likely to be at least as high in Eastern Europe, where capital markets and other mechanisms of asset valuation are even less well developed and where the historical legacy of external economic domination plays equally heavily on public sentiments. Moreover, the exceptional degree of inefficiency of the centrally planned economies of Eastern Europe means that privatization of many state enterprises entails massive layoffs and other dislocations of local economies. Organized labor, whose socioeconomic position stands at greatest risk amidst the transition from plan to market, could find itself possessing sufficient political power in the new multiparty systems to thwart radical privatization programs.

Recent scholarly research on the problems of transition in Eastern Europe has yielded different predictions as to which of these scenarios is most likely to come to pass. Andrew Arato argues that a thoroughgoing economic transformation in Eastern Europe will only be possible under an "elite democracy" which succeeds in neutralizing civil society; such a politically mobilized society as Poland simply won't tolerate the long-term costs of establishing a liberal market economy.[7]

Grzegorz Ekiert goes even further: Economic restructuring in Eastern Europe will produce socioeconomic dislocations that will imperil democratic consolidation; some sort of "coercive policies" may be necessary to accomplish the task.[8]

Similarly, Ellen Comisso doubts that the East European populations will accept radical economic reforms carrying heavy distributional costs, even when implemented by a "legitimate" regime such as the Solidarity government in Poland. Successful im-

[7] Andrew Arato, "Revolution, Civil Society and Democracy: Paradoxes in the Recent Transition in Eastern Europe", Cornell Working Papers on Transitions from State Socialism, #90.5, 1990.

[8] Grzegorz Ekiert, "Democratic Processes in East Central Europe: A Theoretical Reconsideration", *British Journal of Political Science*, 21:3 (July 1991), pp. 285–313.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


plementation would require the state to supply selective benefits to adversely affected social groups, provision of which would undermine the basic objectives of economic liberalism. But, Comisso adds, that pessimistic scenario neglects the free rider problem: For societal actors to mobilize for collective action to thwart a radical economic reform program presupposes their willingness to incur the opportunity costs of political participation. Such costs are likely to be significantly higher in the new democracies than under the one-party system. Consequently, apathy rather than political engagement may come to characterize civil society in Eastern Europe, in which case radical economic reforms might be possible.[9]

By contrast, László Bruszt and David Stark eschew broad generalizations concerning the compatibility of democratization and marketization. The dynamics of transition are best seen in terms of the links between different types of democracies and different types of market systems. Hence, the optimal strategy of social scientific research on post-Communist Eastern Europe is disaggregation of the generic problem of politico-economic transformation into the distinctive paths of extrication from state socialism pursued by individual countries. Specifically, Bruszt and Stark argue that the main determinants of economic transformation in the East European countries that underwent negotiated transitions to democracy are the strategic interactions of the parties to those negotiations. It was the strategies of the interlocutors which determined the institutional framework and political rules of the new democratic regimes; these institutions and rules in turn shape the possibilities for democratic consolidation and economic reform after the transition.

This analytical approach leads Bruszt and Stark to different assessments of the Polish and Hungarian cases. In Poland, the strong links between Solidarity and civil society forced the outgoing regime to seek a compromise solution which guaranteed the Polish Communists a sizeable bloc of seats in the Sejm; those very same representational claims would later provide the Mazowiecki government with the political capacity to engineer a crash marketization program. In Hungary, the perceived weakness of the opposition groups made unfettered elections an acceptable option to the reformist wing of the Communist party. The negotiations thus focused on the procedural rules governing the spring 1990 elections and the institutional design of the new Hungarian democracy, which would be dominated by a powerful parliament. Neither the Communists nor the opposition parties possessed legitimate claims to represent society, and so the interlocutors tabled discussion of economic reform policy. The result was a stable, consolidated parliamentary democracy headed by a coalition of parties which lack the political capacity to implement a Polish-style reform.

Bruszt and Stark claim that this analysis of the strategic interactions attendant to the negotiated transitions in Poland and Hungary yields different predictions than structural approaches which focus on the "starting points" of the two countries: The expansion of the "second economy" in Hungary prior to the collapse of the one-party system would suggest a more rapid economic transformation in the post-Communist period than Poland, where the overwhelming majority of households remained de-

[9] Ellen Comisso, "Property Rights, Liberalism, and the Transition from 'Actually Existing' Socialism", *East European Politics and Societies*, 5:1 (Winter 1991), pp. 180–188.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


pendent on the state sector at the time of the political transition. But the actual outcomes of the two cases belie these expectations, with Hungary pursuing a "gradual statist" approach aimed at diluting the social costs of economic transformation and Poland adopting a "fast radical" strategy designed to concentrate those costs within the briefest possible interval and thereby sustain the support of civil society.[10]

## Summary of the Argument

In this article, I explore the relationship between political change and property reform in Hungary. I embrace Bruszt and Stark's view that disaggregation is likely to prove a more fruitful research strategy than theorizing about the generic problem of transition. To this end, I break up the Hungarian privatization case into its three principal components: (1) Large-scale privatization (i.e., divestiture of large state enterprises); (2) Small-scale privatization (retail stores, restaurants, service shops, and other small businesses); and (3) Reprivatization (restitution and/or compensation of land, church property, and other private holdings nationalized after the Communist takeover in 1948).

However, my argument differs from Bruszt and Stark in that I ascribe greater explanatory weight to structural determinants in the property sphere. While the institutional arrangements which emerged from the East European revolutions strongly condition the policy alternatives available to the successor regimes, it is the starting points of the various countries that determine the scope and character of the privatization problems now confronting those governments. Examination of the interplay of pre-existing structural constraints and the distinctive characteristics of Hungary's parliamentary democracy illuminates the relationship between determinism and voluntarism, the central theoretical issue in the burgeoning literature on transitions from authoritarianism.

I begin with a comparative survey of the privatization policies of the East Central European countries (East Germany, Czechoslovakia, Poland, and Hungary), evaluated along dimensions (1), (2), and (3) above. There remains considerable confusion over the relative position of these countries in the sphere of property reform, with scholarly and journalistic analyses often prone to generalizations which lead to both underestimations and overestimations of the pace of privatization in individual cases. Only by placing the Hungarian case in a comparative perspective can we draw meaningful conclusions as to what has actually been achieved. I continue with an examination of the reforms of ownership relations implemented in Hungary prior to the col-

[10] László Bruszt and David Stark, "Negotiating the Institutions of Democracy: Contingent Choices and Strategic Interactions in the Hungarian and Polish Transitions," Cornell Working Papers on Transitions from State Socialism, #90.8, 1990; Bruszt and Stark, "Remaking the Political Field in Hungary: From the Politics of Confrontation to the Politics of Competition," Journal of International Affairs, 45:1 (Summer 1991), pp. 201–245; Bruszt and Stark, "Paths of Extrication and Possibilities of Transformation" and Bruszt, "Transformative Politics: Social Costs and Social Peace in East Central Europe," in this volume; Stark, "Path Dependence and Privatization Strategies in East Central Europe," in this volume.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


lapse of the one-party system, which play a central part in the privatization program undertaken by the successor regime headed by Jozsef Antall. The conclusion analyzes politics of Hungarian privatization amidst the transition, focusing on the ways in which the exigencies of coalition building conditioned the actions of the Antall government.

## Survey of East European Privatization Programs

Assessment of the East European privatization programs remains hampered by a dearth of data, reflecting the brief period of time which has elapsed since the collapse of the one-party systems. Moreover, what data are available have been subjected to widely divergent interpretations. Nevertheless, there is by now sufficient information to discern the following general patterns:

### *East Germany*

By any reckoning, the most dramatic developments in property reform have occurred in the former German Democratic Republic. Since its creation in March 1990, the giant Treuhandanstalt has overseen the privatization of some 3,400 of the 8,000 large state enterprises and nearly all of the 22,000 small businesses under its control. Of the remaining state enterprises in its portfolio, the Treuhandanstalt has split up hundreds of *Kombinat* into smaller units to make them more attractive to private investors. The vast powers wielded by the Treuhandanstalt in restructuring the East German state sector have earned it considerable notoriety, as evidenced by the April 1991 assassination of the first president of the agency, Detlev Rohwedder. But the presence in Bonn of a very wealthy government and an extensive pre-existing social welfare apparatus, factors not present in the other East European countries, has helped to soften the socioeconomic dislocations which have resulted from the Treuhandanstalt's aggressive privatization policies. The Treuhandanstalt's program is also distinguished by an undisguised preference for West German capital; only a few hundred state enterprises have been sold to foreign investors.[11]

The scale of the reprivatization program underway in East Germany also surpasses that of the other countries, as it seeks to redress injustices perpetrated by both the Nazi and Communist regimes. During the months preceding reunification in 1990, the two Germanies agreed to the restitution or compensation of properties confiscated after 1933. The period of Soviet occupation between 1945 and 1949 was exempted at the insistence of Mikhail Gorbachev. As elsewhere in Eastern Europe, German re-

[11] "Restructuring Germany: The Toughest Nut," *The Economist*, October 20, 1990, p. 88; "Facing Down Protests, Eastern Germany Goes Private," *New York Times*, November 3, 1991; David Stark, "Privatization Strategies in East Central Europe," Bruszt, "Transformative Politics: Social Costs and Social Peace in East Central Europe," in this volume; and Stark, "Path Dependence and Privatization Strategies in East Central Europe," in this volume.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


privatization presents the danger of a legal and economic morass. Since the program was launched, nearly 1.3 million claims have been placed on property in the former GDR. A sizeable number of these involve multiple claims on the same piece of property, adjudication of which is complicated by the fact that many of the relevant title registries are either missing or in poor condition. Valuation of the properties is also difficult in light of the long intervals since original ownership and the effects of East German central planning. With the costs of restructuring estimated at more than $1 trillion over the next decade, full compensation at present market values would likely exceed the budgetary resources of the Bonn government. Thus, there are proposals currently circulating to offer claimants 30 percent over the property's appraised value in 1935.[12]

*Czechoslovakia*

While the East German case is characterized by comparatively rapid movement in all three spheres of privatization, the pattern in Czechoslovakia can be described as follows: Fast progress in the areas of reprivatization and small-scale privatization and slow progress in large-scale privatization. Moreover, the privatization techniques employed in the two cases differ sharply: In Germany, the process has been spearheaded by an extraordinarily powerful state institution charged with mobilizing the vast stock of domestic capital in the reunified country; in Czechoslovakia, the new government ultimately resorted to a voucher scheme aimed at leapfrogging the constraints imposed by the shortage of domestic capital and the absence of a pre-existing securities exchange.

The Czechoslovak reprivatization program, like the German one, has prompted serious misgivings on the part of economists, lawyers, and others concerned about the practicality of returning property to original owners forty years after its confiscation by the Communist party. Nevertheless, the government of President Vaclav Havel, claiming that reprivatization was a moral and political imperative as well as a means of enlarging the middle class whose participation would be crucial to the country's broader privatization campaign, managed to secure the Federal Assembly's assent to an ambitious restitution program. The First Restitution Act of October 1990 provided for the return of property expropriated between 1955 and 1959 to original owners or their heirs. The majority of properties covered by the Act were small businesses. The legal force of the Act has now expired, as individuals were required to present their claims within six months after the law entered into effect. The Second Restitution Act of February 1991 goes farther, authorizing the return of properties nationalized between the 1948 Communist coup and the end of 1989. In cases where the physical condition of the property prohibits restitution-in-kind, claimants will be compensated in cash or government-guaranteed bonds.

---

[12] Katie Hefner, "The House We Lived In", *New York Times Magazine*, November 10, 1991, pp. 33–35, 68, 84–88.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

p0063371


The Second Restitution Act provoked fierce debate in the Federal Assembly. The Havel government succeeded in defusing some of the political controversy over reprivatization policy by excluding both foreign nationals and Czechoslovaks permanently residing abroad (in contrast to Germany's program) and deferred discussion of land and church property for future consideration (in contrast to Hungary, as we shall see).[13]

The Havel government's strategy of moving quickly on the reprivatization issue has also helped to simplify its program of small-scale privatization. The latter program aims to privatize some 120,000 small businesses over a three-year period. The Second Restitution Act stipulates that claims for restitution of expropriated shops, retail stores, and other small enterprises take precedence over privatization procedures. This means that before the authorities can initiate the sale of a business, they must determine whether there was a private owner before 1948. If so, privatization must be deferred until the expiration of the specified period (six months after the relevant law went into force) during which individuals may submit claims. To forestall complications arising from Czech-Slovak tensions, the respective governments of the two republics administer auctions of local small enterprises and receive the proceeds from the sales.[14] By fall of 1991, some 6,000 state-owned shops had been privatized, with 11,000 more scheduled for imminent divestiture.[15]

Meanwhile, Czechoslovakia's large-scale privatization program has encountered an array of obstacles. As noted above, the absence of a large stock of domestic capital precludes a German-type strategy. The program has also been hampered by the fact that the regime which took power after 1968 squelched the sorts of economic reforms which in Hungary served to create the legal/institutional framework requisite to large-scale privatization. By 1991, few Czechoslovak state enterprises had transformed themselves into corporate forms. The failure of the post-1968 regime to implement an economic reform has also had the effect of deterring foreign investors: The task of evaluating risk and probable returns to investment, difficult enough in countries like Hungary and Poland which did enact radical reforms, is even more problematic in Czechoslovakia, whose state enterprises labored so long under orthodox central planning. As of this writing, the one major foreign investment in Czechoslovakia is Volkswagen's purchase of a 30 percent share of the Skoda Automobile Works in April 1991. Significantly, the Czechoslovak legal code imposes no limits on foreign acquisitions of state-owned enterprises; the main limitations to foreign direct investment appear to stem from the hesitancy of foreign investors themselves, rather than domestic political opposition.[16]

Beyond this, the large-scale privatization program is complicated by the nationality problem. Whereas a division of responsibility between the two republics was a fairly simple matter in the sphere of small-scale privatization, for major state enterprises it is a more contentious issue. Here the stakes are much higher: how to allocate

---

[13] Vratislav Pechota, "Privatization and Foreign Investment in Czechoslovakia": The Legal Dimension, *Vanderbilt Journal of Transnational Law*, 24:2 (Summer 1991), pp. 308–311.

[14] Pechota, "Privatization and Foreign Investment in Czechoslovakia", pp. 312–313.

[15] "Business in Eastern Europe", *The Economist*, September 21, 1991, p. 64.

[16] Pechota, "Privatization and Foreign Investment in Czechoslovakia", p. 315.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


the proceeds of sales of enterprises hitherto owned by a federal state, how to distribute the socioeconomic costs which will inevitably arise from privatization.

Against this backdrop, in February 1991 the Federal Assembly approved the Large-Scale Privatization Act, which provides for the redistribution of state assets to a federal fund controlled by the central authorities and two funds controlled by the respective legislatures of the Czech and Slovak republics. The law further requires the federal government to issue a list of state enterprises eligible for divestiture. Each enterprise on the list is in turn obliged to formulate a plan of privatization, subject to the approval of the relevant republican-level authorities as well as the federal ministry of finance. The enterprises have two basic options: (1) direct sale to an investor, or (2) transformation into a joint stock or limited liability company, with the eventual aim of divestiture via public issues of equity.[17]

The aforementioned limitations on foreign capital omit the first option as a primary technique of privatization, leaving the authorities in a position of de facto reliance on the second option, whose possibilities are in turn constrained by the small pool of mobilizable domestic capital as well as the absence of a capital market capable of valuating the assets of state enterprises. These circumstances explain the government's ultimate decision to inaugurate a voucher program, whereby adult citizens will put up one thousand crowns (roughly $35) to purchase coupon books containing one thousand "investment points" transferable for shares in enterprises of their choosing. In its initial phase, the program will function as a sort of simulated capital market: The valuee of the shares will be expressed in terms of number of "points" rather than monetary units; in theory, the true market value of the shares will emerge by way of successive auctions. The government's objective is to use the voucher scheme to privatize approximately 4,200 state enterprises in two phases, the first of which is scheduled to begin in February of 1992 and the second in October of the same year.[18]

Economists have noted that mass distribution programs of the sort to be undertaken in Czechoslovakia have significant advantages over direct sales, public issues, and other privatization techniques. While the latter methods may generate large short-term revenues for the state, they are apt to prove slow and cumbersome in countries, like those of Eastern Europe, where domestic capital markets are poorly developed and where the role of foreign capital is limited by economic and/or political factors. Not only do voucher programs and other mass distribution schemes have the advantage of speed; they may also serve to build broad-based public support for the privatization campaign.[19]

---

[17] Pechota, "Privatization and Foreign Investment in Czechoslovakia," pp. 313–315.

[18] For accounts of the Czechoslovak voucher scheme, see Franz-Lothar Altmann, "Transformation of Property Rights in Czechoslovakia: Present State," paper presented at the Conference on Transforming Economic Systems in East Central Europe, Munich Germany, June 1991; Altmann, "Contrasts in the Polish and Czechoslovak Approaches to Privatization," paper presented at the National Convention of the American Association for the Advancement of Slavic Studies, Miami, Florida, November 1991; Stark, "Privatization Strategies"; "Business in Eastern Europe," *The Economist*, September 21, 1991, p. 64; "Czechoslovaks Take a Stake in Privatization," *New York Times*, November 10, 1991; "Czechoslovaks' Big Stock Gamble," *New York Times*, November 19, 1991.

[19] David Newberry, "Reform in Hungary: Sequencing and Privatisation," *European Economic Review*, 35 (1991), pp. 576-577; "The Gift of Capitalism," *The Economist*, July 21, 1990, pp. 13–14.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


There are two main drawbacks to the Czechoslovak program. The first is the possibility that only a small number of citizens will choose to participate, and that those who do will end up making investment decisions based on highly imperfect information. Public opinion polls taken in early 1991 disclosed that only 15 percent of the Czechoslovak population indicated an interest in the voucher program; 33 percent of the respondents said that they would never participate.[20] The combination of a low level of participation and poor information could impair the ability of an iterative auctioneering procedure to assign meaningful values to the shares of enterprises. Second, a high level of participation would mean wide dispersion of ownership, which, under circumstances of poorly developed techniques of corporate management, could have the effect of weakening discipline on Czechoslovak enterprise managers.

*Poland*

Poland represents yet another distinctive pattern. Owing chiefly to the fact that the overwhelming share of Polish agriculture remained under private ownership throughout the period of Communist rule, reprivatization has not proven as salient a political issue as in East Germany, Czechoslovakia, or Hungary. The comparatively low level of political controversy surrounding the reprivatization issue has in turn greatly facilitated Poland's program of small-scale privatization: By fall of 1991, some 70 percent of the country's retail shops were in private hands.[21] Finally, Poland's large-scale privatization program has been beset by a series of fits and starts, reflecting (1) the Solidarity government's high sensitivity to the concerns of organized labor as well as widespread public misgivings about the role of foreign capital and (2) its preoccupation with macroeconomic stabilization during its first year in power. In the end, the government settled on a voucher scheme which differs from the one underway in Czechoslovakia in two key respects. First, there is no price of admission, which means that the program amounts to a mass giveaway of state property to the Polish citizenry. Second, the program seeks to alleviate the problem of separation of ownership and control attendant to mass distribution schemes through the creation of a number of investment funds designed to serve as intermediaries between citizens and enterprises.

Poland, like the other East European countries, undertook a campaign of agricultural collectivization after 1948. As with the earlier collectivization drives in the Soviet Union, the efforts of the Polish Communists were systematically undercut by the Polish peasantry, whose culture of independence and resistance to central authority was even more deeply rooted than its Soviet counterpart. By 1953, production shortfalls were sufficiently severe to compel the authorities to back off the collectivization campaign; compulsory deliveries were reduced while special exemptions were provided to small private farmers in an effort to spur production. And similar to the Soviet case, the consequent expansion of private activities in the agricultural sector soon led

[20] Altmann, "Transformation of Property Rights in Czechoslovakia."
[21] "Business in Eastern Europe", *The Economist*, September 21, 1991, p. 64.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


to a political backlash and a resumption of heavy-handed collectivization policies. But these efforts were generally unavailing; the harder the center pressed, the more the peasantry resisted. By 1955, the high point of the socialization movement, only 10 percent of cultivated farm land in Poland had been collectivized.[22]

The survival of a private Polish peasantry means, among other things, that the post-Communist authorities do not face the sorts of disputes over reprivatization that confront their counterparts in other East European countries, where private ownership of land was largely obliterated after World War II. The Polish authorities do face a serious problem of a quite different character in the agricultural sector in dismantling the price control system and the state-owned distribution and supply network, which for many years the Communist regime used to discriminate against private farmers. Even after the collapse of the one-party system and the launching of the crash marketization program by the Mazowiecki government, Polish farmers still complained that the state was persisting with its tradition of discrimination against private producers. Farmers were taking the blame from the urban population for soaring food prices, when it was in fact the state that was still capturing a huge margin between wholesale and retail prices while sustaining the pricing, supply, and credit policies which have long impaired productivity in the sector. Under these circumstances, farmers have strong incentives to withhold production, contrary to the hopes of the government that they would respond to the unleashing of market forces by increasing the supply of foodstuffs to long-suffering consumers.[23]

With regard to the small share of arable land which was collectivized before 1989, restitution claims appear not to have presented a major problem. The government expects to retain the remaining collective farms as large units while transforming them into limited liability companies or partnerships.[24]

Unencumbered by the legal and economic uncertainties that would otherwise arise under a major reprivatization program, Poland's small-scale privatization campaign has proceeded apace. The rapid rate of progress in that sphere is attributable to (1) a liberalization of the laws governing the founding of private firms, whose result was the creation of over 500,000 new small businesses in 1990 alone, and (2) the liquidation of fifty of the country's largest state and cooperative domestic trade organizations. The latter measure has enabled the government to sell, lease, or rent scores of retail outlets to private investors. In many cases, the buyers have been employees of the stores.[25]

---

[22] Marie Lavigne, *The Socialist Economies of the Soviet Union and Eastern Europe,* trans. T.G. Waywell (London, 1974), pp. 23–24. For a general discussion of the Polish collectivization campaign, *Polish Postwar Economy* (Westport, CT, 1974), pp. 114–116, 189–206.

[23] From *New York Times:* "Eastern Europe Awaits the Storm," December 17, 1989; "Farmers, Fearing a Drop in Prices, Criticize Poland's Economic Plan," December 19, 1989; "Bread, Up 38 Percent, Gasoline, Up 100 Percent: The Poles Are Shaken but Remain Optimistic," January 3, 1990; "To Market, to Market, but How Will Poland's Garden Grow?" January 11, 1990.

[24] Zbigniew Fallenbuchl, "Polish Privatization Policy," *Comparative Economic Studies,* 33:2 (Summer 1991), p. 65.

[25] Fallenbuchl, "Polish Privatization Policy," pp. 61–64.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


While the Mazowiecki government succeeded in engineering a draconian macroeconomic stabilization program, it made little headway in the sphere of large-scale privatization during its brief tenure in power. Mazowiecki's initial proposal to pursue a Western-style public issue of the shares of state enterprises met with strong opposition from local workers' councils, which favored the exclusive allocation of shares to the employees of the targeted enterprises, either free or at nominal prices. The upshot of this debate was a compromise, formalized in July 1990 with the Sejm's approval of the Law on Privatization. The law established a Ministry of Privatization charged with overseeing the transformation of Poland's 7,000 state enterprises. It specified two methods of privatization: (1) Liquidation of loss-making enterprises, followed by the sale or leasing of their assets to private investors or workers' cooperatives; or (2) transformation of enterprises into joint stock companies, whose shares would then be sold via public issues, auctions, or direct sales. To assuage the concerns of workers, the law stipulated that the relevant workers' councils would select one-third of the members of the boards of directors of the joint stock companies. It also reserved 20 percent of the shares for purchase by workers at preferred prices and established certain limitations on foreign ownership: Foreign investors could purchase up to 10 percent of the equity of Polish enterprises; investments exceeding that level required the specific approval of the Ministry of Privatization.[26]

The Minister of Privatization announced the government's objective of privatizing 15 percent of the state sector in the first year of the large-scale privatization program. However, the actual results of the program fell considerably short of that goal. Some 160 state enterprises were liquidated *per* option (1) above, but virtually all of these involved the leasing rather than the outright sale of the assets of the enterprises to private investors. Meanwhile, a mere seven enterprises were privatized via option (2), all of which were highly profitable and internationally recognized companies.[27]

Mazowiecki's defeat in the 1990 presidential elections signified a shift in Poland's privatization strategy. During the campaign, Lech Walesa proposed to implement a mass distribution program as a means of accelerating the lagging privatization campaign. By summer of 1991, the key elements of the scheme had taken shape. The program, which is designed to complement rather than substitute for the privatization methods codified in the 1990 law, envisages the creation of ten investment funds, formally controlled by Polish boards of directors but operated by Western investment managers. A third of the shares of the targeted enterprises will be allocated to a single fund, another 27 percent distributed equally among the other funds, 30 percent retained by the state, and the remaining 10 percent given away to the employees. An equal number of shares of the investment funds will in turn be allocated to every adult Polish citizen. Beginning in summer of 1993, the citizen-investors will be allowed to

---

[26] For details of the 1990 privatization law, see Fallenbuchl, "Polish Privatization Policy," pp. 53-55; Jan Szomburg, "Poland's Privatization Strategy," paper presented at the Conference on Transforming Economic Systems in East Central Europe, Munich, Germany, June 1991; Christopher Wellisz, "Privatization in Poland: The Problem of Valuation," *Journal of International Affairs*, 45:1 (Summer 1991), pp. 253-254; "Sale, and Yawn, of the Century?" *The Economist*, July 21, 1990, pp. 51-52.

[27] Stark, "Privatization Strategies"; Wellisz, "Privatization in Poland," p. 254.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


trade their shares in the funds. In the interim, the asset managers will be authorized to restructure the enterprises under their control, thereby providing shareholders with a sufficient basis for judging the performance of the funds by the time trading commences. The government initially targeted 400 state enterprises for inclusion in the program; the Sejm subsequently balked and trimmed the list down to 204.[28]

While the outcome of Poland's mass privatization program remains to be seen, its potential economic and political advantages are considerable. By issuing the shares through intermediary investment funds, the scheme serves to concentrate control and diversify risk to a degree not likely to be achieved in the initial phase of Czechoslovakia's direct distribution plan. Moreover, the funds provide access to Western managerial and financial expertise without provoking the sorts of political difficulties which might arise from a high level of direct foreign equity ownership of Polish industry.

### *Hungary*

Hungary's privatization program constitutes the inverse of the Czechoslovak and Polish patterns: comparatively rapid progress in large-scale privatization combined with agonizingly slow progress in small-scale privatization. Since its assumption of power in May 1990, the government of Jozsef Antall has overseen the full or partial privatization of nearly 200 of Hungary's 2,200 state enterprises. Included in this group are some of the largest and most important enterprises in the Hungarian economy. Combined with the expansion of small-scale private enterprise which took place during the pre-transition period, this means that approximately 15 percent of national assets, generating some 25 percent of GDP, are now in private hands. Post-Communist Hungary is also distinguished by the exceptionally high visibility of foreign capital. Foreign direct investment in Hungary in 1990 exceeded that of all of the other former *CMEA* countries combined, excluding the former GDR. The number of registered joint ventures, which stood at 600 at year-end 1989, had jumped to 7,500 by March 1991.[29]

During the same period, privatization of small-scale Hungarian enterprises has proceeded much more slowly. Of the thousands of small state-owned enterprises in Hungary, only ten had been privatized by spring of 1991. The slow rate of progress in that sphere of the Hungarian privatization program is chiefly attributable to an ambiguous structure of property rights in the small enterprise sector, which in turn is a consequence of the Antall government's decision to launch a program of reprivatization of both land and church property nationalized after 1948. This decision was a politically motivated concession by the ruling MDF (*Magyar Demokrata Forum:* Hungarian Democratic Forum) to its two coalition partners in the new government. The

[28] Altmann, "Contrasts in the Polish and Czechoslovak Approaches to Privatization"; Stark, "Privatization Strategies in Eastern Europe," pp. 24–28; Szomburg, "Poland's Privatization Strategy"; "Business in Eastern Europe," *The Economist*, September 21, 1991, p. 64.

[29] Nicholas Denton, "Hungary Takes the Lead on Foreign Investment," *Financial Times*, May 14, 1991; Interviews, National Bank of Hungary, May 1991.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


high degree of politicization of the reprivatization question in Hungary stands in sharp contrast to the other cases: Germany, where the primary concerns over reprivatization are economic rather than political; Czechoslovakia, where the Havel government shrewdly tabled the politically contentious issues of land and church property; and Poland, where the failure of the post-1948 collectivization campaign diminished, if not entirely eliminated, reprivatization as a political issue on the agenda of the new government.

### *Explanation of the Hungarian Pattern*

In the discussion to follow, I will argue that the fast pace of privatization of large Hungarian state enterprises in 1990-91 is attributable to the three factors. First, it was not steps undertaken by the new Antall government, but rather earlier measures either initiated or tolerated by the predecessor regime headed by the MSZMP (*Magyar Szocialista Munkaspart:* Hungarian Socialist Workers' Party), which established the legal and economic foundations requisite to full-scale privatization of the state sector. The efforts of the ancien regime made the job of Antall and his associates much easier than would have otherwise been the case. In this respect, structural predeterminants in the property sphere place Hungary at a strong comparative advantage vis-à-vis Poland and other East European countries.

Second, concerns about the dominant role of foreign capital and the danger of asset undervaluation, which became a source of considerable political controversy during the two years preceding the election, considerably abated after the new government took office. The eventual winner of the election, the Democratic Forum, made a good deal of noise about the sale of undervalued national assets, the "nomenklatura buyouts," and other scandals which attended the earlier phase of the privatization campaign. But such rhetoric largely ceased once the election was over, and the Antall government has accepted the necessity of a rapid privatization program spearheaded by foreign capital. The government and the liberal opposition exhibit certain differences over pace and technique, but not over the general principle of a quick and radical transformation of the state sector.

Third, the large-scale privatization program has been greatly facilitated by the virtual political disenfranchisement of the Hungarian working class. This state of affairs stands in sharp contrast to Poland, where organized labor represents the most important source of political opposition to economic reform.

Outcomes in the other spheres of privatization also reflect the dual impact of structural constraints and the exigencies of parliamentary democracy. In the area of small-scale privatization, Hungary's starting point would again appear to give it strong advantages over the East European countries. And indeed, the MSZMP's liberalization of regulations concerning the founding of new enterprises laid the groundwork for the creation of large numbers of private small-scale businesses after the political transition.

But transformation of existing state-owned small enterprises has proven an altogether different matter. The slow rate of progress in the small enterprise sector is an indirect consequence of the politicization of the reprivatization question. While Hunga-

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


rian democratization has contributed to the political defanging of the actors representing the biggest threat to large-scale privatization, it has served to empower other actors whose political activities have created serious problems in other spheres of property reform. In particular, the elections resulted in the formation of a ruling coalition, two of whose members, the FKGP (*Fuggetlen Kisgazda Part:* Independent Smallholders' Party) and the KDNP (*Keresztenydemokrata Neppart:* Christian Democratic People's Party) have pushed aggressively for reprivatization of land and church property seized after the Communist takeover in 1948. Antall and his associates in the MDF acceded to these demands in order to preserve the coalition. In spring of 1991, the Forum and its coalition partners succeeded in overcoming strong resistance from the liberal opposition parties to pass a reprivatization law in the Parliament, only to see the Constitutional Court declare it unconstitutional. After instituting technical modifications of the law which served to resolve the Court's objections, the government launched an ambitious reprivatization program distinguished by a complicated mixture of restitution and compensation. The politicization of the reprivatization issue has had the following effects: (1) Confusion of an already highly complex and uncertain structure of property rights in the small enterprise sector, with adverse consequences for the program of small-scale privatization; and (2) exacerbation of general political and socioeconomic tensions which threaten to compromise the broader privatization campaign in Hungary.

## Property Reform under the MSZMP

Prime Minister Antall and his associates owe a great debt of gratitude to the MSZMP. Not only was the legal framework for privatization essentially in place by the time the successor regime took over; the gradual liberalization of ownership relations prior to 1989 produced a stock of entrepreneurial skills which would later simplify the technical problem of full-fledged privatization, soften the socioeconomic impact of industrial restructuring, and generally reduce the political risks facing the new government. Moreover, it was during the lame-duck administration of Miklos Nemeth, Hungary's last socialist prime minister, when the first privatizations of major state enterprises took place. It was precisely the inability of that government to control the forces unleashed by the MSZMP's earlier measures which resulted in the scandals and abuses which would compel the successor regime to recentralize privatization policy. The ironic effect of the transition from one-party system to multiparty democracy in Hungary has thus been to strengthen the role of the state in property reform policy.

### *1970s: Emergence of the Second Economy*

Hungary's New Economic Mechanism, like the reforms launched earlier in Yugoslavia, was of the "market-socialist" type: that is, it aimed to make resource allocation more efficient by way of introduction of market- and quasi-market mechanisms, while retaining the dominant position of socialist ownership of the means of production. That the original intent of the reforms was to marketize while stopping short of

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

p0063371


significant expansion of private ownership reflected both the constraints imposed by Marxist-Leninist ideology, the linchpin of which was socialist ownership, and the genuine belief of most reformist economists in Hungary and the rest of Eastern Europe that an efficient "market socialism" was achievable.[30]

Accordingly, the first ten years of NEM did not see an expansion of the legally recognized private sector. Indeed, between 1968 and 1978 both the private and cooperative sectors shrank while the state sector grew. By 1980, the legal private sector represented less than 3 percent of national income in Hungary.[31] Among other things, the diminution of the non-state sectors during this period was the result of sharp legal restrictions on the number of employees of private firms, restricted access to bank credit and fixed capital inputs, and high rates of taxation.

But if the first decade of NEM did not witness the expansion of the formal private sector, it *did* see the growth of both legal private activities within the state sector and illegal and quasi-legal ones outside of it. It is ironic that the Hungarian second economy began its gradual expansion at a time, the mid-1970s, when the economic reform as a whole was encountering its strongest political opposition. This was attributable to two factors.

First, the second economy had a self-reproducing logic, as the appearance of private entrepreneurship in one sector tended to stimulate similar activity in other sectors. Contracting, for example, was initially concentrated in the construction industry, where carpenters and other skilled workers availed themselves of new regulations by working private jobs during their off-hours. This expansion of private construction, in turn, generated private demand for construction materials, which in turn spurred demand for transport of materials, and so on down the chain of transactions.[32]

The development of alternative ownership forms in the second economy was thus more a *de facto* than a *de jure* process, a reform by default rather than by design. In contrast to other elements of NEM, where the introduction of market mechanisms took place through formal policy programs initiated by party and state officials at the top, the second economy was the unintended consequence of uncoordinated actions by scores of individuals from below. Some of these actions involved undetected and/or unsanctioned violations of the law; others entailed the exploitation of opportunities created by the removal of legal restrictions on private activities.[33]

Second, actors at every level of the Hungarian polity, many of whom had contributed to the political attack and eventual reversal of other elements of NEM after 1972, had powerful incentives to support the development of the second economy.

---

[30] See, for example, Wlodzimierz Brus, "From Revisionism to Pragmatism: Sketches Towards a Self-Portrait of a ‚Reform Economist'", and Marton Tardos, "We Must Return to Democracy," in Acta Oeconomica, 40:3–4 (1989).

[31] Kozponti Statisztikai Hivatal, *Statisztikai Evkonyv* (Budapest, 1984, 1986, 1987).

[32] David Stark, "Bending the Bars of the Iron Cage: Bureaucratization and Informalization in Capitalism and Socialism," Sociological Forum, 4:4 (1990), pp. 637–664.

[33] Stark, "Bending the Bars of the Iron Cage"; Ivan Szelenyi, Socialist Entrepreneurs: Embourgeoisement in Rural Hungary (Madison, 1988); Szelenyi, "Eastern Europe in an Epoch of Transition: Toward a Socialist Mixed Economy?" in Victor Nee and David Stark, eds., *Remaking the Economic Institutions of Socialism: China and Eastern Europe* (Stanford, 1989), pp. 230–231.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


For workers, the second economy was a means of supplementing income earned in their regular jobs in the state and cooperative sectors, a factor which assumed great importance amidst the economic austerity conditions which obtained in Hungary after 1978. With wage restraints and rising inflation producing declines of real income in the socialist sectors, workers had strong incentives to seek out moonlighting jobs in the second economy, where wages often exceeded those in the official sectors by a factor of three or four. The second economy also strengthened the bargaining position of workers vis-à-vis their regular employers. Under conditions of pervasive shortage and strong pressure from above for fulfillment of production goals, labor demand by Hungarian state enterprises remained extremely high throughout the reform period. The threat of full or partial exit to the second economy thus enabled workers, and in particular highly skilled workers possessing the idiosyncratic knowledge needed to operate plant and equipment prone to frequent breakdowns, to bid up their wages in the socialist sector jobs.[34]

As for state enterprise managers, the growth of the second economy was not a wholly welcome development, since it served as a drain on the time and energy of their best and most industrious employees and strengthened the latter's ability to extract wage concessions. But for most enterprise managers, the advantages of the second economy overcame these liabilities. Managers facing production shortfalls or encountering unusual technical problems could turn to private contractors, whose small size and flexibility enabled them to respond quickly to the enterprise's needs and obviated resort to cumbersome and heavily bureaucratized contractors in the state sector. And so in contrast to Poland, where state enterprise managers saw the private sector primarily as a threat, their counterparts in Hungary came to view the second economy as a valuable complement to their own activities. It enabled managers to perform their jobs more effectively and enhanced their ability to fulfill the expectations of their superiors in the Party/state apparatus.

For similar reasons, Party and state officials had powerful incentives to support the growth of the second economy. It plugged in production gaps left by the socialist sectors, facilitating the achievement of the goals spelled out in the national plan. It helped to relieve shortages of both capital goods and consumer products. And it served as a safety value for hard-pressed workers who might otherwise channel their discontent over declining real wages and other economic maladies into organized political opposition, like their counterparts in Poland.

But in the environment of the early and mid-1970s, with party conservatives having gained the upper hand and forced a general retreat in the reform program, the Kadar leadership's position on the second economy remained ambiguous. On the one hand, the leadership had a pragmatic appreciation of the aforementioned contributions of the second economy to the functioning of the state sector and to general socioeconomic stability, and this led it to accept a broad range of such activities even when it was widely understood that many of them constituted formal violations of the law.

On the other hand, the second economy *did* represent an independent source of production capacity, a medium of capital accumulation outside the party/state appa-

[34] Stark, "Bending the Bars of the Iron Cage".

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

p0063371


ratus. This, combined with what remained a deeply ingrained ideological aversion on the part of some MSZMP elites to an active private sector, persuaded the leadership to maintain highly discriminatory tax, credit, and investment policies. Legal sanctions against many types of private activities remained on the books; and however indifferently enforced, they served to keep private entrepreneurs under a cloud of constant uncertainty.[35]

### *Early 1980s: Legalization of the Second Economy*

This was the situation at the time of the resumption of NEM in late 1978. While some categories of private economic activity were legally codified, much of the Hungarian private sector operated in the grey area between legality and illegality, its considerable range of operational autonomy checked by uncertainty over the continued forbearance of the political leadership. But by the end of the 1980s, virtually all legal restrictions on private ownership would disappear.

In January 1982, the Hungarian authorities introduced a set of laws whose effect was to legalize most of the alternative ownership forms previously subsumed under the rubric of the "second economy." The most important of these forms were the so-called VGMs (*Vallalati Gazdasagi Munkakozossegek*), associations of workers within state enterprises. Like the second economy, the VGMs were a means of supplementing income during a period of declining real wages and general austerity, thereby helping to prevent widespread economic hardship from spiralling into a Polish-type political crisis. The VGMs had the added advantage of extending the benefits of property reform to the urban proletariat, a large, economically strategic, and politically vital class of actors largely excluded from earlier developments in the second economy. The base of political support for the property reforms now encompassed agricultural and light industrial workers in the countryside, urban-based artisans, craftsmen, and private contractors, and the core urban working class.

And like the second economy, the VGMs provided concrete benefits to state enterprises. They filled in production shortfalls; they enabled managers to find quick solutions to technical problems in the production line by circumventing the state bureaucracy and hiring small and highly adaptable contractors. At the same time, the legal code allowed state enterprises to charge fees paid to the VGMs against their general working capital accounts, rather than the wage fund. This enabled managers to avail themselves of the services of the VGMs while circumventing official wage regulations, which the central authorities were tightening as part of the economic austerity program begun in 1979.

Predictably, the main opposition to the VGM movement came from blue-collar workers lacking the skills to participate in the associations and the National Council of Trade Unions, whose raison d'etre of collective bargaining the VGMs seriously challenged. Union leaders, joined by non-member workers resentful of the enor-

---

[35] A Hegedus and A. Markus, "The Small Entrepreneur and Socialism", *Acta Oeconomica*, 22:3–4 (1979); Marton Tardos, "The Conditions of Developing a Regulated Market", *Acta Oeconomica*, 36:1–2 (1986).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


mous income differentials between themselves and VGM members, attacked the associations for propagating a materialistic outlook, sapping workers' energy, damaging family, and undermining socialist ideological principles. VGM members were even accused, perhaps correctly, of deliberately underproducing during normal working hours so as to ensure satisfactory preparation of materials and equipment for the VGM hours.

But the manifest economic advantages of the VGMs soon overwhelmed these objections. Union demands for the authority to determine the working conditions of the associations were rebuffed, and the National Council eventually renounced all union claims of the right to represent them. The advent of the VGMs was thus a key step towards the political defanging of organized labor, which would later greatly simplify matters for the successor regime. The huge differential between VGM wages and regular hour wages split the payroll of state enterprises into two separate camps, one composed of VGM members and the other non-members. The former had neither the time nor the inclination to agitate for increases in regular wage rates, leaving non-members weakened and isolated and undermining the collective bargaining position of the labor force.[36]

### *Mid-1980s: Reforms of Enterprise Management*

Concurrent with the growth of the VGMs were reforms of the system of management of state enterprises themselves. As part of a reform package approved by the MSZMP Central Committee in April 1984, Hungarian state enterprises were assigned to three general types of managerial structures. Small and medium-sized enterprises were placed under a system of management basically similar to the one used in the cooperative sector in which a general assembly of workers exercised primary control of enterprise decision-making. Control of large state enterprises was devolved to so-called "enterprise councils," comprised of representatives from both labor and management. The third category consisted of certain enterprises, namely public utilities and enterprises running unusually large losses, which remained under the control of branch ministries and local councils.[37]

The principal aim of these reforms was to expand the legal and operational autonomy of state enterprises, reflecting widespread recognition of the failure of earlier phases of NEM to eradicate the old tradition of petty interference in microeconomic decision-making by central authorities. The reforms left several loopholes that enabled Party and state organizations to interfere in the operations of the enterprises. Formally, the general assembly of workers and the enterprise councils possessed the exclusive authority to elect the management, previously appointed directly by the rele-

[36] Stephen Noti, "The Shifting Position of Hungarian Trade Unions Amidst Social and Economic Reforms", *Soviet Studies*, 39:1 (January 1987); David Stark, "Coexisting Organizational Forms in Hungary's Emerging Mixed Economy", in Nee and Stark, *Remaking the Economic Institutions of Socialism*, pp. 140–148.

[37] Jan Adam, "The Hungarian Economic Reform of the 1980s", *Soviet Studies*, 39:4 (October 1987); A. Sipos and M. Tardos, "Economic Control and Structural Interdependence of Organizations in Hungary at the End of the Second Decade of Reform", *Acta Oeconomica*, 37:3–4 (1986).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

p0063371


vant political bodies. But in practice, local Party committees exerted considerable influence over the drafting of the list of candidates for plant management, while the branch ministries retained veto power over whatever choices the councils made.[38]

But while the 1984 reforms did not immediately free Hungarian state enterprises from the "plan bargaining" system whereby the central authorities transmitted their expectations to microeconomic units, they did have long-term consequences that would strongly influence the privatization program undertaken by the successor regime.[39] In effect, the enterprise management reforms and the earlier legalization of the second economy entailed the expansion of two types of ownership rights: (1) use of capital, and (2) access to income streams deriving from the employment of that capital. Yet they denied workers and managers the third main type of ownership right, asset transferability. That the reforms stopped short of endowing microeconomic actors with the right of asset transfer reflected certain objective economic limitations, namely the absence of a well-developed capital market on which the assets of Hungarian enterprises could be traded. It also exemplified the persistence of ideological/political constraints on radical property reform. To decentralize control over the use of capital and disposition of income streams was one thing; but to grant right of asset transfer was tantamount to recognition of the right of private ownership of equity capital, and hence abandonment of the core principal of socialism: that personal income should derive solely from labor, and not from ownership of capital.

By decade's end, however, this last barrier to private capital ownership would disappear, and it was the MSZMP itself that undertook the decisive steps towards the creation of the legal mechanisms for the purchase and sale of the assets of state enterprises. The enterprise councils that emerged from the 1984 reforms would seize upon the opportunities presented by these subsequent measures to reap handsome private returns from the transfer of the assets under their control. The resultant scandals would have a powerful impact on the 1990 electoral campaign and would prove the key factor in the new government's decision to recentralize privatization policy.

### *Legalization of Private Capital Ownership*

The first step towards the legalization of private capital ownership took place in late 1982, when the Hungarian National Assembly approved a law which codified procedures for the issuance of bonds and equity shares. Such financial instruments did previously exist in socialist Hungary. During the Stalinist years, the government frequently resorted to bond issues as a means of revenue generation to supplement the turnover tax. Moreover, an 1875 law prescribing the legal form for share companies had remained in force throughout the socialist period. In fact, a few large state-owned enterprises in Hungary (Ibusz and Tungsram, for example) had retained their formal status as shareholding companies after the Communist takeover to maintain the

[38] Interviews, Ministry of Finance, November 1986.

[39] The most elaborate exposition of the "plan bargaining" thesis is László Antal, *Gazdasagiranyitasi es Penzugyi Rendszerunk a Reform Utan* (Our Economic Management and Financial System on the Reform Path) (Budapest, 1985).

Bayerische Staatsbibliothek
Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


continuity of their external relations, but an extensive array of legal restrictions erected after 1948 had prevented the emergence of any new shareholding companies. What was significant about the 1982 legislation was that it created the legal mechanisms for the issuance of securities by non-governmental entities.[40]

The law authorized Hungarian households to purchase government-guaranteed bonds, but it excluded the population entirely from the market for equity shares. Beyond this, the legal code regulating the equity market was fairly open-ended. As with bonds, state enterprises wishing to issue shares could only do so through a licensed intermediary, subject to specific permission of the Minister of Finance. But no restrictions applied to the size of the issues, the structure of dividends, or the composition of the shareholders, so long as they were institutional investors.

In early 1983, the State Development Bank organized the first bond issue on behalf of the giant OKGT (*Orszagos Koolaj Gaz Troszt:* National Oil and Gas Trust). The success of the OKGT issue prompted other actors to enter the market; first the Hungarian Post Office, then the Skala Cooperative. By mid-decade, there was a small but rapidly growing trade in bonds. The inauguration of the two-tiered banking system in 1987 gave a considerable boost to the growth of the bond market, as the new commercial banks took over the underwriting operations of both the State Development Bank and the National Bank of Hungary. The value of bonds issued that year was nineteen times the level in 1983, the first year of the market; bonds issued to households constituted over 70 percent of the total.[41]

Growth of the Hungarian equity market in the 1980s was far less impressive. The factors limiting growth in stock trading were technical and economic, rather than political and ideological. In particular, problems of asset valuation, the shortage of investable domestic capital, and the paucity of financial intermediaries placed strong objective constraints on the expansion of the equity market. But at the same time, the political and ideological barriers to private capital ownership were quickly tumbling down, at the behest of the ruling party.

In October 1987, the government issued a decree that authorized state enterprises as well as companies operating with foreign participation to issue securities to their own employees. The securities were formally classified as "property shares," but did not possess all the requisite characteristics of equity. They did pay an annual dividend, but were non-transferable and did not impart to the bearers any influence over management of the enterprise. Because of these restrictions, and because the dividends were typically lower than the yields on fixed-rate bonds, few workers exhibited much interest in the employee share program.[42]

The authorities went a step further in early 1988, approving a law that allowed private entrepreneurs to enter into partnerships with state enterprises and cooperatives under limited liability. This constituted an important legal breakthrough: Previously, private actors in Hungary could only establish ventures on the basis of unlimited lia-

---

[40] Zsigmond Jarai, "Development Trends of the Security Market in Hungary", Manuscript, 1988.

[41] Kozponti Statisztikai Hivatal, *Statisztikai Evkonyv*, 1987.

[42] From *Foreign Broadcast Information Service/Eastern Europe* (hereafter *FBIS/EEU*): "State Enterprises to Issue Stock to Workers", November 2, 1987; "Lack of Interest in Company Shares Noted", February 4, 1988.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


bility, whereby bankruptcy could lead to seizure of the total personal properties of the participants. Under the new law, individual participants were only liable for the assets they contributed to the venture, lowering the personal risks of setting up a partnership. The law also raised the maximum number of employees of private companies from 12 to 30. This remained a very modest number, but was a harbinger of measures to follow.[43]

The decisive step came in January 1989, with the National Assembly's passage of the Law on Economic Association. In addition to limited and unlimited partnerships, already codified in law, the new legislation entitled private investors to participate in both of the main types of shareholding enterprises, the limited liability company and the joint stock company. In June of the same year, the Assembly approved another piece of legislation, the Law on Transformation, which prescribed the legal mechanisms for the conversion of state enterprises into one of these shareholding forms. The Hungarian state reserved the right to determine the terms of transformation of enterprises still under the direct supervision of the branch ministries; otherwise the controlling enterprise councils and general assemblies of workers could "voluntarily" decide to transform the relevant enterprise into a shareholding company. The law left it up to the councils and worker assemblies to negotiate the conditions of the transformation with the buyer.[44]

At the same time, the authorities undertook to remove remaining barriers to the movement of foreign capital into Hungary. Hungary's foreign investment laws previously restricted foreign participation to newly created joint ventures. Foreign investors could now acquire up to 100 percent equity ownership of existing state enterprises. The new legislation also granted foreign investors highly favorable tax holidays as well as certain legal guarantees concerning nationalization: The Hungarian state would be obliged to compensate expropriated investors the full value of their assets in convertible currency. And conversion of foreign-denominated earnings, previously determined through ad hoc agreements between the investor and the National Bank of Hungary, was now completely up to the discretion of the investor; foreign investors could freely convert and repatriate all of their after-tax profits.[45]

The result of these measures was a succession of widely publicized sales of Hungarian state enterprises to foreign investors, of which the most notable cases were General Electric's acquisition of a controlling share of Tungsram, the purchase of the locomotive division of Ganz-Mavag by the British company Telfos, the sale of the Ozd Metallurgical Works to the German firms Korf KG and Metallgesellschaft AG, and the sale of a minority share of the tourist company Ibusz to Austria.

The Ibusz deal was especially controversial, underscoring the political risks attendant to the rapid penetration of foreign capital into the national economy. The Hungarian authorities, seeking to sell some 40 percent of the company's registered capital through a public issue, elected to place the shares simultaneously on the Budapest and Vienna Stock Exchanges. The rationale of this decision was that a successful issue

---

[43] "New Partnership Form for Private Entrepreneurs", *FBIS/EEU*, February 4, 1988.

[44] "National Assembly Resumes Work on Amendments: Justice Minister's Address", *FBIS/EEU*, June 1, 1989.

[45] "Foreign Investment Protection Bill Formulated", *FBIS/EEU*, December 15, 1988.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


required the high visibility of the Vienna Exchange; the Budapest Exchange had barely begun operations. As a consequence, some 75 percent of the shares were snapped up by Austrian investors. Within a week, Ibusz stock was being quoted at 255 percent of the initial sales price. Many regarded the episode as clear demonstration of how Western capital could utilize Hungary's liberal foreign direct investment laws to purchase national assets on the cheap.[46]

### *"Nomenklatura Capitalism"*

Nor did Hungarian state enterprise managers lose any time in exploiting the opportunities afforded by the new legal framework. Senior managers, acting on behalf of their enterprise councils, would set up subsidiaries organized as limited liability companies. They would then transfer the fixed capital assets of the parent enterprise to the new company in exchange for shares. In this fashion, the members of the old nomenklatura could not only generate large personal profits, but reacquire control of the parent state enterprise. In some cases, the managers would simply sell off the assets of the subsidiaries which they now controlled to foreign or domestic investors and pocket the proceeds. In other cases, they would engineer salary increases and/or bonuses from the subsidiaries which would enable them to repurchase the shares now held by the parent company. The parent would then be left as a shell company, stripped of its assets but still carrying large debts and other liabilities.

Public controversy over these "nomenklatura buyouts," together with the debate over the role of foreign capital in the privatization campaign, became a central issue in the 1989-90 campaign and the primary impetus for the establishment of the State Property Agency (SPA) in spring 1990. A few of the most notorious cases (e.g., HungarHotels) were ruled invalid by the courts. But amidst the political lassitude of the lame-duck Nemeth government, hundreds of such deals were consummated.

The ultimate effect of the MSZMP's decision to empower enterprise councils with right of asset transfer was thus to create certain complications for the successor regime which would take up the task of privatization. The SPA would have to find buyers of state enterprises that were burdened with heavy liabilities but deprived of their assets. Tracking down and recovering these assets would prove no easy matter, since in many cases the subsidiary limited liability companies had liquidated them.[47]

But in all other respects, the actions of the old regime made matters much easier for the Antall government: The legalization of the second economy wherein resided the entrepreneurial skills which would put Hungary at a comparative advantage vis-à-vis the other East European countries after the political transition; the launching of a capital market and a commercial banking system capable of providing the intermediary services vital to the privatization effort; the establishment of the legal me-

[46] Interviews, State Property Agency, May 1991.

[47] David Stark, "Privatization in Hungary: From Plan to Market or From Plan to Clan?" *East European Politics and Societies*, 4:3 (Fall 1990); Interviews, National Bank of Hungary, May 1991; Interviews, State Property Agency, May 1991.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


chanisms necessary for the creation of new private firms and the transformation of existing state enterprises into private ownership forms; the enactment of the most forgiving foreign investment laws in existence in Eastern Europe.

## The Politics of Privatization Amidst the Transition

During the period between the enactment of the 1989 Law on Economic Association and the spring 1990 elections, privatization was essentially a free-for-all, with the outgoing Nemeth government lacking either the regulatory apparatus or the general political authority to control the process. It was against this backdrop that the newly formed political parties debated the privatization question in the run-up to the 1990 parliamentary elections.

### *Policy Positions of the New Parties*

While the policy platforms of the principal contending parties all called for a radical transformation of ownership relations, they revealed certain differences with respect to the pace and technique of privatization. The key liberal parties, the SZDSZ (*Szabad Demokratak Szovetsege:* Alliance of Free Democrats) and FIDESZ (*Fiatal Demokratak Szovetsege:* Alliance of Young Democrats), urged the fastest possible privatization of the state sector. This meant three things. First, the two parties sought to minimize the role of the state bureaucracy in the process, "privatizing the privatization." The state should be relegated to the role of watchdog of privatization, along the lines of the Securities and Exchange Commission in the United States; for the state to become an active participant in negotiations between sellers and buyers created a danger that political and bureaucratic criteria would supplant market forces. The periodic abuses and scandals which would inevitably attend spontaneous privatization were an acceptable cost of rapid transition to a market economy. Second, the liberals urged the provision of even further inducements to foreign capital. Reliance on foreign capital during the early phase of the privatization campaign was unavoidable. Finally, both the SZDSZ and FIDESZ were highly dubious of employee stock programs, communal ownership, and other arrangements which smacked of "Third Way" theorizing. Hungary, they argued, needed to make a clear and decisive break with the past; Third Way schemes would merely impede the country's integration into the West European community.

The Democratic Forum also called for an ambitious privatization program, proposing to divest 50 percent of the state sector within a four-year period. At the same time, the Forum leaders cautioned against an excessively hasty privatization campaign and insisted that foreign capital, while an indispensable part of the program, should only be allowed to acquire national assets at fair prices. This required a more interventionist role for the state. The Forum, sensitive to the charge of the liberals that its proposals revealed Third Way – type thinking, emphasized in its position papers that its aim was to create a market economy. But it warned that methods of privatization which had proved successful in the advanced capitalist countries couldn't al-

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


ways be applied in unaltered form to Hungary. Accordingly, it envisioned greater reliance on ESOPs, foundations, local governments, and other institutional investment mechanisms in the transformation of the state sector. The Forum's position here was something of a compromise between the liberal parties' preference for a market-driven process and the position of the Christian Democratic and Social Democratic parties, which viewed employee ownership programs as a primary technique of property reform.[48]

To a certain degree, this debate over privatization reflected the efforts of the new parties to jostle for position in the emerging democracy. But it also exemplified certain differences in their underlying political philosophies. The Democratic Forum embodied the populist traditions of rural Hungary; the Free Democrats the legacy of Hungary's urban intellectuals and professionals anchored in the culture and liberal ethic of Western Europe. Both parties regarded the installation of Soviet-style communism in Hungary and the rest of Central Europe as violations of the sovereignty and national traditions of the region. But they placed this event in different historical and political contexts.

The MDF tended to view the post-1945 developments as yet another misfortune inflicted upon the long-suffering Hungarian nation by an external aggressor. The leaders of the Forum saw themselves as the rightful inheritors of Hungarian history; their mission was to restore the country to its proper historical trajectory. This was the root of the Forum's nationalist orientation. The MDF's appeal to nationalist instincts was initially cloaked within the context of wide public displeasure over the treatment of the ethnic Magyar minority in Romania. The party subsequently extended this nationalist line to its economic policy plank. The Forum's misgivings about the high visibility of foreign capital, its *dirigist* conception of the state's role in the privatization process, were part and parcel of the party's broader historical mission of preserving Hungary's distinctive national identity.

By contrast, the Free Democrats viewed Hungary's sufferings within the context of the postwar fate of East Central Europe as a whole. Their concerns about the treatment of the Hungarian minority in Romania were linked to broader beliefs concerning universal human rights, pursued within the framework of Western liberalism. For this reason, the policy program of the SZDSZ emphasized above all the restoration of Hungary to the political, economic, and social system of Western Europe, where it always belonged. The Free Democrats regarded the MDF's approach to the minority problem, with its religious and nationalist undertones, as an appeal to the provincial and backward elements of Hungarian society. They also tended to view the leaders of the Democratic Forum themselves with a measure of condescension which sometimes bordered on disdain, believing that the cream of the Hungarian intelligentsia had gravitated towards the liberal parties.[49]

---

[48] "Hankiss Analyzes MDF/SZDSZ Dichotomy," *FBIS/EEU*, October 27, 1989; Mihaly Laki, "Economic Programs of the Ex-Opposition Parties in Hungary," *East European Politics and Societies*, 5:1 (Winter 1991), pp. 76-82; Interviews, Institute of Economics and Institute of Political Science, Budapest, May 1991; Interviews, Hungarian Parliament, May 1991.

[49] Laszlo Keri, "Hungary: From the Single-Party System to Free Elections," Manuscript, 1990; Adam Michnik, "Notes on the Revolution," *New York Times Magazine*, March 11, 1990; Interviews, Budapest University of Economics, May 1991.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


The bitter exchanges between the Form and the SZDSZ during the campaign, which included strong undercurrents of anti-Semitism, stemmed in no small part from these philosophical disparities as well as differences in the social milieu from which the two parties drew their leaders. The result, among other things, was to eliminate the possibility of a coalition between the parties. The Forum, which won a plurality but not a majority of parliamentary seats in the election, was compelled to seek other coalition partners. As we shall see momentarily, the MDF's choice of partners would prove of great importance to post-election politics and reform policy in Hungary.

But notwithstanding the philosophical and personal disagreements between the leaders of the Forum and the SZDSZ, in practical terms their differences over the specific question of privatizing large-scale state enterprises were not vast. The differences focused on pace and technique, but not the overarching objective of radical transformation of the state sector. And so while the liberal opposition continued to carp about the slow pace of the new government's privatization program, to complain that the State Property Agency possessed too much authority, to assert that Antall and other Forum leaders still harbored an affinity for Third Way ideas and a distrust of foreign capital, it is not clear that an SZDSZ victory in the elections would have produced a significantly different result in the sphere of large-scale privatization. The post-election period saw a general diminution of political controversy over that particular issue. The MDF leadership moved closer to the liberals' position on foreign capital: About two-thirds of the privatizations achieved during the government's first year in office were the result of foreign direct investment.[50] And the State Property Agency turned out not to be the barrier to privatization the liberals feared. Indeed, in some respects it served to accelerate the process.

## *Role of the State Property Agency*

Consistent with the MDF's general position on the role of the Hungarian state in the privatization process, the SPA's legal authority encompasses both SEC-type regulation and active participation in specific divestiture cases. Spontaneous privatizations initiated by investors or state enterprises are subject to SPA approval. For cases initiated by the SPA itself, the staff prepares specific guidelines for the divestiture: Preferred method of sale (public issues of shares, competitive tenders, direct sales); proportions of foreign and domestic ownership; percentage of shares reserved for employees of the enterprise. In cases involving majority foreign ownership of Hungarian enterprises, the SPA can invoke a "Gold Share" provision, similar to the system set up in Great Britain as part of the Thatcher privatization program, to protect certain economic, historical, or cultural interests. In a privatization campaign necessarily constrained by heavy reliance on foreign capital, the SPA's ability to stipulate the conditions of sale of national assets helps to preserve public confidence in the program. And foreign investors, far from viewing the SPA as an obstacle to the movement of Western

[50] Interviews, National Bank of Hungary, May 1991.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

capital into Hungary, generally welcome the assertion of order and coordination over a privatization process which under the Nemeth government had been characterized by a fair degree of chaos and confusion.[51]

The two major privatization programs which the SPA initiated during the first year of its existence illustrate its attempts to correct some of the excesses of the earlier phase of the campaign. The "First Privatization Program," launched in fall of 1990, targets twenty blue-chip companies. The Agency's rationale here is that selecting the best managed and most visible state enterprises for its first program would give impetus to the privatization campaign as a whole. These are also the companies which stand the best chance of early placement on the Budapest Stock Exchange, whose expansion is a top priority of the government; tender offers or direct sales would be the only options for the much larger number of loss-making enterprises which the Agency would be handling in later programs. Included on the list is Ibusz, whose earlier placement of shares on the Vienna exchange had generated such controversy. The SPA's aim in this case is to dispose of the company's remaining share capital in such a way as to promote the development of the Budapest Exchange.[52]

The "Second Privatization Program," launched in spring 1991, is essentially the opposite of the first program. It is composed of some seventy of the weakest state enterprises, most of which had become shell companies in the period immediately following the 1989 privatization acts. The list of Hungarian enterprises which fit this category is much longer, and the SPA's public announcement of the program stipulates that all Hungarian enterprises which have transferred at least 50 percent of their assets to limited liability companies would be eligible for privatization. In dealing with these cases, the Agency would seek the cooperation of the enterprise management, the employees, and the relevant trade union organizations. But participation in the program is not voluntary; the SPA would proceed with the privatization regardless of whether it obtained the assent of labor and management.[53]

As for state enterprises which have yet to transform themselves into limited liability companies, and therefore lack the requisite legal form for divestiture, the SPA possesses the authority to force them to make the transformation. The SPA lacks the staff and technical resources to handle large numbers of such cases, as transformation would entail legal registration of the enterprises as limited liability companies, appraisal of their assets, appointment of their boards, and so on. But the Agency's hope is that selective employment of this authority will spur laggardly state enterprises to take the plunge themselves, and thus to stimulate the spontaneous side of the privatization campaign.[54]

In short, the legal organization and activities of the State Property Agency suggest that under the circumstances of an economy undergoing a transition from central economic planning, the creation of a new state organization designed to oversee privatization need not necessarily impede the process, as the liberal parties argue. To the ex-

---

[51] Interviews, Price Waterhouse Budapest, May 1991.

[52] State Property Agency, "First Privatization Program", Budapest, September 1990.

[53] State Property Agency, "Second Privatization Program", Budapest, March 1991; Interviews, National Bank of Hungary, May 1991.

[54] Interviews, State Property Agency, May 1991.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


tent that it sustains the confidence of the public and foreign investors by curbing abuses, to the degree that it nudges reluctant state enterprises off the fence, such an organization may actually expedite the process.

*Political Emasculation of the Working Class*

The SPA's public announcement that it would consult with the trade unions involved in the Second Privatization Program, but would not be bound by their viewpoints, illustrates the political weakness of organized labor in Hungary amidst the transition. As we have seen, measures undertaken by the MSZMP, which professed to be the party of the working class, were partly responsible for the political disfranchisement of labor in Hungary. In particular, the Party's decision in the early 1980s to legalize the second economy provided a means of exit for entrepreneurial members of the working class, deepening the split between participants and non-participants in the VGMs and other activities.

The 1990 elections further undercut the political position of blue-collar labor. The leftist vote was splintered among four parties: The MSZP (*Magyar Szocialista Part:* Hungarian Socialist Party), the SZDP (*Szocialdemokrata Part:* Social Democratic party), the ASZ (*Agrarszovetseg:* Agrarian Alliance), and the old MSZMP. Of these, only the MSZP received enough votes to qualify for inclusion in the Parliament. Several analysts have noted that the electoral results underestimate the potential strength of the Hungarian left: the combined vote of the four left-wing parties amounted to nearly 25 percent of the total. Notwithstanding widespread antipathy for the Communist period, these results suggest that there remains a substantial reservoir of support for a leftist/socialist alternative to the ruling coalition and the liberal parties. Such a movement might emerge in Hungary if the leftist parties rally around a leader or find some other way of coordinating their efforts.[55]

The MSZP appears to be the likeliest candidate for leadership of the Hungarian left. The Social Democratic Party is wrought by fierce internal conflicts, and the MSZMP is widely distrusted by a significant portion of the working class. The poor electoral showing of the MSZP stemmed in large part from its recent Communist affiliations, a liability the party sought to overcome in a congress held shortly after the elections. The MSZP leadership utilized that opportunity formally to disassociate the party from Marxism-Leninism, defining it instead as a "social democratic-socialist" party seeking to fulfill the role of constructive opposition.[56]

But even if a leftist movement organized around the MSZP emerges, it seems quite unlikely that it would be able to impede or divert the rapid march towards a market economy. This reflects not merely the post-election convergence of the MDF and the liberal opposition parties on the overarching goal of a swift transition, but also the

[55] Tamas Kolosi, Ivan Szelenyi, and Bruce Western, "The Making of Political Fields in Post-Communist Transition: Dynamics of Party and Class in Hungarian Politics, 1989–90", Cornell Working Papers on Transitions from State Socialism, #90.7, 1990; Barnabas Racz, "Political Pluralization in Hungary: The 1990 Elections", *Soviet Studies*, 43:1 (1991), pp. 124–133.

[56] Racz, "Political Pluralization in Hungary", p. 127.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


fact that the dynamics of Hungary's economic reforms militate against the political activization of blue-collar labor, the linchpin of any credible left-wing challenge. The socioeconomic fallout of the privatization campaign, while not inconsiderable, has not been as severe in Hungary as in Poland and East Germany, thereby dampening working class opposition to the program. This in turn demonstrates the effects of the reforms undertaken in Hungary under the one-party system, which lessened the imperative of the kinds of massive restructuring needed to prepare state enterprises in other East European economies for privatization. While the MSZMP's New Economic Mechanism did not make a decisive turn towards a market economy, its cumulative effects did make a difference, serving to lower the economic costs and political risks of privatization for the successor regime. At the same time, the rapid expansion of opportunities for exit to the private sector has deprived organized labor of its most skilled and energetic members and sapped the general cohesion and political efficacy of the Hungarian working class. Privatization in Hungary has left a sizeable number of hard-core unemployed or underemployed workers. But they are geographically concentrated, and the only party which has made any serious efforts to mobilize their support is the old MSZMP, now marginalized and politically discredited.

## Compensation, Restitution, and Coalition Politics

The main threat to reform of ownership relations in Hungary, as it turned out, would come from the right. If Hungary's transition to multiparty democracy witnessed an eventual depoliticization of privatization policy, and hence an acceleration of the transformation of large-scale industry, it had quite different consequences for the question of reprivatization of land and church property seized by the Communist regime. The exigencies of coalition politics quickly transformed reprivatization into the most contentious issue confronting Hungary in the post-Communist period, with serious implications for the broader program of property reform.

The MDF's policy statements on the reprivatization issue during the campaign were consistent with its general political philosophy and sense of historical mission, described earlier. The communist regime had inflicted a great injustice on the Hungarian people during its forty years in power, and in particular on the peasantry. To accept the present status of properties confiscated by the Communists after 1948 as the legal starting point for Hungary's new democracy would be tantamount to a declaration that what the Communists had done was legally justified. To the extent possible under prevailing circumstances, Hungary should endeavor to redress that historical injustice.[57]

But while the Forum committed itself to some sort of program of reprivatization of nationalized properties, it did not endorse a specific method for achieving the goal of undoing the injustices of the post-1948 period. The issue at hand was the choice between (1) compensation, whereby individuals presenting claims on old properties

[57] Interviews, Hungarian Democratic Forum, May 1991.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


would be given transferable vouchers, and (2) restitution-in-kind, whereby the original properties would be returned to the owners or their descendants.

FIDESZ took an unequivocal stand on this issue. It was impossible to devise a restitution program which provided justice to all affected parties, and so therefore none should be attempted. The Hungarian peasantry wasn't the only group who had suffered an injustice, and the Communist party wasn't the only perpetrator; other groups (notably Jews and ethnic Germans) had been expropriated by non-Communists before 1948. And a compensation scheme was out of the question in light of budgetary constraints. The national interest would be best served by setting the reprivatization question aside and getting on with the more critical tasks of transforming the state sector and integrating the economy into the West.

The SZDSZ's position was more ambiguous. Like FIDESZ, it rejected restitution-in-kind as hopelessly impractical. Much of the land in question had been irrevocably changed by the establishment of the agricultural cooperative system, and restitution would prove a legal and economic nightmare. Insofar as compensation was concerned, the party was divided. Some of the SZDSZ's economists left open the option of a partial compensation scheme, arguing that an issue of vouchers might have a salutary effect on domestic investment and spur turnover of securities on the fledgling stock exchange. Others contended that a voucher system would not only place severe strains on an already tight state budget, but would have damaging effects on the national economy to the extent that liquidation of the vouchers raised domestic purchasing power, intensified inflationary pressures, and drove down the general prices of securities.[58]

On the right stood the Independent Smallholders, which organized its campaign around a single issue: "Return the land." The FKGP had a narrow electoral base, drawn mainly from the rural population and the elderly. It ended up capturing less than 12 percent of the national vote, slightly more than the MSZP. But, together with the Christian Democrats, whose policy program included a proposal for reprivatizing church properties, the Smallholders were able to maneuver themselves into a strategically vital position in the political field. The bitter exchanges during the campaign having ruled out a "grand coalition" of the center-right Democratic Forum and the liberal parties, the MDF leadership fashioned a coalition with the FKGP and the KDP.

The result of this marriage was a political fiasco. The MDF's campaign position on the reprivatization question, while clearly distinct from that of FIDESZ, was not greatly dissimilar from the position taken by the SZDSZ. It seems likely that an MDF/SZDSZ coalition would have reached some sort of compromise on a limited compensation program. But the coalition with the FKGP and the KDP forced Antall to the right, and the reprivatization law which the government ultimately pushed through the Parliament was an ambiguous mixture of compensation and restitution. Under the law, Hungarians who could prove direct descendant ownership as of June 8, 1949 would be awarded compensation coupons transferable on the securities market. The law implied that under some circumstances, the coupons could be used to repurchase the original property. Such repurchases would be unlikely in cases where the land had

[58] Interviews, Institute of Economics, Budapest, May 1991; Interviews, Hungarian Parliament, May 1991.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


been capitalized or otherwise significantly altered. In cases of open tracts of land where transfer of property to the original owner was physically possible, the law suggested that claimants could seek restitution-in-kind. In either case, the ambiguity of the law suggested that a large percentage of claims would be subject to lengthy and costly litigation. Beyond this, there was considerable uncertainty over what the compensation portion of the law would cost the Hungarian state. The Antall government announced that the maximum tolerable burden was HUF 90 billion; some economists estimated the cost of the voucher scheme at HUF 150 billion.[59]

And so at the same time as the government and the opposition were moving towards a modus vivendi on the problem of privatizing large-scale enterprises, the new law on compensation and restitution soured the political debate over reprivatization. The SZDSZ and FIDESZ charged that the Forum had caved in to pressure from the Smallholders and Christian Democrats on the restitution question in order to preserve the fragile coalition. The law, they claimed, would not only bust the budget, but would split rural communities by allowing rival contestants to the same property to present claims. The ultimate beneficiaries would be the lawyers who would handle the endless stream of litigation which would doubtlessly result from the law.

### *Impact on Small-Scale Privatization*

The dispute over the reprivatization law had important consequences for the government's program of transformation of small-scale enterprises. In the fall of 1990, the Parliament passed a law establishing the legal mechanisms for the privatization of state-owned retail stores, restaurants, catering establishments, repair shops, and other service establishments. The government's objective is to sell the more than fifty thousand enterprises that fall into these categories to economic work teams, limited partnerships, limited liability companies, and private entrepreneurs. The State Property Agency is charged with executing the sales through public auctions or tenders. Foreign investors are specifically excluded, the only such restriction in the legal code governing privatization and foreign direct investment in Hungary. The exclusion of foreign investors from the small enterprise sector is not a matter of great controversy: The MDF and the liberal opposition generally agree that, in view of the dominant position of foreign capital in large-scale industry, small-scale enterprises represent the best opportunity for promotion of domestic capital formation. And in any case, few if any foreign investors have exhibited much interest in that sector.[60]

That only a tiny handful of buyers have thus far availed themselves of the opportunity presented by the law reflects certain objective constraints on small-scale privatization which would obtain irrespective of the party in power or the political controversy over reprivatization. The key problem is weakness of domestic demand. Even high-income households possessing the requisite savings to purchase small businesses prefer higher-yielding assets, such as real estate. But the slow pace of the program

---

[59] Interviews, National Bank of Hungary, May 1991.
[60] National Bank of Hungary, *Market Letter*, October 1990.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


also demonstrates the highly confused structure of private rights in the small enterprise sector. The SPA and putative buyers would have to consider the claims of no fewer than three actors: (1) The large-scale monopolies which control the retail chains that form much of the small enterprise sector, (2) the local operators who lease the stores from the parent enterprise, and (3) the local municipalities which usually own the physical premises of the outlets. Until the ownership rights of these actors are clarified, it is unlikely that large numbers of Hungarian entrepreneurs will enter the market for small businesses.[61]

The dispute over reprivatization created even more uncertainty. Even if the SPA succeeded in resolving the rival claims of parent companies, operators, and local municipal authorities to the satisfaction of potential buyers, investors would have to worry about the possibility of other actors utilizing the reprivatization law to lay claims on the land on which the shops were situated. This is a consequence of the failure of the coalition's program to delineate clearly between compensation and restitution. The reprivatization law appeared to rule out restitution-in-kind for properties on which large factories, roads, and other public services had been constructed in the years since the nationalization of peasant properties. But this gave small-scale private investors little cause for confidence; purchasers of small shops could find themselves tied down for years in litigation with original owners or descendants presenting claims on the real estate.

## MDF's Clash with the Constitutional Court

The whole matter was further clouded in May 1991, when the Hungarian Constitutional Court declared the reprivatization law unconstitutional. The basis of the Court's ruling was that the law treated land as a special kind of property: It made a quantitative distinction by stipulating that expropriated land could be compensated up to HUF 1 million, while limiting compensation of non-lands to HUF 200,000. It made a qualitative distinction to the degree that it indicated that claims on land would under some circumstances be eligible for restitution, while claims on non-land would be limited to compensation via transferable vouchers. The Court declared that the Hungarian Constitution required that land and non-land be treated as legal equals.[62]

The Antall government thereupon introduced several technical changes in the law designed to meet the court's requirements: It blurred the quantitative distinction between land and non-land and modified the qualitative distinction by deleting the provisions relating to direct restitution-in-kind. The revised law would instead allow claimants seeking return of the original property to receive transferable vouchers which they could use in auctions to bid for the property. Claimants need only match the top bid to win the auctions. The most important legal restriction applied to claimants who elect to pursue restitution in lieu of compensation is that they must till the land if they succeed in winning the auctions.

[61] Interviews, Hungarian Parliament, May 1991.

[62] Interviews, National Bank of Hungary, May 1991.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


The Court's objections now satisfied, the law entered into force in early summer of 1991. By the end of October, some 180,000 individuals had submitted claims. Faced with increasing political pressure from his coalition partners, Antall agreed to extend the deadline.[63]

## Conclusion

All three spheres of Hungary's privatization program illustrate the impact of structural determinants inherited from the Communist rule and voluntary choices made by the new government against the backdrop of coalition politics. Property reforms undertaken during the pre-1990 period established the legal, institutional, and economic framework for large-scale privatization which would place the successor regime at a strong comparative advantage vis-à-vis its counterparts in the rest of Eastern Europe. Ironically, it was precisely the rapid pace of movement in the property sphere during the lame-duck Nemeth Administration which contributed to the sharpening of the political debate between the contestants to succeed the MSZMP, with the nascent parties engaging in a spirited and sometimes acrimonious discussion of the state's role in the process and the visibility of foreign capital. But the post-election period saw the emergence of a working consensus between the MDF and the liberal opposition that belied the hyperbolic tone of the campaign. At the same time, the collapse of the left and the rapid growth of the absorptive capacity of the private sector served to diffuse the potentially explosive issue of socioeconomic dislocation of blue-collar labor.

By contrast, the transition to multiparty democracy served to heighten political discord and socioeconomic tensions over the question of reprivatization. In contrast to the situation in Poland, the collectivization of agriculture and nationalization of church property after 1948 meant that reprivatization would be a major issue on the political agenda of the successor regime in Hungary. As with large-scale privatization, the policy positions of the MDF and the major liberal party, the SZDSZ, on the reprivatization issue revealed sufficient common ground for a compromise solution, which would have probably assumed the form of a modest compensation program. But this grand coalition did not come to pass, leading the MDF to forge an alliance with two marginal parties whose platforms were based on uncompromising insistence on restitution of expropriated lands and church properties. The upshot was a reprivatization law which offered an ambiguous mixture of compensation and restitution, raising the specter of endless legal and political disputes that threaten the other elements of Hungary's privatization campaign.

---

[63] Information concerning recent developments in the Hungarian reprivatization program comes from Jozsef Borocz, "Social and Political Obstacles to Privatization", Roundtable Discussion at the annual convention of the American Association for the Advancement of Slavic Studies, Miami, Florida, November 1991.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371



*JANUSZ M. DABROWSKI*
*MICHAL FEDEROWICZ*
*ANTHONY LEVITAS*

# The State Enterprises in the Process of Market Creation in Poland*

## The Macroeconomic Aspects of Stabilization

Till the end of 1989, Polish state enterprises operated within the typical conditions of the economy of shortage, characterized by reglementation of goods and resources, centrally controlled prices, developed system of consumer and producer subsidies, and the like.The main interest of the state firms has been the achievement of political and financial support from the central authority. Because of economic paternalism of the state, the enterprises have never been afraid for their survival or development, and a satisfactory growth of wage fund was the main objective of their economic and social activity. This informal but dominating goal of operation has been proved by many researchers.[1]

In January 1990, the Polish government began an economic program whose stated aim was to create as quickly as possible a market economy based on a "normal European property structure." Reformers conceived of the transformation as a sequential process composed of three elements: stabilization, privatization, and industrial restructuring. the government's main energies were focused, however, on ending the hyperinflation that had begun in August of 1989. Little progress was made in privatizing state manufacturing enterprises.

The stabilization program slashed consumer and producer subsidies, froze central investments, raised interest rates, and made the zloty exchangeable internally. Most important, enterprises were free to set their own prices for the first time, while wages remained centrally controlled through a punitive tax system. On the one hand, by freeing prices, tightening fiscal and monetary policy, and opening the economy, the government hoped to subject Polish enterprises to the discipline of the market. On the other hand, by holding wages down during liberalization, the government hoped to reduce inflation rapidly and to control the tendency of state enterprises to maximize wages.

The effects of the stabilization program on the price level have been positive but inconclusive. Inflation for the year ran at about 250 percent. Prices rose by 132 percent in the first quarter, 17.4 percent in the second, 10.3 percent in the third, and 17.4 per-

---

* The empirical research for this project was made possible by grants from the Polish Ministry of Education and the German Marshall Fund of the United States. We thank our colleagues at the Gdansk Institute for Market Economics and at the Labor Market and Firm Adjustment Group. Extremely helpful comments on earlier drafts of this paper were provided by Urszula Grzelonska and Joshua Cohen.

[1] J. Kornai, Economics of Shortage (Amsterdam, 1980); J. Beksiak, ed., *Zarzadzanie przedsiebiorstwami-uczestnikami rynku dóbr konsumpcyjnych*, vols. 1 and 2 (Warsaw, 1978), vol. 3 (Warsaw, 1983), vol. 4 (Warsaw, 1990); E. Balcerowicz, *Przetarg planistyczny* (Warsaw, 1990).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

cent in the fourth. The price shock of the first quarter was considerably higher than government forecasts, and the apparent stabilization of the economy during the second and third quarters was faster than expected. The rise in inflation in the fourth quarter accompanied a weakening of state financial discipline and an increase in wage pressure.[2]

Over the year, production fell an estimated 23 percent and the GNP some 12 percent. In the first quarter, production in the state sector declined an estimated 30 percent. Demand and output began to rise in the third quarter. At the same time, however, the expansion was accompanied by a loosening of credit and wage policy. The private sector grew 17 percent and its share in the non-agricultural GNP has increased from 8 percent to 12 percent. Living standards declined between 15 percent and 20 percent and personal savings fell an estimated 60 percent.[3]

Unemployment increased from "zero" to over 1.1 million persons. Unemployment significantly exceeded the stated expectations of the government, but was considerably lower than World Bank estimates. Employment in the state sector declined by 17 percent (in the state industry, 14 percent), while it increased by 20 percent in the private sector (350,000–400,000 persons).[4]

Despite continuing inflation, the exchange rate remained stable all year. Undervaluation, the fall in domestic demand, and the collapse of Eastern markets pushed and pulled exports to the West, which grew 40 percent. Western imports rose 1.3 percent. Imports of investment goods rose a brisk 30 percent, while foreign consumer durable purchases declined by 25 percent to 35 percent. The rise of exports and the stability of imports produced a trade surplus of 5 billion dollars. The rise in exports testifies to at least a moderate ability of Polish firms to compete on Western markets.

The positive effects of the stabilization program can be summarized as follows. The hyperinflation of 1989 was stopped and product markets approached equilibrium. Supply problems for both consumers and producer goods have radically decreased. Market equilibrium, stabilizing price levels, and the removal of entry barriers encouraged the rapid growth of the private sector, particularly private trade. State enterprises have streamlined their employment profiles and increased exports. On the negative side we find steep declines in wages, living standards, and production, and dramatic increases in unemployment, particularly in rural regions. There has been little progress in privatizing state manufacturing enterprises, marginal improvements in the banking sector, and increasing signs of renewed inflation.

Between these positive and negative effects of the stabilization program lie the state manufacturing enterprises that provide the overwhelming share of production and employment in Poland. Any assessment of the viability of the reform process must be based on the performance of this sector.

---

[2] "Komunikat o sytuacji gospodarczej w roku 1990", *Rzeczpospolita*, February 2, 1991.

[3] L. Zienkowski, ed., *Recesja i drogi wyiscia* (Warsaw, 1990); I. Topinska, *Crash Stabilization from the Point of View of the Household Budget* (Princeton, 1990).

[4] Statistics from GUS, Glowny Urzad Statystyczny (Main Office of Statistics).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


**The Structure of State Firms in 1990**

The juridical status and sociological composition of Polish state enterprises have changed radically, beginning with the summer strike of 1988 and continuing through the relegalization of Solidarity in June 1989. The main role was played by the passage of a new State Enterprise Law in March 1990. This law clarified the rights of the firms vis-à-vis the state and strengthened the managerial role of the Employee councils that now acquired the full authority for hiring and firing managers and veto powers over the strategic decisions of the firms, including decisions regarding privatization.

Given the difficulties of privatizing large numbers of state enterprises under virtually all scenarios, this novel situation is liable to remain in practice for the foreseeable future. Not surprisingly, however, the structure of industrial authority is still in flux and it remains too early to speak of a "post-Communist" industrial relations system. The relative power and functions of management, the Employee Councils, and the unions have yet to settle into a "standard practice," and different patterns are emerging in different sectors of the economy.

During the first months of the stabilization program, organized labor did not strike out blindly at factory managers for their past political allegiances or for the immediate hardships presented by the stabilization program. Indeed, surprisingly few industrial conflicts were over wage issues. Instead, shop floor disputes centered around managerial capacities to adjust to the new environment. In our first round of research, we found that disputes over management generally facilitated rather than blokked firm adjustment.[5]

Between the relegalization of Solidarity and the end of December 1989, Factory Committees of the union re-formed in most firms, and in some, the Factory Committees forced early reelections of management-dominated Employee Councils and some of these Councils in turn moved to fire managing directors and began the process of replacing them through the open competitions legally required.

In twenty-three of our fifty firms, new managing directors have been named since the spring of 1989, about a third elected before the stabilization program began. Generally, the Councils and the unions – particularly Solidarity – argued that the existing management was slow in adjusting to the new environment. Council and union leaders often claimed that employment reduction and pay reform were insufficient to insure firm survival and that the old management was afraid to change existing structures for fear of being thrown out by the workforce. In twenty of the twenty-three cases where managing directors were fired, the change was regarded as positive, even if the new managers did not fulfill all the expectations of the workforce. In only three cases was the decision questioned after the fact.

Moreover, the replacement of managing directors facilitated rather than blocked enterprise adjustment. Deep organizational reform was always associated positively with the appointment of new managing directors. Conversely, weak or no reform

---

[5] J. M. Dabrowski, M. Federowicz, and A. Levitas, "The Behavior of State Enterprises: The First Six Months of 1990", Working Paper Series on East Central Europe, Harvard University, 1990.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


more frequently took place under incumbents. New directors, in short, were more able than old ones to make changes in the operation of their firms.

Nonetheless, this was not always the case, and 25 percent of newly elected directors made no significant reforms. Moreover, it must be stressed that in close to two-thirds of our firms little or no overall improvement was made. In most cases, both management and labor were passive, and failure was not the product of open warfare. In the cases where reform was blocked by one or another actor, it was as often management as it was labor who did the stonewalling.

Large enterprises almost always began reform only after serious difficulties had been encountered and their financial reserves were exhausted. In small and medium firms, more than half of the "deep" or "significant" reforms were made before the onset of financial difficulties. A few firms initiated changes in 1989, or during the first quarter of 1990. The largest wave of reform began during the second quarter of 1990 after the election of new Employee Councils.

In small and medium firms the unions and the Councils compete with each other over how to save jobs and firms. In general, this competition insures that management has at least some allies for firm restructuring among organized labor, and while management typically leads adjustment efforts, the most successful cases of reform have been characterized by cooperation between management and labor. In large enterprises, however, real adjustment inevitably means disturbing the interests of large numbers of workers. With or without changes in management, it is much harder here for the representatives of labor to make compelling arguments about immediate sacrifices insuring the greatest gain for the greatest number. And conversely, it is much more dangerous for management to take upon itself the risks of radical reform.

The increased autonomy of state enterprises has facilitated the break-up of some large firms, however. In 1990, 950 divisional organizations were made independent enterprises and the number of state firms has increased from about 7,600 to 8,700. Some of the new firms had previously wanted to operate independently, but were refused autonomy by higher administrative units, and some have emerged when large enterprises have cut loose unprofitable divisions and streamlined operations. This latter type of decentralization is a completely new element on the industrial scene.

Along with managerial autonomy, firms have acquired the right to sell or lease up to 10 percent of their assets without ministerial approval. Some 30 percent of the firms in our sample have sold or leased physical assets. Some enterprises leased underutilized production and office facilities to private firms while others sold vehicles and machines to their employees. The transfer of physical assets to other state firms is rare. Some large enterprises are giving unused buildings and land to local governments to reduce tax burdens, and are renting out non-productive assets.

Little progress has been made in privatizing entire enterprises, however. In July – after stormy discussion – privatization legislation was passed. The new law allows for a wide variety of property transformations – including the state give-away of shares – but does not specify their application. For firms, the uncertainties regarding privatization remain high.

Nonetheless, 20 percent of the firms in our sample had begun to develop plans to privatize themselves. These plans were typically the work of small group of people assigned to review the possibilities for property transformation. Frequently they invol-

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

p0063371


ved discussions with the entire workforce, for some element of worker ownership is always a part of these plans. All respondents stated that ignorance and rear will make privatization a lengthy and difficult procedure. Some 60 percent of the firms, however, tried to find foreign partners for joint ventures and three (six percent) had signed contracts. In two, the deal involved divisional offices and not the entire enterprise.

In sum, 1990 had been a rather paradoxical year for privatization. On the one hand, the government repeatedly stressed that rapid privatization is a necessary precondition for lifting wage controls and initiating substantial restructuring efforts since, without new owners, state enterprises cannot be trusted to limit wage growth or responsibly make use of investment capital.[6] On the other hand, there has been limited progress in transforming the property structures of firms and it has become clear that this process will be long and difficult.

## The Performance of State Firms in 1990

The primary goal of the stabilization program was to introduce demand barriers into the Polish economy by simultaneously freeing prices, tightening fiscal and monetary policy, and opening the economy to foreign goods. Confronted with demand barriers, state firms would have to adjust by reducing the costs of production, changing production profiles, and finding new markets. Ultimately, firms that proved incapable of adjusting would be forced off the market while scarce capital would be redirected to dynamic firms.

After a year of operation, the stabilization program has had mixed success. On the one hand, it is clear that at least some state firms have adjusted to market pressures, at a minimum streamlining operations at home and increasing exports abroad. On the other hand, these adjustment efforts in general remain limited in both depth and scope. Moreover, the number of bankruptcies has been trivial and the allocation of capital remains haphazard and capricious. The reforms, in other words, have yet to create the institutional or market mechanisms capable of distinguishing winners from losers.

Some of the reasons for this are relatively simple: the structures, resources, and obligations that enterprises brought to the stabilization program were largely bequeathed to them by the old regime. The capricious mixture of "endowments" they inherited meant that the initial consequences of liberalization were almost as capricious and independent of firm efforts as the endowments themselves. Some of the reasons are more complicated, however, and relate to the monopolization of the economy, and the ability of socialist firms to operate as highly inefficient zombies, unable to turn a profit but able through various maneuvers to keep paying their bills.

---

[6] This view was stressed by such authors as J. Lewandowski and J. Szomburg, "Transformation Model of Poland's Economy", Papers on Economic Transformation, No. 1 (Gdansk, 1990) and rejected by such scholars as R. Bugaj and T. Kowalik, *W Kierunku gospodarki mieszanej*, Zycie Gospodarcze, 1990, No. 37.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


*Financial Performance*

In the first months of 1990, as inflation skyrocketed and sales collapsed, the average profit rates (calculated by subtracting the costs of production from the value of sales and then dividing the residual by the costs of sales) of Polish firms remained stable at about 40 percent. The unexpected maintenance of profitability rates during the first quarter was the first surprise of the stabilization program and was caused by four factors. First, many enterprises entered the new year with inventories purchased at pre-stabilization prices, and so their costs of production during the first quarter were extremely low compared to the prices they then charged for their goods. Second, centrally imposed limits on wage growth meant that the share of pay in production costs dropped from an average 11 percent to 12 percent in 1989 to 7 percent in January 1990, while at the same time firms virtually ceased borrowing from state banks.[7] Third, the new exchange rate brought immediate increases in profitability for firms with even marginal exports. Fourth and most important, enterprises – now free to raise prices as they saw fit and expecting increases in the costs of their inputs – choose astronomical price levels for their products in an attempt to insure that they would not be caught on the wrong end of the inflationary spiral.

Over the course of the year, and in line with expectations, average levels of profitability fell and evened out. Some correction of monopoly practices was exacted by imports and/or the threat of them. Firms with particularly high levels of profitability in the beginning of the year (above 50 percent) suffered more dramatic declines than firms that began with lower profit rates. And firms that began the year with extremely low profit rates (5 percent to 20 percent) slowly but systematically raised this indicator. nonetheless, the initial price response of Polish firms allowed some enterprises to accumulate vast financial reserves, which insulated them from subsequent market pressures.

In our sample, overall profitability levels moved fairly characteristically between 1989 and 1990. In 1989, they averaged around 45 percent, with the highest rates obtained by medium-sized enterprises and the lowest rates by small firms. In the first half of 1990, the profitability fell on average by about 10 percent, but – also characteristically – the fall was not even. Medium-sized firms saw profit rates fall by 4 percent and small firms, 7 percent. Large enterprises suffered a more dramatic fall of 15 percent. During the second half of the year, moreover, the profitability of large firms continued to fall by 4 percent while in medium-sized firms it fell further by only 1 percent. The low profitability of many large monopolists after the first quarter suggests that ultimately demand barriers imposed limits on the prices they could charge for their products, while simultaneously they proved most incapable of lowering the overall costs of production.

Medium-sized firms found themselves in the best financial situation by the end of 1990. Their financial condition in comparison to 1989 did not undergo a significant deterioration. Small firms, and most importantly large firms, generally saw their financial position weaken. The privileges with which large firms operated have been redu-

---

[7] B. Wyznikiewicz, *Sruba,* Gazata Bankowa, 45 (1990).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

p0063371


ced. In the past, their financial well-being was achieved not through their efficiency, but because their political importance allowed them to manipulate the prices they paid for inputs and charged for outputs. In the new situation, their adaptation was slowest though many managed to accumulate windfall profits at the beginning of the year. The financial condition of small firms was poor, but it is important to note that they were also in the most difficult financial situation at the start of the year. It is worth underlining that the fall in profitability between the first and second halves of 1990 in small and medium-sized firms was insignificant.

The inter-firm arrears and especially their scale are the new and very important effect of firm adjustment in 1990. High levels of inter-firm debt continue to plague both the real economy and assessments of firm performance. Borrowing between firms remains a source of inflationary pressure and allows marginal enterprises to muddle on. Attempts to reduce debt levels by making state credit available for the payment of inter-firm arrears and by raising the interest rates on inter-firm borrowing have not been particularly successful. Indeed, the overall level of inter-firm borrowing has not been reduced and, relative to monthly sales or profits, it has actually risen during the last year. On average, firms owe to other firms between one to two times the value of their monthly sales.

Nonetheless, the average figures mask significant differences across firms with relation to inter-firm borrowing. Currently we can distinguish three groups of enterprises with different approaches to the problem. The first group is composed of firms who do not have serious financial problems, have high levels of cash reserves, and are not encountering difficulties in the sale of their goods. Their strong financial position makes it unnecessary for them to pressure debtors for payment. These firms continue to allow others to buy on credit. The level of debts owed to them is growing continually (they are owed 1.5 to 2 times more than they owe).

The second group is composed of firms whose financial situation is not bad, but who do not possess large financial reserves. To function normally they require steady cash flows and regular payments for goods sold. It is these firms that are trying to reduce the overall level of debt owed to them by demanding interest payments on unpaid arrears, withholding deliveries, and accepting only bank checks. Most of the 10 percent of state enterprises who sold debt to third parties come from this group. And it is these firms who most frequently agree to write off interest payments on arrears if debtors will immediately payoff the principal, or place orders whose value is significantly higher than the interest owed on earlier purchases.

The third group is composed of enterprises that either have had or continue to have serious financial problems. Their debt obligations exceed what is owed to them and are systematically growing. For them, inter-firm borrowing is the simplest way to save themselves from being unable to make payments to the state budget, banks, or to their workers. These firms do try to pay the interest payments on their debts, however, if for no other reason than to be able to borrow in the future. These firms are responsible for increasing the overall level of inter-firm debt.

It should be stressed that the role of informal creditor is generally filled by financially healthy firms (average profitability near 50 percent) while the role of borrower is most often filled by firms that have profitability rates near or below 20 percent. In short, the weak are desperate for help, and the strong do not particularly care about

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371



repayment. From our observations of inter-firm arrears along the dimension of firm size, it appears that medium-sized enterprises are more frequently creditors than debtors. More than 50 percent of these enterprises credit other firms, while they least frequently borrow heavily. Conversely, large firms are most frequently heavy borrowers and more than half of them are being subsidized by others.

It should also be stressed that the structure of credit had changed dramatically in 1990. Short-term borrowing to relieve cash flow problems has increased and investment loans have fallen by about ten percent. Firms borrow for investment only if the capital outlay is small and the expected returns quick. Firms prefer to borrow from such institutions as the Development Bank, the World Bank, and from other firms rather than from the newly commercialized state banks. By the fourth quarter we encountered more and more suspect loans, and a number of firms that were clearly performing well had been refused credit repeatedly.

In forty of our fifty firms, we were able to establish the dynamics of borrowing across the entire year. Twenty-one firms (53 percent) increased their borrowing during the year, twelve firms (30 percent) reduced their bank obligations, and seven (17 percent) kept their bank debts stable. Thus far there seems to be no correlation between firm or branch size and changes in the levels of borrowing at state banks over the last year. In other words, banks continue to lend to the same clients and, despite declarations of restraint, firms have begun to make use of state loans at levels not significantly different from those of previous years.

On the negative side, firms in poor financial condition are making more use of state loans than healthy firms. The levels of borrowing are correlated with profitability levels. The vast majority of firms in poor economic situations (profitability below 15 percent) expanded their borrowing during 1990. Firms with average or slightly above average levels of profitability increased borrowing a little more frequently than they reduced it. Firms with high profitability indicators reduced borrowing as often as they expanded it. In short, borrowing continues to subsidize minimal survival and does not promote development.

### *Production and Sales*

During 1990, sold industrial output fell by 23 percent, state sector production declined an estimated 25 percent, and private production increased an estimated 8 percent. The decline was steepest in light industry and food processing (40 percent and 30 percent) and mildest in the oil and energy industries (10 percent) and metallurgy (20 percent). The decline was fastest during the first quarter of 1990. Production continued to fall through may, but at slower rates. In our sample population, output fell between 20 percent and 60 percent in the first half of 1990. It was steepest (40 percent to 60 percent) in the textile, shoe, apparel, and electronics industries. In short, the recession hit consumer durables producers much harder than it hit others.

Price increases were the principal method firms employed to insure themselves against the uncertainties caused by liberalization once controls were lifted.

During the second quarter, production continued to fall but at slower rates. Some firms lowered prices a little between March and May. From June through September

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


production levels stabilized, as did prices. From September on, however, prices, production, and demand began to rise across all branches. Fourth-quarter price hikes were steepest among monopolists, and a few firms blatantly restricted output to maintain price levels even when reductions would have increased sales and gross profits. In firms operating on competitive markets, price rises were delayed longer and were proportionately lower than elsewhere.

The movement from a seller's to a buyer's market is represented by the fact that only 10 percent of the firms in our sample said they still had major problems buying domestic inputs. Nonetheless, during the second half of the year, firms began to note difficulties in purchasing steel and chemical and paper products, and 25 percent of our sample said that monopolists continue to dictate prices and play fast and loose with deliveries.

Despite the continuation of monopoly practices, negotiating prices has become more widespread than ever before. In competitive sectors, producers now pay serious attention to their clients' product needs and delivery requirements. Firms changed suppliers in only 25 percent of our sample. Moreover, these changes have been concentrated in the trading sector as firms responded to the collapse of wholesale trade by trying to buy directly from producers.

Most firms have created new marketing and sales divisions. Consumer durables producers very quickly organized the street sale of their products, developed consignment systems, and opened factory outlets. Others attracted buyers through rebate and installment plans. Most important, there was a rapid rise in the number of small private buyers during the second half of the year. In 20 percent of our firms, sales to private buyers had become a significant percentage of overall sales (a year earlier such buyers were rare). About 20 percent of our firms started to research potential markets, and a number of enterprises have made efforts to improve the packaging of their goods. Print advertisements are now fairly common, radio and TV campaigns decidedly less so. For the vast majority of firms, however, marketing and market research is a completely new area of activity. Radical attempts to improve performance on this front, as with the organization of retail and factory sales, has been limited to firms operating under competitive pressure. Among monopolists almost no attempts were made to find new clients. For them, the main problem remains how best to manipulate prices to keep both production and profits at an acceptable level.

According to our observations, small firms have reacted to the fall in domestic demand by trying to activate domestic markets, but they have been unable to expand exports. Large firms, on the other hand, have made little effort to improve sales domestically and instead have concentrated on winning foreign markets. Larger firms have the resources and contacts. Curiously, the frequency with which monopolists and large firms operating under competitive pressures attempt to increase exports seems to be virtually identical.

Polish firms have succeeded in expanding exports considerably during the last year. Again, this must be counted as one of stabilization's more positive effects. Dollar exports increased by 40 percent over 1989. State sector exports grew 10 percent and private sector exports grew 200 percent.[8] The growth has been stimulated by the collapse of domestic demand and the undervaluation of the zloty.

[8] Komunikat

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


While there has been considerable change in the sales and marketing behavior of Polish firms, there has been virtually no change in product lines. In our sample, only five firms had initiated such projects and none had yet realized them. Given the scarcity and cost of capital, the lack of knowledge about external markets, and shortages of skilled labor, this is hardly surprising.

Firms did shift existing assortments to meet market demand, however. Generally, the proportions of existing production were altered by reducing or eliminating the output of some goods and increasing that of others. Less frequently, firms made minor improvement on old goods using the same machines and workers. Small adjustments of both sorts were most frequent in firms producing consumer durables or operating under strong competitive pressure.

Our observations indicates that 46 percent of small firms made some changes in the actual goods they produced, while medium and large firms undertook such changes in only 21 percent and 23 percent of the cases. Adjusting output levels within the existing assortment took place in 38 percent of small firms and in only 16 percent to 18 percent of the larger enterprises. Similarly, monopolists changed their production profiles considerably less frequently than firms in competitive situations and adjusted the output levels of existing assortments to meet shifts in demand a little less frequently. In short, small firms adapted to market pressure more flexibly than large firms and monopolists.

All firms found it extremely difficult to reduce the costs of production. Attempts to modernize production and to reduce energy and material usage were limited. They occurred only when large capital outlays were not necessary. Twenty percent of our firms closed plants or eliminated entire production lines. Wages as a share of total production costs fell sharply from the already low levels of 1989, but the gains here were eaten up by increased capital and material costs.

### *Employment*

During the first half of 1990 the average monthly reduction of employment in the state sector was 1.15 percent (in state industry – one percent). In the second half of the year, however, as output slowly increased, firms laid off workers more aggressively. The monthly average reduction of state sector employment rose to 1.55 percent (in state industry – 1.25 percent). By the end of the year, state sector production had fallen by 23 percent and state sector employment by about 17 percent (in state industry – 14 percent).[9]

Employment fell more rapidly in small firms than in medium and large ones. Two-thirds of small firms reduced employment by more than one percent monthly and one-third by more than two percent monthly. Among large firms only one in six decided upon radical reductions of employment and only half of them reduced employment by more than one percent monthly.

[9] GUS: Biuletyn Biura Ochrony Pracy, *NSZZ* Solidarnosc – Warsaw, No. 9, October 1990.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


The faster reduction of employment in small and medium firms is explainable by two distinct factors. First, market pressure is generally stronger for these firms than for larger ones whose cash reserves or monopoly positions allow them to maintain employment levels. Second, in smaller plants it is easier to convince internal actors that immediate sacrifices are necessary to insure long-term survival.

In the thirty-two firms where we were able to determine the relative proportions of blue-collar to white-collar firings, we found sixteen cases in which blue-collar firings were disproportionately higher than white-collar hirings, four cases where the opposite tendency prevailed, and eight cases where the firings were more or less equal relative to the numbers employed in both categories. This suggests that most enterprises reacted to the fall in demand principally by firing blue-collar workers. Given the overbuilt supervisory structures and high percentage of bureaucratic positions in state firms, this tendency is not encouraging. It also suggests that the unions are not as powerful as many believe. Relatively rarely was employment reduction accompanied by complex attempts to rationalize the overall structure of employment.

Despite a certain corrective tendency in the last five months, the "gap" between the fall in industrial production and the rise in unemployment remains wide. It must be remembered that state sector employment has declined by 13 percent, even if the unemployment level has only reached 6.3 percent. The most important reason for the difference is the dynamic growth of the private sector. Retirement rates have also been higher than normal because of incentives put in place by the state this year. In most cases, the decline is at least partially compensated by new hires, at once making state enterprises younger and reducing their wage bills.

### *Wages*

One of the most striking features of the first six months of stabilization was the incredible wage restraint exercised by firms and workers. While real wages dropped by 38 percent, strikes were exceedingly rare at thirty and only a small percentage of firms exploited the maximum limit on their wage norms (10 percent in our sample).[10] Most remarkably, the vast majority of firms (80 percent) came in significantly under these norms and only a handful of firms paid tax penalties for exceeding their wage limits.

For some firms, particularly in textiles and other consumer durables, wage restraint was dictated by the rise in material costs, the collapse of sales, and the high price of credit. These enterprises lacked the cash to make full use of their permissible wage limits, let alone exceed them. The majority of firms, however, experienced a real increase in both profits and financial reserves. This unexpected rise in profits, profitability, and cash holdings was caused by massive price hikes in goods made with materials purchased at pre-stabilization prices. These firms, despite their unexpected financial gains, still chose not to raise wages above the taxable norms during the first six months of 1990 and generally paid out less than their norms allowed them.

In other words, some state firms did not raise wages to the permissible limits

[10] Zienkowski, *Recesja*

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


because they could not afford to, while other enterprises could afford to raise wages, but chose – at least initially – not to. For the former group of firms, wage restraint was not dictated by the wage tax system, but by their liquidity problems. For the latter, and more interestingly, the under-shooting of the permissible norms suggests that considerations other than the tax were responsible for wage moderation.

Initially, it seems, fear of bankruptcy and unemployment inclined both managers and workers toward a wage restraint greater than that required by the tax system during the first half of 1990. By July 1990, however, the number of firms willing to approach or cross the taxable norms increased visibly. The payment of profit premiums for 1989 in April 1990 slowed if not stopped the radical fall in demand that had characterized the early months of the stabilization program. The July decision of the ministry of finance to expand the indexation coefficient, along with "corrections" in agricultural and credit policy, signaled to managers that the worst was over. Managers of troubled firms saw that their own short-term survival could be insured through price increases, inter-firm borrowing, and moderate adjustment strategies, and the much feared wave of firm failures never materialized. In fact, after a year of stabilization only a handful of firms were in receivership.[11]

## Conclusions

A year of empirical research on the adjustment patterns of Polish state enterprises makes three basic points. First, stabilizing prices, the appearance of demand barriers, and tighter financial discipline for firms has improved the performance of the state sector. It should be noted that, in general, state firms have accepted sufficient responsibility for themselves to allow markets to approach equilibrium, and at a minimum have not dismembered the state's attempt to impose financial discipline on the economy as a whole. The firms are now thinking at least in terms of balancing incomes and expenditures and have reformed some of their business practices. Change has occurred most frequently in the area of sales and employment reduction; less often in the way firms structured their wages, debts, and production profiles.

Second, despite this improvement, stabilization has yet to create either the institutional or market mechanisms capable of distinguishing good firms from bad, and it has done little to improve the allocation of scarce capital and to help firms restructure their operations. The failure is most apparent in the state's unwillingness to get involved in restructuring the bad debts held by commercial banks. Without rewriting the balance sheets of the banks, it is unreasonable to expect them to pass along to firms the hard budget constraints of the state because bankrupting debtors simultaneously means that the bank must bankrupt themselves. Rewriting the balance sheets of the banks will require political determination of how losses are to be economically and socially absorbed.

Third, the structures and expectations that firms bring to the reform process critically affect their adjustment patterns, and the macroeconomic indicators do not cap-

[11] M. Oblicki, *Likwidowac czy poczekac*, Tygodnik Solidarnosc, No. 39, 1990; Zienkowski, *Recesja*.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


ture significant differences in the behavior of firms along the dimensions of size and sectoral monopolization. The internal structure of firms, their expectations, and the differences in firm behavior across size and sector must be appreciated if we are to avoid simplistic characterizations of the state sector's reactions to marketization and to avoid policy mistakes based on uniform characterizations of this sector. In particular, we argue that small and medium Polish enterprises are adjusting more dynamically than their larger counterparts. Given the slow process of privatization, these enterprises must be identified and aided in their adjustment efforts now, while more aggressive efforts must be made to bankrupt marginal firms. At the same time, the state must figure out some way to withdraw from centrally regulating wages.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371



*Zhiyuan Cui*

# Recessionary Bias of Polish Stabilization in 1990: Perspectives from the Economics of Incomplete Markets

On September 12, 1989, the first post-Communist government took office in a Poland that was dissatisfied with past economic performance and concerned about accelerating inflation.[1] This government prepared an extensive stabilization program, known as "Balcerowicz Plan," which was put into effect on January 1, 1990.[2] It emphasized balanced budgets, tight credit, wage control in the state sector, drastic elimination of subsidies, liberalization of almost all prices, devaluation and fixing of exchange rate and so forth. The preliminary results were encouraging, for inflation slowed even though prices initially rose more than forecast by the government.

Due to its comprehensive and drastic nature, the "Balcerowicz Plan" was also termed the "shock therapy," "big bang," or "cold turkey" approach. Naturally, this plan caught the attention of the other Eastern European countries and the Soviet Union. What lessons could these countries draw from the Polish stabilization experience? Should they follow suit? Or should they make substantial revisions?

The orthodox theorists of the International Monetary Fund-type stabilization program tried to standardize the program. Abraham Maslow once said that if the only tool you have is a hammer (in this case, neoclassical economics, especially its monetarist version), everything begins to look like a nail. This Polish "shock therapy" drew mixed reactions in other Eastern European countries. Of course, radical economists, like Janos Kornai, are in favor of Polish-like stabilization in their own countries.[3] But different voices are often heard. Among academics and politicians, the debate is heated between proponents of "soft-landing" and "fast-landing." For example, Gyorgy Matolcsy, Hungarian Prime Minister Jozsef Antall's chief economic adviser, announced at the press conference on October 30, 1990, that Hungary needed a similar "shock therapy." This event triggered a heated debate between him and Minister of Finance Ferenc Rabar, who believed that the economy could not withstand the shock of a radical cure and thus favored a cautious gradualist approach. The result of this debate was that both Matolcsy and Rabar resigned in late 1990.[4] Another example is

[1] In the first half of 1989, inflation in Poland accelerated to about 8 percent per month, corresponding to a yearly rate of 150 percent. In August, the monthly rate rose to 40 percent. In the last quarter of 1989, due to reductions in budgetary expenditures and the issue of bonds, inflation slowed down slightly, resulting in an annual rate for 1989 of 740 percent. The figures are cited in *European Economy* 43 (March 1990), p. 171.

[2] This plan was put forward at the International Monetary Fund Assembly in Washington in September 1989 by Leszek Balcerowicz, Minister of Finance in the new Polish coalition government.

[3] The Balcerowicz Plan was strongly influenced by the advice of Jeffrey Sachs, a Harvard economist who had also served as an adviser to the Bolivian government in its 1985 stabilization effort. Kornai said that he and Sachs are in complete agreement in every aspect of the stabilization program. *See Brookings Papers on Economic Activity* 1 (1990), p. 137.

[4] See *Report on Eastern Europe*, January 11, 1991, p. 13.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


from the Soviet Union. The well-known Shatalin's "500-day plan" clearly had the flavor of the Balcerowicz Plan. But he was accused by the conservative think tank, "Experimental Creative Center" (ECC), as an "agent of imperialism."[5]

To analyze the merits and demerits of the Polish stabilization plan, from the perspectives of the economics of incomplete markets and the lessons of the Latin American experiences, the Polish stabilization plan is just another application of the "standard dose" of IMF medicine for stabilization, already applied to Latin America.[6] The reason for resorting to the economics of incomplete markets is that even though the recessionary bias of the standard stabilization program has been widely recognized, the program cannot be redesigned successfully without a theoretical breakthrough in understanding the real mechanisms of market operation.

## A Brief Outline of the Polish Stabilization Plan in 1990

According to Jeffrey Sachs, Polish stabilization was to be achieved by a set of five mutually reinforcing policies aimed at reducing aggregate demand and anchoring the price level.[7] The elements are: First, budget balance would be quickly restored by a sharp cut in subsidies and investment spending. Second, the growth of net domestic credit of the banking system would be tightly controlled, partly through a sharp increase in interest rates in the banking system. Third, the exchange rate would be devalued and made convertible, and then stabilized at the new depreciated rate. Fourth, the nominal wage growth would be limited through a tax-based policy designed to limit the rate of increase in the wage bills of state enterprise. Fifth, prices would be liberalized, except in certain regulated sectors (such as public utilities) where there would be a sharp, one-time adjustment.[8]

More concretely, (1) The size of subsidies has been reduced from 14 percent of GDP in 1989 to 6 percent of GDP in 1990;[9] (2) Reduction of real money supply by 13 percent and increase real interest rate toward non-negative value;[10] (3) The official

---

[5] ECC was originally a semi-private club, whose organizer, Sergei Kurginyan, is such a master of political organization that he developed it into a most influential conservative think tank. *See Report on the USSR*, May 24, 1991.

[6] Typical IMF "stand-by" arrangements with a country amount to a line of credit tied to a macroeconomic program set out in a Letter of Intent negotiated between local authorities and the staff of the Fund.

[7] Strictly speaking, the Polish plan should be termed "orthodox stabilization with liberalization." Orthodox stabilization means two things: (1) correction of fiscal deficits to reduce inflation; (2) real depreciation of the exchange rate to correct deficits in the current account of the balance of payments. By contrast, heterodox stabilization (like Argentina's and Brazil's plan in 1985-87) freezes prices, wages, and exchange rates in order to reduce inflation. Clearly, the Polish plan is closer to the orthodox stabilization.

[8] David Lipton and Jeffrey Sachs, "Creating a market Economy in Eastern Europe: The Case of Poland," *Brookings Papers* on *Economic Activity* 1 (1990), p. 112.

[9] Mark Schaffer, "State-owned Enterprises in Poland: Taxation, Subsidization, and Competition," *European Economy* 43 (1990), p. 192.

[10] D.M. Nuti, "Internal and International Aspects of Monetary Disequilibrium in Poland," *European Economy* (1990), p. 180.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

E:063371


exchange rate was first depreciated from Zlotys 6500 per dollar to Zlotys 9500 per dollar and to be fixed as a nominal anchor;[11] (4) Money wages are another nominal anchor, only partially indexed at a very low rate;[12] (5) Almost complete price liberalization, less than 10 percent of all output is now sold at prices controlled by the state.[13]

Polish stabilization in 1990 is a success at controlling inflation. Since this plan has a serious recessionary bias – officially measured output was 30 percent lower in January-September 1990 than a year earlier, it is not clear that inflation will not increase again.[14] The monthly increase in retail (in percent):[15]

| Year | Month | Increase 1990 |
|---|---|---|
| 1990 | 1 | 79.6 |
| | 2 | 23.8 |
| | 3 | 4.3 |
| | 4 | 7.5 |
| | 5 | 4.6 |
| | 6 | 3.4 |
| | 7 | 3.6 |
| | 8 | 1.8 |
| | 9 | 4.6 |
| | 10 | 5.7 |
| | 11 | 4.9 |
| | 12 | 5.9 |
| 1991 | 1 | 12.7 |

As Stanislaw Soltysinski emphasized, a 30 percent recession in Poland has no precedent in the post-1945 economic history of Europe.[16] As the government had only anticipated a three percent to five percent recession, this certainly undermined the credibility of the reform government.[17] Moreover, the danger of the recession-biased stabilization program is that it may be self-defeating: without real growth, such roots of hyperinflation as high budget deficits and high foreign debts cannot be eliminated; the next round of hyperinflation would start all over again. Latin American stabilizations had been characterized by a stop-and-go pattern, "temporary stabilizations followed by major blowups."[18] The mechanisms that make recession-biased stabiliza-

---

[11] Ibid.

[12] Ibid.

[13] Mark Schaffer, "State-owned Enterprises", p. 192.

[14] The figure is cited in The World Bank, *Newsletter about Reforming Economies*, 2:1 (1991).

[15] *Report on Eastern Europe*, March 1, 1991, p. 25.

[16] Stanislaw Soltysinski, "Risks and Opportunities in Eastern-Central Europe", (Paper presented at the Tenth International Monetary and Trade Conference, September 1990).

[17] Jan Kulig, "Which Way to market Economy: Through Stabilization or Growth Resumption?" *The European Journal of Development Research* (December 1990), p. 153.

[18] Rudiger Dornbusch et al, "Extreme Inflation: Dynamics and Stabilization", *Brookings Papers on Economic Activity* 2 (1990), p. 5.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


tion self-defeating are: (1) The contractionary monetary policies tend to lead to real appreciation of the exchange rate.[19] This results in a loss of international competitiveness in traded goods production, illustrated by the experience of the U.K. under Margaret Thatcher.[20] The Polish real exchange rate increased in 1990, and this decreased its international competitiveness and hence its ability to repay foreign debt. The fiscal crisis intensified. For every major product group, Poland cannot compete in the EC market with the most newly industrialized developing countries (NIC), even though the wage rate of Poland is only one-third of the NICs.[21]

(2) The use of wage as a nominal anchor reduces the real wages. In Poland, measured consumption for the first three months of 1990 was 20 percent below its 1989 level, and this provoked popular dissatisfaction.[22] For example, the bill governing the 1991 tax on excess wages (called "popiwek" in Polish) led to a political crisis.[23] The socio-political pressures may lead to the relaxation of wage control and the inflation rate may start to increase again.[24] This shows that wage control that is too stringent may inflict a populist setback.

(3) The reduction of budget deficits in 1990 was done mostly by removing subsidies and exemptions, and, to some extent, by imposing a high "dividend tax" on enterprise capital, increase the government revenue in the short-run, but it has a strong recessionary effect since it was fixed in nominal terms and hence would be a greater threat to enterprise solvency.[25] In the medium run, this heavier burden will do damage to growth, and eventually reduce the budget revenue.

(4) Devaluation of the zloty by almost a half (45 percent) may have contractionary effects when imports initially exceed exports. As Krugman and Taylor pointed out, "devaluation gives with one hand, by raising export prices, while taking away with the other, by raising import prices. If trade is balanced, and the terms of trade are not changed, these price changes offset each other. But if imports exceed exports, the net result is a reduction in real income within the country."[26]

Someone might argue that the recession-bias of stabilization is not a problem, since what follows the stabilization program is, according to the IMF and the World

---

[19] Rudiger Dornbusch showed that appreciation occurs because the restrictive monetary policy raises the domestic nominal interest rates. See his "Expectation and Exchange Rate Dynamics," *Journal of Political Economy* (December 1976). As a matter of fact, in the first three months of 1990, Poland's cumulative real interest rate was as high as 80 percent. See Jan Kulig's paper cited in footnote 15.

[20] See Paul Krugman, "The Narrow Moving Bank, The Dutch Disease, and the Competitive Consequences of Mrs. Thatcher," *Journal of Development Economics,* 27 (1987), pp. 41-55.

[21] See "The Low Level of Competition between Eastern Europe and the Developing Countries on the EC market," *Economic Bulletin,* 1991.

[22] Olivier Blanchard, et al, *Reform in Eastern Europe* (Cambridge, MA), p. 19.

[23] For details, see *Report on Eastern Europe,* March 1, 1991, pp. 23-27. The bill set the limit of wage increase as a percentage of the monthly increase in retail prices. For January and February 1991, the limit is 60 percent of the rise in prices. Firms that exceed this limit by more than 5 percent must pay a 500 percent tax on the sum of excess wages.

[24] Walesa complained that "we are building democracy but people do not benefit from it," *Gazeta wyborcza,* May 17, 1990.

[25] Mark Schaffer, "Enterprises," p. 193.

[26] Paul Krugman and Lance Taylor, "Contractionary Effect of Devaluation," *Journal of International Economics* 8 (1978), p. 449.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


Bank, "structural adjustment": privatization and restricting industrial structure and the like. However, there is a possibility that the recessionary effect of the stabilization is so strong that it jeopardizes the subsequent "structural adjustment." In this perspective, it is very important to observe that investment in the private sector went down from 1989 to 1990 because of the austerity policy of the stabilization plan.

The recession-bias of the "standard" or "orthodox" stabilization programs has already been recognized. Hollis Chenery, vice president of the World Bank, pointed out that "the conventional separation between stabilization and development, or short-term and long-term policies, has become increasingly inappropriate to the international economic problems of this decade, in which the adjustment policies of individual countries must be assessed over periods of or ten years."[27] Also, Vito Tanzi, Director of the Fiscal Affairs Department of the IMF, asserted that "stabilization programs must pay attention to growth to ensure that stability is not won at the price of stagnation."[28] He made a useful distinction between "macroeconomic" and "microeconomic" approaches to stabilization policy: the former concerning aggregate demand management and the latter supply-oriented structural core. The upshot of this "microeconomic" approach to stabilization is that changes should be encouraged that would increase the fiscal deficit in the short run but would have desirable supply-side effects on the economy in the medium run.

Tanzi points out that "over the years the formulation of stabilization programs has been much closer to the macroeconomic, than to the microeconomic, alternative," even when the harmful recessionary bias of the orthodox stabilization programs (Tanzi's "macroeconomic approach") has been realized.[29] The Polish stabilization plan of 1990 is also a "macroeconomic approach": "reducing aggregate demand and anchoring the price level."[30] How can we explain this seeming paradox: the recognition of the recessionary bias of an orthodox stabilization program on the one hand and the persistence of the unmodified forms of the program on the other? One may be tempted to cite Hegel: "The only thing we learn from history is that we learn nothing from history."[31] In order to bring the "microeconomic approach" into the design of stabilization programs, we must have a thorough theoretical re-analysis of the basic assumptions underlying the standard stabilization programs, and we can do so only by resorting to the latest development in economics – the economics of incomplete markets.

## Lessons from the Latin American Experiences

Before I turn to the economics of incomplete markets, I will discuss briefly the Southern Cone stabilization plans of the 1970s and the 1980s, programs that are similar to

[27] Hollis Chenery, "Comments," in William Cline and Sidney Weintraub, eds., *Economic Stabilization in Developing Countries* (Washington, 1981), p. 115.

[28] Vito Tanzi, "Fiscal Policy, Growth, and the Design of Stabilization Programs," in Mario Blejer and Ke-young Chu, eds., *Fiscal Policy, Stabilization, and Growth in Developing Countries* (Washington, 1989), p. 15.

[29] Tanzi, "Fiscal Policy," p. 17.

[30] Lipton and Sachs, "Poland," p. 112.

[31] Cited in Tariq Banuri, *Economic Liberalization: No Panacea* (Oxford, 1991), p. 27.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


the Polish 1990 stabilization plan.[32] Moreover, the theoretical justification of the "orthodoxy" stabilization program – monetarism – can be seen very clearly in these cases.

As Rudiger Dornbusch pointed out, "the Southern Cone surely was a testing ground for a particular conception of monetarist policy – namely, that financial discipline together with exchange-rate discipline and the reliance on substantial international price connections should work well as a stabilization program."[33] There were two stages of monetarist policy – the evolution from conventional to open economy monetarism, as illustrated by the Chilean case.

During 1975–77, the conventional monetarist approach to stabilization in a closed economy was implemented in Chile, based on the assumption that inflation is "always and everywhere a monetary phenomenon" and its cure must be contraction of money supply, elimination of fiscal deficit, and "getting the price right." During 1978–82, when the Chilean economy became an open economy, the so-called "monetary approach to the balance of payments" replaced the conventional monetarist approach, because, in an open economy, money supply is an endogenously determined variable.[34] Under this new form of monetarism, the fixing of the exchange rate, rather than the control of the money supply, became the central nominal anchor. In February 1978, the system known as "tablita" was put into effect, preannouncing a declining rate of devaluation for a period of time up to a year. The rationale for this is: "First, it would channel inflationary expectations downward for a fairly long period of time. Second, and more important, it was expected that the system would work in a way similar to a text-book-type fixed exchange rate regime, where the law of one price holds."[35]

It is clear now that the major theoretical justification for monetarism is "law of one price." This implies the belief that an automatic adjustment of prices is able to restore macroeconomic equilibrium quickly. The experience of the Southern Cone stabilization, however, did not confirm this "law of one price." As Alejandro Foxley described the situation, "given limited price flexibility and supply inflationary shocks, the use of conventional contractionary demand policies by themselves are likely to generate adjustments that are far from optimal. The economy will react mainly by reducing output (and increasing unemployment) whereas the decrease in the rate of inflation

---

[32] A title in a Polish newspaper read "Menem like Balcerowicz." Carlos Menem is the President of Argentina. Cited in Adam Przeworski, "Economic Reform in New Democracies: The Polish Experience," p. 6.

[33] Rudiger Dornbusch, "Comments," in Nicolas Baeletta, et al, eds., *Economic Liberalization Policies in Argentina, Chile, and Uruguay,* (Washington, 1983), p. 118.

[34] Why is money supply endogenous? Alejandro Foxley provided the following explanation: "The two main components of the monetary base are loans to the national treasury and changes in reserves. Of these, the first one is irrelevant once the fiscal deficit has been brought under control. The change in international reserves, on the other hand, is an endogenous variable. It depends on the size of the trade deficit and on external capital flows, which are regulated by the difference between international and domestic interest rates, adjusted by expected devaluation of domestic currency." See Foxley, *Latin American Experiments in Neo-Conservative Economics* (Berkeley, CA, 1983), p. 115.

[35] Sebastian Edwards and Alejandra Edwards, *Monetarism and Liberalization The Chilean Experiment* (Chicago, 1991), p. 36.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

2063371


will be more slow to come, due to price and wage rigidities."[36] Even to the extent that disinflation had been achieved, it "was achieved at substantial costs in terms of unemployment, reduced production, and complete collapse of the financial sector. What is worse, the curbing of inflation was short-lived; between 1982 and 1984 inflation wandered around twenty-five percent, not far from the historical average."[37] The following table[38] shows clearly the ineffectiveness of the orthodox stabilization and liberalization plans:

| | Low-income | Middle-income |
|---|---|---|
| Budget deficit/GDP | | |
| before | 7.6 | 6.0 |
| after | 7.6 | 5.7 |
| Current account/GDP | | |
| before | −9.0 | −7.2 |
| after | −7.0 | −4.5 |
| Investment/GDP | | |
| before | 19.2 | 24.7 |
| after | 18.1 | 19.2 |

## Perspectives from the Economics of Incomplete markets

The Law of One Price is a central justification for the monetarist approach to stabilization. It holds that a given commodity is sold at the same price by all stores (countries). From the perspective of incomplete markets, this is not true in general. As Joseph Stiglitz pointed out, "when different submarkets face different demand or supply shocks with costly information, the resulting price differences will not be fully arbitraged away. There will exist an "equilibrium amount of disequilibrium," With costly arbitrage, some price differences must persist."[39]

In the case of international trade, modern trade imposes less commonality on price-level movements than the trade of seventy-five years ago. Paul Krugman explained this very well: "In 1913 most trade was in relatively homogeneous commodities, for which arbitrage determined a world price. Thus, a rise in the price of wheat in Canada was equally reflected in a rise in the price of wheat imported to the United Kingdom . . . By contrast, in the 1980s most of the trade of advanced countries is in manufactured goods – typically in differentiated products that do not behave like commodities. Goods manufactured in the United States are not auctioned off at pri-

---

[36] Foxley, *Experiments*, p. 127.

[37] Edwards, *Monetarism*, p. 48.

[38] Source: World Bank, *Report on Adjustment Lending*, August 8, 1988. "Before" and "After" refer to the three-year periods preceding and following the first World Bank adjustment loan received by the countries in question. The table summarizes the experiences of 30 countries.

[39] Joseph Stiglitz, "Imperfect Information in the Product markets," *Handbook of Industrial Organization*, vol. 1 (1989), p. 821.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


ces that are closely affected by the prices of competing goods manufactured abroad; they are instead sold by price-setting firms that are quite resistant to changing their prices in domestic currency."[40] Based on this observation, we can argue for caution when choosing the exchange rate as a key nominal anchor in stabilization as required by the open-economy monetarism discussed above.[41] The heart of the notion of a "nominal anchor" is the classical "nominal-real dichotomy" of neoclassical economics: excess demand functions in every market are homogeneous of degree zero in all nominal variables or, in other words, are functions only of real variables; however, the price level remains indeterminate in general equilibrium unless other nominal variables (for example, the money stock or nominal exchange rate) are fixed. But if we accept Krugman's observation of price stickiness, the classical nominal-real dichotomy breaks down.

The law of one price can be seen as a special case of arbitrage-free equilibrium in complete markets. A complete set of markets is one where the number of independent securities is equal to the number of states of nature. This certainly does not exist in any real world. But the First Theorem of Welfare Economics – the modern justification of Adam Smith's invisible hand – is valid only under the condition of complete markets. In a real world, where contingent markets are incomplete and information is imperfect, the so-called "Greenwald-Stiglitz Theorem" tells us that market allocation is not constrained Pareto-optimal. To use the words of Stiglitz, "Adam Smith's invisible hand may be more like the Emperor's new clothes: invisible because it is not there."[42] From this perspective, it is easy to understand the recession and high costs caused by the orthodox" stabilization program. Moreover, the theory of incomplete markets is the foundation of so-called "New Keynesian Economics" because its emphasis on price and wage rigidities provides an ideal micro-foundation for Keynesian macroeconomics.[43] By emphasizing the market incompleteness, the New Keynesian macroeconomics can make sense of inflation-output tradeoff; in contrast, the New Classical macroeconomics, based on the classical dichotomy of nominal and real variables, suggests unrealistically that stabilization could be costless.[44]

The implication of the Greenwald-Stiglitz Theorem is that "there exist market interventions, which respect the limitations on information and risk distribution opportunities, which can make everyone better off."[45] Of course, theorists of the rent-seeking school (or neoclassical political economy in general) will counterargue that any market intervention would produce social wastes. While there are some truths in this position, Albert Fishlow is correct when he says that "the principal deficiency of the

---

[40] Paul Krugman, *Exchange-Rate Instability* (Cambridge, MA, 1989), p. 9.

[41] In Yeager's survey, all stabilization plans, except the Italian disinflation of 1945, has the key element of fixing nominal exchange rate. See L.B. Yeager, *Experience with Stopping Inflation* (Washington, 1981).

[42] Joseph Stiglitz, "Whither Socialism? Perspectives from the Economics of Information," Wicksell Lecture, 1990.

[43] See N. Gregory Mankiw and David Romer, eds., *New Keynesian Economics* (Cambridge, MA, 1991), vols. 1 and 2.

[44] See Thomas Sargent, "The End of Four Big Inflations," in R. Hall, ed., *Inflation* (Chicago, 1982).

[45] Joseph Stiglitz, "The Invisible Hand and Modern Welfare Economics," in David Vines, ed., *Information, Strategy and Public Policy* (1991), p. 22.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

p0063371


neoclassical approach is its failure to inform about the conditions under which the state can play a positive role."[46]

The conclusion is that programs like the Polish stabilization plan of 1990 should be adopted with extreme caution. Though we do not live in Leibniz's best of all possible worlds, we still should try to develop a growth-oriented, rather than a recession-biased stabilization plan for the rest of Eastern Europe. At the very least, we should not forget the question asked by Carlos Diaz-Alejandro about the stabilization programs of the Southern Cone of Latin America: "Are These Hardships Really Necessary?"[47]

An anticipated criticism of this position is that any emphasis on growth must end up with "populism," which, according to Dornbusch and Edwards, is "an approach to economics that emphasizes growth and income distribution and deemphasizes the risk of inflation and deficit finance."[48] I agree fully with this critique, especially now that populism is already on the rise in Poland, but I want to highlight the possibility than a growth-oriented alternative to the orthodox stabilization can be designed without violation of fiscal discipline.[49] The key point is that the orthodox, IMF-sponsored stabilization plan is only stipulated at the aggregate level, and no attention is paid to specific measures that the country may employ to achieve the stipulated level of fiscal deficit. To use the words of Tanzi, it is a "macroeconomic approach" rather than a "microeconomic approach." In my view, it is important to realize that within the constraints of reducing fiscal deficits to a certain level, there is still room for an active policy to promote growth. Tanzi observed that "it can make a substantial difference to the growth prospects of a country if the fiscal deficit is reduced by eliminating a totally unproductive expenditure or by raising a tax that has strong disincentive effects, even though in terms of the result would appear to be the same."[50] From this perspective, it may be advisable that the "dividend tax" in Poland is not to be set too high, and the government should use investment incentives and tax measures to deflect the impact of high real interest rates away from investment.

---

[46] Albert Fishlow, "Some Reflections on Comparative Latin American Economic Performance and Policy," in Tariq Banuri, ed., *Economic Liberalization: No Panacea* (Oxford, 1991), p. 166.

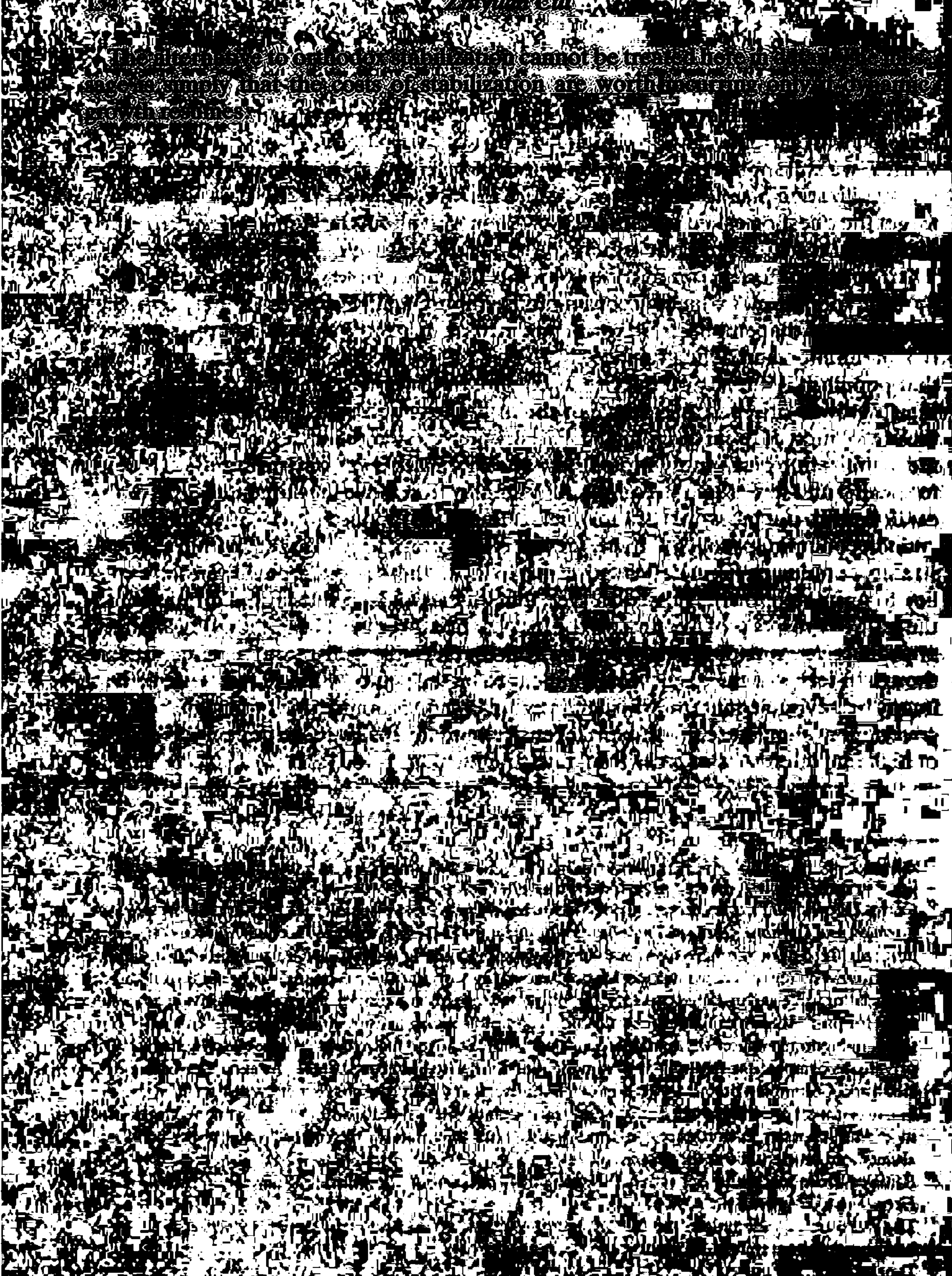
[47] Carlos Diaz-Alejandro, "Southern Cone Stabilization Plans," in Sebastian Edwards, ed., *Economic Adjustment and Exchange Rates in Developing Countries,* p. 134. His answer to this question is worth citing here: major costs of Southern Cone stabilization plans included a reduction in output and a lag in capital formation. Austerity in consumption has not necessarily led to more investment, but to under-utilization of the labor force and installed capacity. It is difficult to accept that this waste is necessary either as atonement for past excesses or for future efficiency. Too simple a diagnosis of inflation leads to an excessively sharp reduction in aggregate demand, credit use, and fiscal and incomes policies. A doctrinaire faith in private, as compared with public, investment contributes to these costs. Here one can contrast the Brazilian and Colombian practice with that of Chile; Brazil and Colombia have maintained fairly active public investment programs even during stabilization plans. The more those public investments contribute to expand capacity in bottleneck sectors, or the more they fit with the restructuring of the economy along more efficient lines, the better.

[48] Rudiger Dornbusch and Sebastian Edwards, "Macroeconomic Populism," *Journal of Development Economics,* 32 (1990), p. 247.

[49] The old official trade union, the OPZZ, increased their voices and membership by acting against the hardships of the stabilization plan.

[50] Tanzi, "Fiscal Policy," p. 23.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access



The alternative to orthodox stabilization cannot be treated here in [illegible] sage is simply that the costs of stabilization are worth bearing only if dynamic growth resumes.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

p0063371



*JAN SZOMBURG*

# Polish Privatization Strategy: Evolution and Features

"How does someone who is not the real owner, sell something of unknown value to someone who has no money?"

– Janusz Lewandowski

## Theoretical Discussion of the Model of Privatization (January 1988-June 1989)

### *The 3xS State Enterprise Paradigm and Its Erosion*

When Poland won sixteen months of "Solidarity Freedom," neither economists nor non-communist politicians were able to think beyond the dogma of state ownership.[1] Solidarity was able to produce a program of reform of the socialist economy, but not a complete change of the existing economic system. A characteristic feature of this newly adopted perspective was a complete lack of understanding concerning the need for the introduction of properly defined property rights, but there was a general consensus of the need to develop market mechanisms within the economy.

Open discussion of the future of the economy produced a new idea, which developed into the concept of the 3xS model for state enterprise management. The intention was to create an enterprise that would remain formally state owned, but would at the same time be:

Self-ruling in decision making – not subordinated to the decisions of central planning,
Self-financing – expenditures would be financed internally and not by state subsidies,
Self-managing – run by employee-council organs.

The 3xS model was a substitute or proxy for private enterprise management. It would suit the market mechanism, and at the same time it was attractive to Solidarity leaders in the political sense.[2]

The first step in implementing this model meant getting rid of the Communist nomenclature directors who were nominated to their positions from outside the enterprise. The direction of enterprises would now be subordinated to the organs of employee councils and not the Communist party. If this model were fully implemented, there was a possibility that Solidarity, through the employee councils, would acquire real control over all the state-owned enterprises (SOE). This would mean control of the economy as well, because the SOEs contributed 80 percent of Poland's GNP.

---

[1] That period lasted from the strike wave of the summer of 1989 that ended with the emergence of the first independent trade union on August 31, 1980, until the imposition of martial law on December 13, 1981.

[2] Nearly all opposition groups and those seeking independence were combined with Solidarity at this time.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


In a larger perspective, the realization of the 3xS model of state-owned enterprise management would lead to the complete victory of the peaceful revolution that had been initiated by the Gdansk Shipyard strike in August 1980 and would mark the disintegration of the Communist system in Poland. For some participants in the debate and struggle, those who had no left-wing sympathies, the implementation of this model with its worker self-management element was a king of fig-leaf, a politically more acceptable demand than a demand of self autonomy for SOEs alone. It became a necessary political component in justifying the claim for autonomy of the state enterprises in relation to the state bureaucracy apparatus.

In the economic sense, self-management was for that managerially oriented group, a kind of concession to the more important cause of the extension of liberty and a change in the political system.[3] An overwhelming majority of economists were subject to wishful thinking, however, believing that the 3xS model would bring outstanding economic performances.

This illusion had its sources in two factors. First, the ponderous question of property rights was such a politically explosive issue that self-censorship blocked it from discussion. Second, there was an air of fascination for the works of J. Kornai, a Hungarian economist who ascribed the poor performance of socialist enterprises mainly to "soft-budget" constraints.[4] This faith in the magic ability of efficiency enhancement to be achieved by hardening the budgetary constraints of enterprises without proper definition of property rights seemed to dominate the scene. This thinking still existed to a certain extent during the first stage of implementation of the Balcerowicz Plan.

In the autumn of 1981 the political and intellectual force that stood behind the 3xS model was so strong that, in spite of heavy resistance by the Communist party, the Polish parliament adopted two laws. The first was "State Owned Enterprise Law," which ended central state planning in Poland. The second law was "State Owned Enterprise Workers Self-Management Law." This legislation was the tool through which the 3xS model was to be implemented. It legally established self-management within state-owned enterprises.

When martial law was declared in December 1981 it re-established the political subordination of enterprise managers to the Communist party but did not change the legal status of SOE and self management.

In the mid-eighties some of the economists associated with opposition circles developed an interest in studying the theory of property rights. The concept of ownership was gradually included in the underground thinking on the future of the system. The process of reevaluation started. This led to the erosion of the paradigm of reform of the socialist economy based on the 3xS model. Some people became aware that without a general change in the ownership structure in Poland, the implementation of an effective market system would be impossible. At the same time, however, a pronounced weakening that would lead to the collapse the Communist system in Poland could be felt.

---

[3] At that time, questions of ownership were seldom raised and there was debate over management and self-management options.

[4] The socialist enterprises have always acted under such soft-budget constraints as subsidies and soft loans and have never been based upon the principle of self-financing.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


*Break Point, 1988*

In this climate, Stefan Kawalec (vice minister of finance and a close aide to Vice Premier Leszek Balcerowicz) organized what was to become a historically significant scientific conference in Warsaw in November 1988 on the "Propositions of Changing the Polish Economic System." During this conference the basic foundations were laid for privatization strategies in post-Communist economies.

Communists still held full power in Poland. The authors of the papers presented during this conference were asked, what should be done if there were no political or geopolitical constraints existing in Poland. the main answers to this question were to define the main direction of thought and practical actions in the following years.

One answer, proposed by M. Swiecicki (later minister of international economic cooperation, in the T. Mazowiecki government), suggested nationalization of state enterprises via reconstructing them into limited liability companies and then creating state-owned holding companies. It was an option similar to the one proposed at that time in Hungary by M. Tardos.

Another answer, proposed by M. Dabrowski (later vice minister of finance in the T. Mazowiecki government), suggested the transformation of state-owned enterprises into collectively owned units, that is, group ownership. This option was also supported by the then powerful workers' self-management lobby.

A third answer, proposed by S. Kawalec, aimed at the actual privatization of the economy by establishing individual and transferable ownership rights. This model was to be patterned after the British experience, which made these rights public available after the sale of shares of a particular enterprise.[5]

A fourth answer, proposed by J. Lewandowski (currently minister of ownership changes) and J. Szomburg, had the most radical and original character. It proposed a radical acceleration of the privatization process via the application of freely distributed privatization vouchers, that is, via free acquisition of ownership rights by the whole citizenry.[6]

The authors of these concepts were academicians at that time, but they soon acquired high-level posts in both the T. Mazowiecki and the J.K. Bielecki governments. This had unfortunate consequences because after publicly expressing their positions as academicians, the authors found it difficult to change their opinions as government officials.

After this conference, discussion of the main options of ownership changes was transferred to the media, especially the popular weekly magazines. In the first half of 1989, for the first time in forty years, all of Polish society could openly confront and discuss key problems of privatizing the economy. The barrier of auto-censorship was broken and the time of geopolitical taboo was over. Many people quickly acquired the idea that without privatization, emergence of a market economy would not be possible. A new approach to the future could be felt. This paralleled the thinking about reforming the whole of the socialist economy and fully legitimized thinking of an

---

[5] The Kawalec view was later published in *Communist Economies* 1:3 (1989).
[6] Their work was also published there.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


entire transformation of the economic system. A characteristic feature of that system was a kind of "model-like" thinking. Participants in the discussion declared support for one method of privatization as the best one without looking at any others. Technical and organizational details were largely overlooked. This discussion took place among leading economists and journalists and did not yet include political groupings.

## In the Shadow of the Stabilization Plan –The Struggle of Two One-Sided Approaches (July 1989-June 1990)

With the collapse of Communism in Poland in mid-1989 and the formation of the first non-Communist government, the problem of ownership changes became, for the first time, a matter for practical discussions. A need to build a privatization program as an element of strategy in the building of a market economy now existed.

The sociopolitical conditions for the formulation of such a strategy had, however, a particular character. The old, one-party political system was disintegrating. New systems of political parties had not yet developed. There was only one quasi-political organization functioning, the Solidarity trade union.

Where such an influential organization as Solidarity existed, the development of new political parties was difficult. Moreover, Polish society felt a deeply rooted aversion to politics, as such, after forty years of Communism. There was a complete lack of social and political organizations that would be able to articulate the interests and opinions of different segments of the population on the key question of privatization. In this situation the government did not have any partners in the discussion of the key elements of transforming the system.

The only participant in the debate was the seasoned workers self-management movement, experienced from the struggle for the adoption of the State-Owned Enterprises Workers Self-Management Bill in 1981. This movement included dynamic activists who had strong support in the post-Communist economic press and an active lobby in the Polish parliament.

The workers self-management lobby represented the interests of enterprise employees, typically insiders who supported the decentralized model of privatization, which provided for the possibility of acquiring ownership rights under very favorable financial conditions. The position of this lobby was in direct conflict with the interests of several million citizens employed by the state in the nonprofit, service sector. These teachers, doctors, civil servants, and the like did not have their interests organized or articulated. A similar situation prevailed in the private sector, which at that time produced around 20 percent of Poland's GNP.

When T. Mazowiecki's government came into power, inflation was raging over a thousand percent per annum. Balance was missing on a macroeconomic scale as prices were well below market prices. This meant macroeconomic policy had to gain priority. The actions of Deputy Prime minister L. Balcerowicz, who was responsible for the entire economy sector within the government, supported this by restoring the general balance, fighting inflation, and liberating prices. In fall 1989 preparations for the Balcerowicz Plan (or shock therapy) were begun. Winter and spring 1990 brought the monitoring and control aspects of the plans. Privatization was not a priority item

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

p0063371


in the transformation strategy at that time. Difficulties of the nature of intellectual concept and legal organization, and lack of direct political impact tended to push aside the privatization problem and it ranked second among other issues of government activities. Also, the successful stabilization program in 1990 did much to avert attention from privatization issues. By a radical tightening of monetary policy and price liberation, inflation rapidly declined in the first months of 1990. There was no wave of bankruptcies among the SOE as anticipated.

Under such circumstances hope persisted for adaptation and restructuring within the SOE (the Kornai paradigm), but no one really cared to push privatization through.

Within the T. Mazowiecki government the preparation of the privatization program was in the hands of the Governmental Plenipotentiary for Ownership Changes and the Ministry of Finance.

The group of very ambitious people responsible for the Polish privatization process identified their professional ethos with the technical perfectionism of the British model. Thanks to this orientation and the privileged situation of Poland as the first country to depart from the Soviet-type economy, the intensive import of privatization know-how is still being felt today.

On the other side the approach of this group was characterized by a reluctance to reflect deeply and creatively on the unique character of the transformational situation after the downfall of Communism and its consequences for the formulation of an adequate privatization strategy. In particular the question relates to the following factors: lack of domestic capital; lack of such institutional infrastructure as banks and securities exchanges, and a lack of skills needed in a market economy.

In effect, the approach adopted by the government to the problem of privatization was characterized by one-sidedness, mechanical imitation of British patterns, and lack of sociopolitical realism. The one-sidedness of this strategy was expressed by focusing only on large enterprises and only on the one privatization technique of the Initial Public Offering (IPO). This would address only those who had savings or capital. Preference of the IPO as a method of selling an enterprise was linked from the beginning to a strong preference to accelerate the creation of the capital market and a securities exchange in Poland. It reflected the domination of Anglo-Saxon patterns and completely ignored the German pattern. It is interesting to note that of two thousand German enterprises that privatized before mid-1991, not one was sold by IPO. This reflects their economic philosophy; they emphasize the role of a well defined and concentrated property right rather than the functioning of capital markets. Simplifying this, one may say that behind the choice between the German or the Anglo-Saxon model of privatization there stood the question of what type of efficiency one wanted to acquire first. This is in contrast to Socialist economies where one has to deal with both poor allocative efficiency and poor productive efficiency.[7]

Simple productivity reserves in SOE existed, but there is a lack of efficient utilization of resources directly as a result of the lack of a real owner and market pressure.

---

[7] Western literature does generally not use the term "productive efficiency." A corresponding concept is the so-called x-efficiency (organizational) efficiency introduced by H. Leibenstein.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


Differentiation between allocative efficiency and productive efficiency is very useful from the standpoint of analyzing the sequence of transformation of post-Communist economies. Generally speaking, the improvement of the latter is much easier and cheaper than improvement of the former. Allocative efficiency requires large transaction costs. After forty-five years without a market economy that would have institutionalized such infrastructure, there will be a need for very large sunk transaction costs.

Basic improvement in the allocative efficiency of the economy is necessarily time-consuming. In the short run it is much easier to achieve an improvement in productive efficiency through both positive and negative incentives inherently contained in well-defined property rights. It is possible, via privatization of small and medium-sized state enterprises, where the assets go into the hands of a concrete owner.[8] It means that assets are being shifted from an inefficient user to an efficient one. The utilization of the strength of a well-defined and concentrated property rights in the first years of system transformation, is of key importance. This is because implementation of a radical stabilizing macroeconomic policy is profoundly difficult and makes it hard to overcome a recession in the economy. Establishment of real, long-term owners of small and medium-sized enterprises is a very good anti-recessionary tool. This is true in spite of the lack of a developed banking system, stock exchange, and other elements of institutional infrastructure of a market economy.

Another aspect of this one-sided approach was the complete rejection of the idea of free distribution of property rights to the whole citizenry through privatization vouchers. This idea has not been tested either in the technical or in the economic sense. It has not been taken into consideration at all. From the present perspective, it was an error that cost about one and a half years of lost time. Serious operational studies of this idea were undertaken in February 1991.[9] Because of the technical and organizational complexity of this undertaking, however, implementation of mass privatization will not take place earlier than 1992.

The adoption of a stiff, technocratic stand by the government team exposed it to nearly a year of wasted effort in conflicts with the workers self-management lobby. A spectacular example of this is the successful blockage by the lobby of the government's initiative to transform all SOE into joint-stock limited liability companies solely owned by the state treasury. They were motivated to oppose this initiative because it would have meant liquidation of the Workers Council.[10]

During confrontations with the workers self-management lobby, the former government team began to recognize the usefulness of the ideal of free privatization vouchers. The insiders had aimed for a quasi-closed privatization process that would favor the employees of enterprises. However, the government thought it could defend an open privatization process by appealing to citizens not employed in SOE, as they would have to pay for shares within the framework of an IPO, this idea did not have any political support. This was because after the adoption of the Balcerowicz

[8] There are more than 5,000 such firms in Poland.

[9] The services of S.G. Warburg were taken advantage of in the process.

[10] In the former GDR such a move has not met any obstacles.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

plan on January 1, 1990, the value of citizens' savings was reduced by half and the "Excess Wages Tax" was implemented. The argument for the creation of equity and capital opportunities for the public by selling shares through IPOs seemed not realistic.

In spring 1990 the forum for the continuation of this conflict was the parliamentary commission that was preparing the "Law on Privatization." It concluded in a compromise. The government, intent on limiting the acquisition of property rights by employees, had to include the possibility for the acquisition of property rights by privatization vouchers for every citizen. At the same time, the workers self-management lobby accepted the limitation of being allowed to acquire only up to 20 percent of privatized SOE shares at half price.

Compromise has also been achieved in the area of the structure and competencies of privatization. A central administrative organization has been created, the Ministry of Ownership Changes (MOC). Its objectives, functions, and competencies are far different from its centralized German counterpart, the Treuhandanstalt. The compromises concerning the privatization model were based on the ideas of de-concentration and partial decentralization. From the beginning, a number of decision makers at different levels were established. The authority and competencies of the MOC have been curtailed from above and below as well as from the sides.

Decision making powers concerning the privatization of SOEs have been divided among the MOC, the founding organs who control a SOE on behalf of the state treasury and organs of the enterprise itself.[11] The division of competencies within the two privatization paths that are envisaged by the Privatization Law (privatization through commercialization and privatization through liquidation) are shown in Figures 1 and 2. All participants in the process have a say and all, in principle, must agree to the privatization project. It is important to note that the insiders, workers' self-management organs, and directors, were granted the right to initiate the privatization process as well as the right to protest in cases of state initiation of the process.

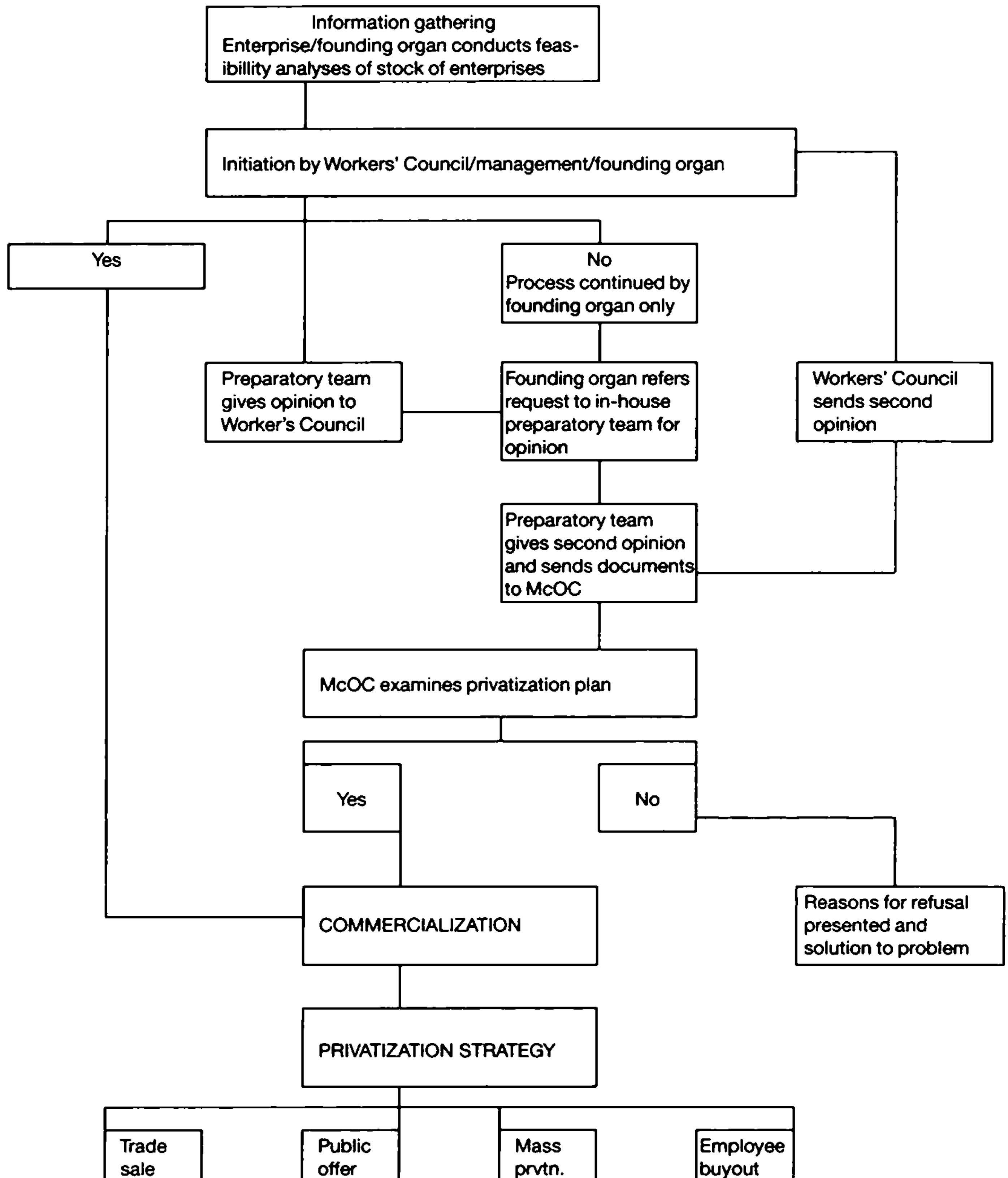
As regards privatization techniques, the compromise reached through the Privatization Law allows for various possibilities, such as leasing, management buyouts, and privatization vouchers. In the legal sense, the year-long struggle of the one-sided approaches, both the technocratic one and self-management one, brought about on July 13, 1990 a multi-tracked approach. This opens many possibilities for practical privatization policies in the future.

The passing of the Privatization Law was the greatest achievement of the workers self-management movement. It was at the same time the last major achievement by this movement and by mid-1990 its political importance started to decline. In the practical sense this quasi-political movement lost ground to the emerging normal system of political parties. In the ideological property, both exclusive and transferable (but not collective) property rights. In spring 1991 it practically disintegrated. The organizational form disappeared but the vindictive attitudes among enterprise employees have not gone away fully.

---

[11] The function of the organ is the responsibility of either fifteen branch ministers, or in larger enterprises – there are some 3.500 of them – or *voivodes*, i.e., heads of regional state administration.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access



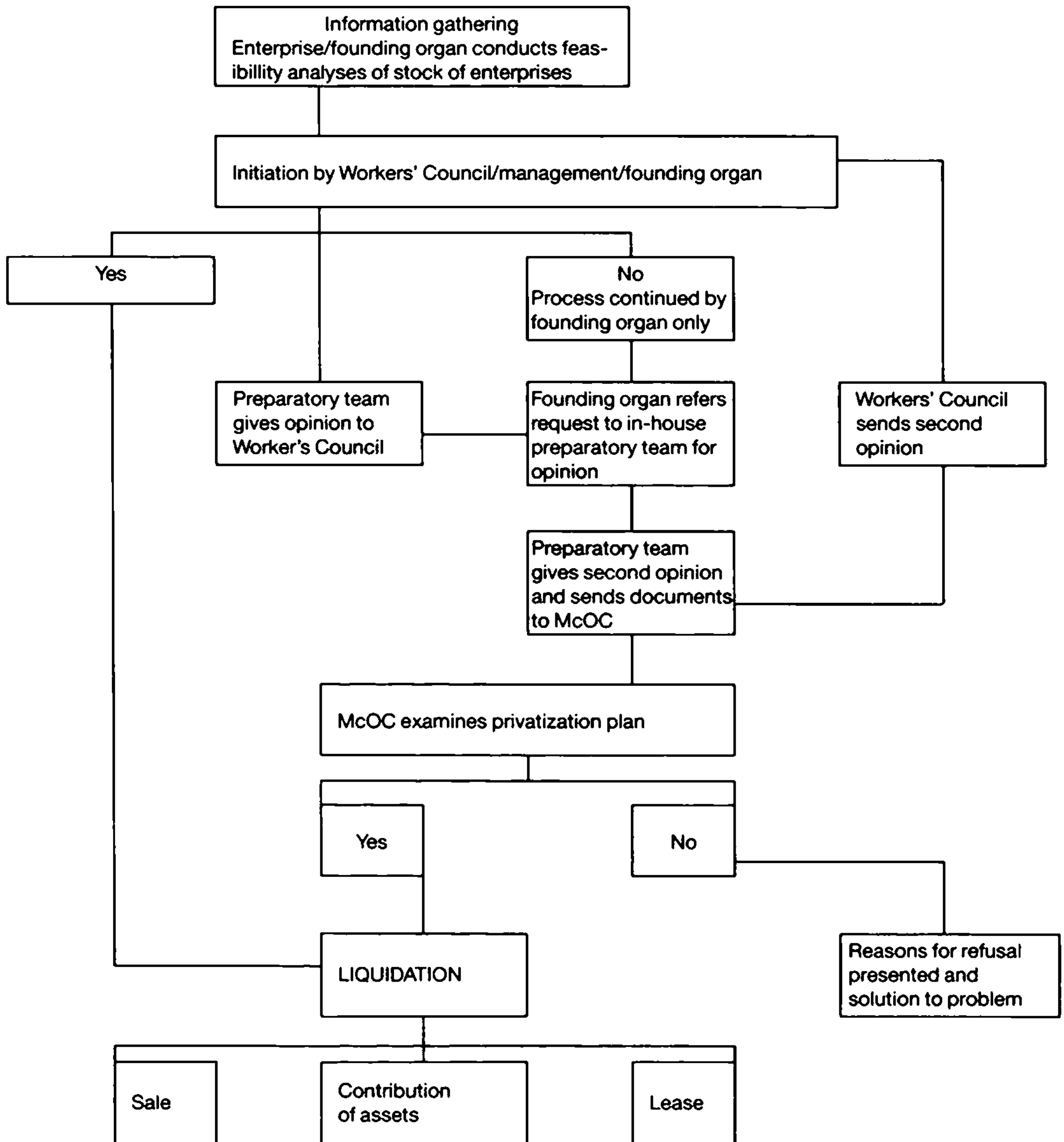

It must also be pointed out that during this period, June 1989 through June 1990, Solidarity had its hands tied as the main designator of the cabinet and blocked by the full scope of varied options and values held by members of its ranks. Practically it has not taken part in the dispute about the shape of the Polish privatization process.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371



## Privatization through Liquidation




Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


## Opening-up Privatization Strategy (July 1990-June 1991)

In late spring and early summer of 1990 there was an attempt to change the approach of the governmental group responsible for privatization, primarily by Jeffrey Sachs and his colleagues working as experts at the ministry of finance. Their proposals were based on the concept of a free property assignment to the entire society. They proposed adding a new element to the original voucher concept, that of financial intermediary institutions such as Mutual Funds (MF).[12] Two options emerged from this approach: the Indirect Free Distribution through Mutual Funds (J. Sachs Group) and the Free Distribution through Vouchers (R. Frydman, A. Rapaczynski). Both suggested using Mutual Funds as an intermediary between citizens and companies.

According to the first option, all citizens would be granted, free of charge, not stocks in companies but shares in a mutual fund, to which companies would be allocated. In the second option, citizens would be given vouchers freely, to use them either for the purchase of shares in a mutual fund, or for buying directly into companies through stock ownership.

The experts' proposals for the new privatization program were turned down by government technocrats who were centered around K. Lis, the government plenipotentiary in matters of privatization. In spite of the statutory obligation to present the privatization program to parliament within two months of the passage of the privatization law on July 13, 1990, the government was unable to do so until December 1990. The barriers were a lack of clarity of the concept, no political pressure exerted, and a lack of urgency on the part of the economy itself.

The implementation of the Balcerowicz Plan was relaxed in the middle of 1990 and this turned out to be a mistake. In the second half of 1990, there were still no bankruptcies of SOE, while their actual inability to adapt became even less obvious.[13] The groups of technocrats responsible for privatization did not alter their approach when W. Kuczynski, appointed as acting minister in the Ministry for Ownership Changes (MOC), became its formal head in September 1990, as he concentrated his efforts on privatization by initial public offering (IPO).

The presidential election campaign in November and December 1990 contributed a new mechanism to the process of formulation of the privatization strategy. Lech Walesa, a candidate for election and chairman of Solidarity, declared that he supported free distribution of national assets among all the citizens, through the use of privatization vouchers. This compelled other candidates, especially his major opponent, Tadeusz Mazowiecki's then prime minister, and also W. Kuczynski, the minister for ownership changes in Mazowiecki's cabinet, to follow this trend. Thus the opening program of this, in its verbal sense, took place near the end of 1990 and it found its ex-

[12] Among the most zealous advocates of the novel plan to launch intermediary institutions in the privatization scheme, apart from Sachs, were Kostrzewa, Frydman and Rapaczynski, Bell, Berg, Rostowski, and Lipton.

[13] Inefficiency of state-owned enterprises continued to be hidden by the unsound practice of giving credits based upon connections than on normal business criteria by state-owned banks, which derived substantial profits from supporting firms that were bankrupt, in fact. Also, the practice of SOEs who allocated credits to each other hid the true financial status of these firms.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

p0063371


pression in the privatization program adopted by the government in December 1990, based on a multi-track approach.[14]

This approach had separate privatization paths for the various categories of enterprises, and the use of different privatization techniques within a category. This implied matching privatization instruments, or techniques of large, medium, and small enterprises to their performance.

The presidential election campaign had a decidedly positive influence on the development of a political system in the country. The Solidarity movement split, with several strictly political groupings emerging. New organizational structure of sociopolitical life began to take shape in Poland. Lech Walesa won the election, and a new government, headed by Jan K. Bielecki, was constituted in January 1991.

Janusz Lewandowski, a pragmatic liberal with sound political sense and a transformative imagination became the new government minister for ownership changes.[15] In February 1991 the Sejm (lower chamber of the Polish parliament) adopted a document on "Privatization Paths 1991," which made the multi-track nature of Polish privatization strategies even more profound and encompassed, among other things, a Mass Privatization Program (MPP) with free distribution of national assets.

Detailed studies had been undertaken precisely to lay down the assumptions and logistical management aspects of MPP.[16] The result of those studies was the choice of this concept to be used in the implementation of mass privatization, and was presented by Minister Janusz Lewandowski in June 1991.

The first half of 1991 witnessed a total change in the economic position of SOE. Bankruptcies, or the threat of the winding up of former SOE, began to occur. Admittedly, "soft" state-owned banks and mutual loans by enterprises to support one another still existed, but two novel factors appeared. The first was the shock of losing the Soviet market, and this involved quite a large Number of firms.[17] The second was the shock of the tacit but actual Balcerowicz Plan II, which tightened up monetary policy to make amends for the detrimental effects of the unnecessary relaxation of this policy in the middle of 1990.[18] As a result of the latter, in July 1991, the rate of inflation for the first time became zero, but profitability of SOE in the first half of 1991 rapidly dropped down to a level that shook the entire state budget. Only then did it become apparent that the Kornai paradigm did not work as it was supposed to and that expectations for the adaptation and restructuring of SOE were proven to be futile.

On one hand, the threat of the surge of bankruptcies among the SOE and its domino effect provided a practical urge to speed up privatization, but on the other hand, the rapid action necessary to carry it through immediately was impracticable. The question was raised in respect to all those firms: where was SOE headed? Deep changes had taken place in the thinking on this issue.

---

[14] Its main authors are I. Grosfeld, J. Lisowski, and St. Welisz.

[15] K. Lis, who used to be the leader of the privatization technocrats, left the government.

[16] The working out of the districtive aspect of vouchers was entrusted to DRTCompany; S.G. Warburg having become Chief General Adviser of MOC in respect of MPP.

[17] After having switched over to dollar currency in its transformations with its former trade partners of the CMEA, the *USSR* generally reduced import quotas from these countries.

[18] Among others, a repeated rise in the inflation rate, up to five to six percent per month.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


After the decline and fall of the Communist regime, SOE were left with more formal decisive power of their own – that had been introduced as early as 1981 – but also, by virtue of the elimination of the system of apparatchiks (nomenklatura), they had stopped being state-controlled in the personal sense as well. The so-called state sector in Poland has been in existence in name only ever since 1990.[19] In reality, it has been a hybrid formation of ill-defined ownership rights. Its style in respect to decision making and exercising authority is sometimes called the "Bermuda Triangle," with its three links being management, trade unions, and workers councils. A Bermuda Triangle, by giving rise to internal conflicts and hampering rational adaptive and development processes, leads firms astray. Workers councils are its most discredited link. The absence of a clear-cut division between employer and worker started to reveal its negative effects, which are now generally perceived. Actually, workers councils in many of the SOE receded, to the benefit of trade unions.

By the middle of 1991, many of the recent sponsors and advisers of the workers self-management lobby would gladly see councils eliminated from enterprises and they are in favor of more clarity in the employer-worker relationship.

In its first year, what practical experience has been collected from the functioning of privatization through liquidation? In terms of quantity, a budget of advances in privatization is listed in Table 1 (next page). Among the major barriers delaying the privatization progress in SOE is the absence of ample mortgage registers of lands and a lack of clarity regarding land ownership.[20]

It takes time, much financial expenditure, and technical organization to overcome forty-five years of the purposeful obliteration of ownership rights that occurred by throwing everything into a "common bag" of Communist-controlled property. Far from being easy, it also can generate conflicts. Among the major areas of bargaining

[19] There has never before been state enterprises of such an advanced autonomy.

[20] The problem is not merely to answer the question, who is the owner (e.g., which SOE, after its numerous reorganizations, owns land; the commune or the state; a cooperative or a state-owned firm, etc.). Also it is hard to establish where boundaries of land lots are. Exact survey maps have yet to be drawn.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371



**Progress in Privatization**

| | December 31, 1990 | May 31, 1991 | June 30, 1992 |
|---|---|---|---|
| a. Total number of state enterprises: | 8453 | 8578 | 7735 |
| b. SOEs transformed into joint-stock companies in the process of commercialization (started in September 1990) | 59 | 153 | 464 |
| c. Number of privatized SOEs<br>1. privatization through liquidation or closing by founding organ including: | 59 | 302 | 1249 |
| – under Privatization Law | 37 | 156* | 542 |
| – under State Enterprise Law | 22 | 148** | 707 |

*including:

- 59 service firms
- 36 industry firms
- 34 trade firms
- 22 construction firms

**including:

- 60 service firms
- 39 industry firms
- 19 trade firms

| | December 31, 1990 | May 31, 1991 | June 30, 1992 |
|---|---|---|---|
| 2. Privatization through commercialization (July 1, 1991)<br>(s. c. capital way)<br>including: | 1 | 13 | 36 |
| – Leveraged Buyouts | 1 | 2 | 6 |
| – Public Offerings | – | 5 | 9 |
| – Trade Sales | – | 6 | 21 |

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


for property is the process of drawing borders between local government property and state-owned property, a process that certainly will last at least a few years.[21]

Interesting experiences were disclosed by way of the privatization by liquidation procedure, which addresses small and medium companies. The three alternatives provided under this path, are:

sale of all or part of the assets of the liquidated firm;
contribution of assets to a new company (for example, joint venture);
lease of assets (regular or involving an eventual transfer of property rights) to a new joint-stock company created by the employees of the former SOE.

In practice, only the third option was utilized to any significant extent. This meant that insiders had principal access to small and medium firms being privatized. Again, prospective investors, whether domestic or foreign, were given little chance of buying into small and medium SOE. Thus the privatization of these SOE, essentially has become unilateral in both its purchasers (insiders only) and methods (leasing only). Practice has proven that the decision-making power assigned to company management organs under the privatization through liquidation scheme is strong enough. However, it has also shown that the formal and political position of founding organs as representatives of the state treasury is so feeble that they are unable to manage privatization projects of their own unless these projects also suit the interests of coalitions of insiders. This one-sided character of the privatization process in small and medium enterprises implies that any entrepreneurship and private initiative that exists in Poland would be left idle and be given little chance to develop. It would also slow down property reforms. To add to this difficulty, newly transformed companies at times have had such a dispersed ownership structure (when shares in employees' stock ownership are equal), that it is even harder to manage them efficiently after privatization than before. Wherever management dominates the ownership structure, company efficiency is usually high and its assets are better used.

This single-track method of small and medium companies' privatization induced the MOC to devise another active sales policy for them. This was designed to stop passive acceptance of leasing applications coming from below (workers and managers).

The so-called Privatization through Commercialization begins by transforming an SOE into a joint-stock company (corporation) and proceeds rather smoothly along the routes that have been programmed by the group of government technocrats. By improving the IPO and modalities, eight enterprises became privatized from September 1990 to July 1991. All of them found their way to the Warsaw Stock Exchange, which was commissioned on April 16, 1991. Shares were bought in packages, and their composition was as shown in Table 2. This was quite an efficient start to the public capital market in Poland and to the regulations laid down by the Public Trade of Valuables Act, adopted by parliament on March 22, 1991. This path is proving to be slow, cost-intensive, and ineffective, and economic ownership transformation may not rely on this path, because it would take decades – a perspective that is wholly unacceptable in view of the progressive decay of SOE. So the domestic course of British-style privatization confirmed that genuine solutions must be found for our priva-

[21] In Poland until 1990 there was no communal/municipal property at all because local government did not exist legally.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


**Large privatizations**

1. Public Offerings (for 1991)

| Name/Industry | Total Shares Offered (mm) | Price Per Share (US $) Others/ Employees | Share Take-up Number (000) % of Total Domestic Public Offering | Foreign Investors | Domestic Institutions | Employees | Management |
|---|---|---|---|---|---|---|---|
| | | | January 31, 1991 | | | | |
| **EXBUD S.A.** Constructions | 1.0 | 11.20<br>6.60 | 450<br>45.0% | 175<br>17.5% | 0<br>0.0% | 200<br>20.0% | 175<br>17.5% |
| **SLASKA FABRYKA** KABLI S.A. Cables | 1.0 | 7.00<br>9.50 | 700<br>70.0% | 100<br>10.0% | 0<br>0.0% | 200<br>20.0% | 0<br>0.0% |
| **KROSNO S.A** Glass manufacturing | 2.2 | 6.50<br>3.25 | 1100<br>50.0% | 44<br>2.0% | 616<br>28.0% | 440<br>20.0% | 0<br>0.0% |
| **PROCHNIK S.A.** Garment manufacturing | 1.5 | 5.00<br>2.50 | 855<br>57.0% | 90<br>6.0% | 255<br>17.0% | 300<br>20.0% | 0<br>0.0% |
| **TONSIL S.A.** Audio equipment | 1.5 | 8.00<br>4.00 | 480<br>32.0% | 450<br>30.0% | 270<br>18.0% | 300<br>20.0% | 0<br>0.0% |
| **WOLCZANKA S.A.** Textile June 10, 1991 | 1.5 | 4.34 | 510<br>34.0% | 945<br>23.7% | 450<br>30.0% | 900<br>20.0% | 225<br>15.0% |
| **SWARZEDZ** Furniture May 20, 1991 | 1.9 | 4.34<br>2.7 | 900*<br>47.4% | 517<br>27.2% | 489<br>25.4% | * | – |
| **ZYWIEC S.A.** Brewery July 7, 1991 | 1.54 | 8.69<br>2.17 | 420<br>22.6% | 500<br>26% | 540<br>28.4% | 240<br>12.0% | 200<br>10.0% |

* employees are included in domestic public offering

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


2. Leveraged Buyouts

| **ZAKLADY MIESNE INOWROCLAW** | | |
|---|---|---|
| Meat Processing | | |
| October 31, 1990 | | |
| Equity owned by employees | $0.54 million | 5,000 shares, fully paid up |
| Debt | $2.46 million | to be paid up over 5 years |
| | 2 years maturity, variable rate | |
| Total proceeds | $9.00 million | |

3. Trade Sales

| | | | |
|---|---|---|---|
| **FAMPA S.A.** | | | |
| Textile machinery | Single investor: | Beloit | 80% for $ 7.0 million |
| February 16, 1991 | | | plus $ 15.0 million in new capital |
| **POLAM PILA S.A.** | Single investor: | Philips | 51% for $ 15.0 million |
| Light bulbs | Employees | | 20% |
| | Treasury | | 29% |
| **NORBLIN** | Single investor: | Universal S.A. | 80% for $ 2.8 million |
| Steel mill | Employees | | 20% |
| **THOMSON-POLKOLOR** | Single investor: | Thomson Consumer-Electronics- | 51% for $ 35 million |
| Electronics | | Videocolor -Polkolor | 49% |
| **POLLENA** | Single investor: | Unilever | 80% for $ 20 million |
| Chemistry | | | |

tization, and these solutions must fit into the unique situation that exists in Poland.

Furthermore, the period under review also featured the discrediting of scrupulous valuation as a condition for privatization. It has become obvious that the main flow of privatization may not rely on it, because it is not the most important matter. Rapidly changing economic-financial conditions turned the issues of prolonged valuations of enterprises into a joke. Left over was the consciousness that valuation is a necessary procedure for the sales of assets to foreign investors and as a prerequisite to the Initial Public Offering program.

A major practical lesson taught for the long run is that there is an obvious imperative to carry through the privatization of banks as soon as possible. State-owned banks already have played a negative role by delaying and restricting healthy systemic transformations of selecting enterprises in the stabilization program. This has re-

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

p0063371


sulted in a superfluous pile-up of bankruptcies of SOE. Sluggish state-owned banks are also a barrier to an active privatization policy, as they do not give sufficient financial support in the purchasing of small and medium SOE by private Polish investors.

The final practical lesson appears to be that privatization in post-Communist countries should be considered in terms of an indispensable element of systemic transformation rather than a means to provide funds to the state budget. Revenues assumed in the Budget Law of 1991 were to amount to about PLZ 15 billion. This was to constitute about six percent of the total income of the state budget, yet not even one-half of what was expected was attained.

## Toward Attainment of an Active, Multi-Track, and Multi-Address Privatization Strategy

The dramatically worsening financial position of SOE in the first half of 1991 and their obvious adaptational difficulties have posed two questions. The first is whether and how, if possible, to speed up privatization. The second is what possible changes in the formula to privatize or reorganize SOE should be implemented to reduce at least some of its negative side effects.

The latter question still has no satisfactory answer. Admittedly, the government has proclaimed corporatization of about three hundred SOE during the second half of 1991. This is to abolish the "Bermuda Triangle" of power in the binding formula of SOE, but this trend does not seem promising. Such a corporatization would, in fact, be nothing but a renationalization could never be worse. The state – in the political and administrative sense, is in a transition stage. Its political system is just now emerging and it probably will lack stability for a while. Central administration will also have to undergo radical changes, as at the present it is weak in terms of personnel, management structure, and finance. Old usages and a longing for conducting business through personal contacts by SOE make them lag behind. Given such realities, the state may not be a good owner, not even relatively so.

It is also essential to understand the psychology of SOE. Most of SOE have decided to wait to see if the Balcerowicz Plan will collapse, hoping for the good old, paternal times of "soft" and flexible financing to return. Now faced with the realistic threat of bankruptcy, these firms would gladly give up their self-dependence and self-management in exchange for a return to the custody of the state, as the state would never allow the worst to happen to them. Therefore mass renationalization (through corporatization) would send a false signal to those firms and prolong their passive and infantile stage.

Managerial contracts probably will be a better solution. This option was created by Parliament in July 1991 in their Amendment to the "Privatization Law for State-Owned Enterprises." Workers councils can now apply to their founding organ to entrust their management, under a separate contract, to a natural, or legal person for a time period not shorter than three years. Workers councils (worksite self-management organs) are to be phased out as soon as the new manager takes over his duties.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


Still the two solutions cited above are merely palliatives. The real challenge was addressed to the privatization strategy itself, where the new element was the necessity of connecting it with restructurization activities.

The answer to this is furnished by the three elements of privatization strategy formulated by J. Lewandowski. They are: more rapid and an altered mode to privatizing small state-owned firms, mass privatization, and sectoral approach.

At the same time, methods applicable so far, such as leasing, IPOs, and Trade-Sale, were to be continued. He attempted to introduce this comprehensive strategy in summer 1991 but the attempt by various groups to politicize the privatization issue led to over one year delay in the Mass Privatization Program. According to the current timetable, MPP is to be introduced in January 1993.

This program initially will involve privatization of six hundred medium to large corporatized SOEs with a total turnover in 1990 of up to $15 billion. A 60 percent stake in the companies will be transferred to Investment Funds (IF) that will be run by fund managers, while the balance will be split between the government or the Polish social security system (ZUS) (30 percent) and employees (10 percent). The only shareholders in the IF will be Polish people. Each adult citizen will automatically be allocated one free share in each IF. This method of allocating fund shares to the population has been proposed to ensure that the MPP is seen to be completely fair.

Shares in the companies allocated to the MPP will be transferred as follows:

| | |
|---|---|
| 30% | of shares allocated to lead fund |
| 27% | of shares distributed pro rata among all other funds |
| 60% | total percentage of shares held by funds |
| 10% | of shares given free to employees |
| 70% | percentage of privatized shares |
| 30% | of shares retained by the state and/or ZUS |
| 100% | total share capital |

The investment funds will be closed-ended and will, in due course, be listed on the Warsaw Stock Exchange.

The inducements to introduce IF and give up the variant of issuing privatization vouchers for direct purchase of shares in the companies have been:

- to eliminate excessive economic risk inherent in the side effects of privatization on the macroeconomic equilibrium of the country (inflation-generating stimulus);
- to eliminate excess political risk involved in being given for gigantic market shares for speculations which would lead to socially unacceptable wealth accumulation;
- to avoid the necessity of SOE valuation at the beginning of ownership transformations;
- to ensure the technical and logistic feasibility of the program;
- to enable from the start the achievement of an economically feasible concentration of control of companies, despite the wide disbursement of actual owners;
- to provide for the possibility of rapid importation of western management, without mass transfer of ownership control to foreign capital.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


Recognized, highly experiencedWestern companies will be hired to manage the IF. It is expected that by virtue of MPP, the positions of owner and employee (with no more workers councils) will be clarified in the companies covered by the MPP program and that consequently those companies would gain the ability to implement transformation programs, which might be painful to their staff.

It is further assumed that IF will perform the function of actual privatizers, by attempting to find joint-venture partners from abroad, and by raising capital through future stock issues. This denotes a decentralized privatization mode by establishing core strategic investors. After this profound privatization comes true, it will be possible either to wind up the IF, transform them into open-ended funds, or swap their shares for shares in other funds.

MPP is to be introduced in 1993. After 1993 the results of companies and the IF will be published. Shares in IF held by citizens will start being traded in 1994. It is expected that MPP will provide a political umbrella to protect privatization for the strategic investors both foreign and domestic, as well as for the entire system transformation. The beneficiary of these rationalizing measures in the enhanced privatization will not be the state but rather will be society.

The third novel element in the privatization strategy was the sectoral approach which has emerged in the wake of practical circumstances and experiences. The collapse of the planned economy has laid bare the rather shocking fact that databases available to the SOE, branches, and sectors are practically nonexistent. When the government ofT. Mazowiecki in 1990 developed its program and decided not to conduct an industrial policy, state databases on the economy certainly did not improve.

On the other hand, sales of specific SOEs to foreign investors taught a lesson that such privatization of one plant or company can exert negative effects on the functioning of others and that there are cross-company effects or side effects. The sales also pointed out the danger of "cherry-picking" because investors often thought in categories of the entire sector and not just one plant; while there are no databases to steer sales policy of enterprises consciously to those investors. On top of this, the interrelation between privatization and the restructuring of enterprises creates implications for the structure of privatization decisions in 1991.

In view of these circumstances and considering the low throughput capacity of the MOC, the sectoral approach to privatization (SA) came into existence. The essence of SA is in the selection and hiring of a lead adviser (possibly a consulting company) who shall have full responsibility for:

analysis of a sector, both domestically and internationally;
developing a sector strategy and policy;
preparing recommended actions with respect to privatization and restructuring of each company within the sector;
implementing recommended privatization and/or restructuring actions.

The SA is not a privatization path in itself, like IPO, trade sale, liquidation, LBO nor is it a transfer to privatization funds ("mass privatization"). SA can lead to any of those and furthermore may help to initiate coordinated actions in the field of the company or industry restructuring. Therefore sectoral privatization should be seen mainly as a way of assigning companies to the various privatization and/or restructuring paths without a sufficient database.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


Sectoral privatization is a tool for "soft" but "applied" industrial policy; its objectives are:

avoiding unintentional cross-company effects and cherry-picking by investors;
implementing economies of scale: lower unit costs and higher throughput of the preparation and coordination of work within the privatization decision process;
achieving a better bargaining position when negotiating with investors;
providing better information to potential investors.

The privatization strategy outlined above was subject to yet another public debate in connection with parliamentary elections due on October 26, 1991. This time its participants were political parties representing different interests and variegated ideologies. Privatization process was subject to intense criticism during this period. The government appointed in January 1992 was instrumental in blocking the entire process of privatization in Poland. The new governent, in the power since June 1992 moved quickly to implement the passage of the MPP law. Public opinion appears to shifted in favor of the MPP concept.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371



*Franz-Lothar Altmann*

# The Transformation of Property Rights in Czechoslovkia

As in the other countries of Eastern Europe where the means of production were held predominantly by the state or by cooperatives, Czechoslovakia's preparations for privatization started soon after the political change of late 1989. Privatization has four main constitutional activities:

Provision of equal legal status for all kinds of ownership, private and state-owned and cooperative;

Restitution (reprivatization) of property that had been expropriated by the Communists;

Privatization of small state-owned businesses;

Privatization of large state-owned enterprises.

In addition, the economies must also be opened for foreign investment by adopting modern joint venture legislation that not only allows for nonresidents to establish private joint companies but also provides the possibility of starting exclusively foreign-owned private businesses in each post-Communist country.

## Provisions of Equal Legal Status and Restitution in the CSFR

By April 1990 the Federal Assembly in Prague had approved laws enabling Czech and Slovak citizens to establish private businesses with no upper limit concerning the number of employees, giving private firms equal legal status with state-owned enterprises. Parliament regulated the establishment and the functioning of joint-stock companies and joint ventures.

On October 2, 1990, the first Restitution Law was announced allowing people to reclaim some 70,000 small shops, hotels, restaurants, and other businesses, mainly service related, which had been expropriated between 1955 and 1961.

On February 21, 1991, a second restitutional law, the so-called Law on Extrajuridical Rehabilitation, was passed by the Federal Parliament following intensive criticism that properties that had been expropriated before 1955 were excluded from restitution. This law went into effect on April 1, 1991, and provided the necessary legal basis for the return of businesses and industries confiscated between February 25, 1948, and January 1, 1990. There remained some limitations, however, since restitution could only be made to individuals, not, for example, to political parties or churches. Perhaps later separate laws will regulate these cases. The law also excludes emigres not residing in Czechoslovakia.

Restitution means actual return of the property. If improvements to the property have been done over the past forty years, then the former owners or their heirs may either pay the appropriate costs to the state and take over the property, or they can accept financial compensation instead, mainly in the form of vouchers that later could be exchanged for shares in newly privatized companies. Approximately 10 percent of all state-owned property might be affected by this restitution.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


Land was not included in this restitution legislation until Parliament passed a Land Restitution Law on May 21, 1991, which regulates the return of land seized by the Communists after February 1948. It could affect 3.3 million former land owners but it sets upper limits for restitution at 150 hectares for arable land and 250 hectares for forests. It leaves aside the question of the transformation of agricultural cooperatives into enterprises of the market economy type.

## Small Privatization

The Law on Small Privatization passed the Federal Assembly on October 25, 1990, very soon after the announcement of the first restitution law providing for privatizing state-owned small businesses not foreseen for restitution. Some 130,000 state-run shops and smaller enterprises, mainly in the service sector would be auctioned off to private bidders, in a series of sales beginning on January 1, 1990.

If the state did not own the building where the shop was located and restitution of the building might become possible, the state guaranteed that new private small entrepreneurs will not be expelled from the premises for two years. This guarantee was extended to five years in a law of late 1991. When the state owns the building, the real estate would be sold along with the company. Local committees supervised the auctions in the first round, in which only Czechoslovak citizens could participate. Some spectacularly large amounts of money were paid for relatively small businesses. It was assumed that not only black-market money came to the surface but also that foreigners or emigres without Czechoslovak citizenship participated in these auction rounds through Czechoslovak intermediaries. Foreigners are allowed to participate in the second round of small privatization in 1992.

A major problem is the unclear boundary between "small" and "large" privatization, leading to disputes among members of the government as in the case of large trading companies. Such officials as Czech minister for domestic trade and tourism, Stěpová wanted to remove from the auction program those trading companies residing in premises with more than four hundred square meters and sell them directly to foreigners instead. Nevertheless, some 10,000 Czech and 3,000–6000 Slovak small state firms had been auctioned off to private bidders before October 1991.

Together with newly founded private businesses, the number of private entrepreneurs was already close to a million by the end of October 1991. However, 98 percent were one-person companies, and only for 20 percent of them this private business was their main occupation. Many so-called self-employed worked for other private entrepreneurs who thus could escape the payment of the quite high wage tax.

## Large Privatization

Probably even more than in the other East European countries in transformation, in Czechoslovakia large firms dominate industry. It was clear that privatization of these large firms could not be pursued quickly through open sale of stock to the public. Among the problems for such a procedure there were three major ones:

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

p0063371


Lack of domestic capital that could be involved in purchasing assets from firms considered by the public as inefficient and not competitive in market economy environments, in particular on the world market;
Technical difficulties of determining the value of such enterprises in the absence of a fully functional stock market;
Politically motivated and enhanced restrictions on foreign ownership due to fear of "sale of the nation's wealth."

On the other hand, it was also obvious that some program of mass privatization of large enterprises was absolutely necessary in order to strengthen and support the transition to a market economy, to gain efficiency through improved enterprise management, to create motivated property owners, to start and deepen capital markets, and to distribute state property equitably among all citizens.

On February 26, 1991, the Law on Large Privatization was adopted by the Parliament in Prague, and a Fund of National Property was established on April 1, 1991, with its own institutions in the Czech lands and in Slovakia for property held by the republics. According to guidelines issued in summer 1991, the governments each published two lists of enterprises:

The first lists companies foreseen for privatization and those that will not be privatized because of liquidation;
The second gives information on companies that will not be privatized during the next five years. By the end of 1991, a total of approximately 4,000 companies was foreseen for mass privatization, which should take place in two phases, with about 2,400 in the first phase.

Companies selected for privatization have to prepare proposals specifying different privatization methods. These may be either direct sale to domestic or foreign parties or, after first being transformed into joint-stock companies, sale of shares either directly through auctions or in exchange for vouchers, the latter being the main privatization method.

Until the end of October 1991, the enterprises were supposed to present their privatization proposals to their "founders," in most cases the respective ministries, where competing proposals from others might also be delivered. The founders or ministries were expected to review the proposals until the end of November 1991 and then to forward the approved proposals to the respective ministries where decisions would be made on the final list of the companies to be included in the coupon privatization scheme.

At the same time, October 1991, the entire adult population was given the opportunity to obtain coupon books and registration stamps for a fee of 1,000 Kčs in post offices and some other designated places. Registration of those willing to participate with their coupons started on November 1, 1991, at 641 registration bureaus, enabling coupon owners to bid with their investment points for shares of the enterprises that would be auctioned in two waves scheduled to start on February 1, 1992. This was delayed for a month because the review process had been more complicated and time-consuming than anticipated.

Coupon owners were to be able either to bid for shares of companies during the auctions or to use the services of investment funds to be created by private initiative following guidelines prepared by the government. Individuals and/or investment funds will bid for companies' shares in up to five rounds in each of the two waves. It is

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


expected that not more than five computerized rounds will be necessary to find the appropriate prices for the respective shares, to balance supply and demand in each of the privatization waves. The first wave should be finished by June 1992, probably to provide a kind of success report just before the next parliamentary elections.

This time schedule becomes more and more problematical because the reviewing process for 1,700 Czech and 700 Slovak enterprises could either be extremely superficial but quick or be more thorough but slow. Furthermore, it turned out that the interest of the public is much smaller than politicians – in particular federal minister of finance V. Klaus – predicted. The sale of vouchers and the subsequent registration of the coupons for the auctions proceed at a much slower pace than expected, and by November 1991 the Czech minister of privatization started a public dispute with Klaus, the main protagonist of the voucher method, over how much more time is needed for checking the single privatization proposals and, in particular, possible restitution claims. Although a broad information campaign on television and radio as well as in brochures and newspapers and on posters was launched, criticism arose that public information was insufficient. Finally, many difficulties arose over the right book values of the assets of the enterprises. However, all of a sudden in late December 1991 and in January 1992 a rush for the voucher books and the registration started, because obviously people did not want to miss a chance that in fact does not need too great an investment (Kčs 1000!): At the end 8,5 million voucher books had found their way into Czech and Slovak households.

To sum up, the whole program of mass large privatization gives the impression of the predominance of politically motivated speed over thorough evaluation and selection. Instead of revenue considerations, speed seems to be the major objective of the voucher program.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371



*Roland Schönfeld*

# Transformation and Privatization in East Germany
# Strategies and Experience

Among the previously socialist countries of East Central Europe, the former GDR is a special case. After the collapse of the Communist regime, the transition to a market economy was facilitated by the unification with West Germany, Europe's richest source of investment capital. Despite this comparative advantage, the transformation and privatization of the East German economy turned out to be more complicated than expected.

## State of the Economy

The economic unification of the two German states started with the "Economic, Currency, and Social Union" on July 1, 1990.[1] The West German DM became the official currency of the GDR; the Ostmark was given up. A common German market was created by removing all trade barriers between the two states to free the flow of goods, services, and capital. Full labor mobility was brought about immediately by canceling travel restrictions.

Having benefited from certain membership privileges in the inner-German trade so far, the GDR became a full member of the European Community (EC). The central planning of production and distribution ended. Prices of goods and services – except rents, transportations, and energy – were set free. With the political unification of the FRG and the GDR on October 3, 1990, the West German legislation, including economic, tax, and social laws, was extended to East Germany, a Blitz transition from a planned to a market economy. The effects were devastating. When the hitherto totally protected East German industry was exposed abruptly to West German and international competition, its production collapsed.[2] Damages and deficiencies caused by socialist planning in production, services, housing, infrastructure, agriculture, and environment became evident.

The East German economy was in a desolate state. The leaders of the GDR had stubbornly refused to implement reforms of the highly centralized planning system. Unlike Hungary, Poland, or even Bulgaria, the GDR did not experiment with limited price liberalization, with the transfer of decision-making processes to production units, or with permitting small private enterprises in the service sector. Though utterly submissive to the Soviet leaders, the East German Communists defied the Soviet model of perestroika.

---

[1] Der Vertrag über die Schaffung einer Währungs-, Wirtschafts- und Sozialunion zwischen der Bundesrepublik Deutschland und der Deutschen Demokratischen Republik. Erklärungen und Dokumente (Presse- und Informationsamt der Bundesregierung, Bonn, June 1990).

[2] Bernhard Eschweiler, "East Germany's integration with the West", *World Financial Markets*, September/October 1991 (New York: Morgan Guaranty Trust Company), pp. 3–17.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


Suffering from the cutting down on oil and raw material supplies by the USSR, the GDR ran into growing balance-of-payments constraints. The collapse of the CMEA, accounting for two-thirds of East German foreign trade, added to the crisis. The GDR's weak trade position with the West deteriorated. In spite of continued financial backing by the Federal Republic, the GDR accumulated foreign debts of 17 billion dollars through 1989.[3]

The technological gap to the industrialized West could be counted in decades. Antiquated machinery produced poor quality at high costs and with a considerable rate of waste. Labor productivity came up to only one-third of the West German level. Most factories were overstaffed. Principal industries were concentrated in "rust-belt" sectors – steel, chemical, heavy engineering, ship-building, textiles – with worldwide surplus capacities. In fact, the pre-war production structure of East Germany was kept up and enhanced by the crude division of labor in the CMEA, notwithstanding fast changing world market conditions.

Infrastructure was obsolete and totally inadequate. Roads, railways and telecommunications had stagnated at a pre-war level and were badly in need of repair. Public services lacked modern equipment. Pollution, caused by lignite-burning power plants, factories, and households, and by a startling neglect of environmental protection, was enormous. Damages done to the health of the population, to agriculture, to the water supply, and to housing can hardly be estimated. Significantly, historians and official curators of monuments are worried that fast modernization of the East German economy will destroy one of the last regions in Europe featuring "monuments" – machinery and equipment as well as complete factories – from the early industrial age.[4]

When the Communist regime of the GDR collapsed, hundreds of thousands of East Germans migrated to West Germany, mostly young, skilled blue- and white-collar workers and professionals with their families. After the wall in Berlin and the border fortifications surrounding the GDR had been torn down, this migration increased. The drain of labor was undesirable for political and social reasons, and the economy of the GDR became unviable. In West Germany, older workers were pushed out of jobs, and housing shortages in industrial centers were exacerbated. To reduce the migration from East to West was one of the main reasons to offer quite favorable conditions to the East German population when the Currency Reform was implemented. In fact, with the Economic, Currency, and Social Reform put into operation on July 1, 1990, the migration decreased, though it never ceased completely.

---

[3] Roland Schönfeld, "Unification and the Future of German Trade", in Gary L. Geipel, ed., *The Future of Germany* (Indianapolis: Hudson Institute, 1990), pp. 78–92.

[4] Gerhard Staguhn, "Wo der frühe Kapitalismus überlebte", *Frankfurter Allgemeine Magazin*, April 12, 1991, pp. 52–62.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


## Effects of Economic Unification

After the Wall was opened, the exchange rate of the East German currency had dropped to 20 Ostmark for 1 DM.[5] With goods from the West being readily available and the stability of the domestic currency being increasingly distrusted, the value of the Ostmark kept tumbling. Despite warnings of the Deutsche Bundesbank that inflationary tendencies were being unleashed in the currency area by unrealistic conversion rates, the West German government offered quite generous conditions, for political and social reasons. By the Currency Union on July 1, 1990, East German savings, running up to approximately 175 billion Ostmark, were converted at a rate of 2 Ostmark for 1 DM, and limited amounts per head even at a rate of 1 for 1. Thus about 120 billion DM were created from one day to the next, increasing the total amount of DM circulating by roughly 10 percent. With West German firms using surplus production capacities and additional imports to cover the sudden East German demand, however, the suspected inflationary pressure failed to appear.

Wages, salaries, and old-age pensions were converted at par to keep income differences between East and West Germany from growing even more. By a conversion rate of 2 Ostmark for 1 DM, the huge 260 billion Ostmark debts of East German enterprises were cut by half. The consequences of the Currency Union and the creation of a common German market for commodities, labor, and capital were disastrous for the East German economy. East German consumers refused to buy expensive low-quality goods from domestic production. Sales to East European countries dwindled when charged in DM. It became evident that the production costs of East German industry were far too high to let enterprises prevail in the fierce international competition.

The industrial enterprises of the GDR producing for foreign markets had spent between 4 and 10 Ostmark of production costs to earn 1 DM in export. The gap was closed by state subsidies and special exchange rates for currency proceeds. Even enterprises with relatively modern equipment proved not to be competitive when prices were converted 1 for 1. East German camera maker Pentacon, tipped as a likely post-union success, ended up as a failure. Its production costs per unit turned out to be seven times higher than its earnings from sales.[6]

By the end of 1991, East German industrial production had shrunk to less than half of the 1989 level. Many factories closed down. Many more will follow. Others tried desperately to avoid closing by laying off workers. Restructuring schemes for inefficient state enterprises are based mainly on a greatly reduced labor force. Mass unemployment has been spreading rapidly in the new Länder. While the labor market conditions improved in West Germany in 1990–91, due to the production boost caused by the demand for western goods of 16 million East German consumers and by huge government orders to the construction industry, millions of jobs have been destroyed in the East.

---

[5] The official exchange rate was fixed at 3 Ostmark for 1 DM on January 1, 1990. The black-market rate rose to about 5:1, when the discussion about a currency union between the two German states started in January 1990.

[6] *The Economist*, May 11, 1991, p. 67.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


At the end of 1991, in East Germany about one million (11.7 percent of the labor force) were registered as unemployed. Further, 1.1 million were on short-term – in most cases virtually "zero" – work.[7] Though these favorable conditions securing most of the former salary were extended, many more will lose their jobs when their contracts finally expire. By now, every third East German employed in 1989 was laid off. According to the forecasts of leading German research institutes, the jobs available in East Germany will shrink from 6.6 to 5.5 million.[8] About 700,000 workers have left East Germany for good. Further half a million are commuting to jobs in West German cities. Several hundred thousands have accepted favorable offers of early retirement. The high rate of women employed has decreased to the West German level.[9]

Without any doubt, unemployment in East Germany is accelerated and the creation of new jobs is hampered by fast-rising wages. Increasing more rapidly than labor productivity, wages have reached about two-thirds of the West German level. Trade unions exert considerable pressure to close the gap between incomes in East and West Germany. Their efforts are supported by West German industries worried about "unfair" competition of East German enterprises employing cheaper labor. Investors are forced to economize on labor and to implement capital-intensive production methods, an odd thing to do in a region with major unemployment. On the other hand, it would be hard to keep up two different wage structures in one labor market over the years. As prices of consumer goods and foodstuffs are the same in the German market, and rents, energy, and transport prices are approaching West German levels, lower wages, unemployment benefits, and old age pensions become less socially acceptable.

## Alternative to Unification?

Was there an alternative to the chosen methods of economic unification?[10] The conversion rates of Ostmark implemented by Currency Union can be questioned. However, even an exchange rate of 2 Ostmark for 1 DM for wages would have reduced East German incomes to less than one-quarter of the West German average.[11] This setback would have accelerated, definitely, the migration of flexible young East Germans to the West.[12]

---

[7] *Frankfurter Allgemeine Zeitung*, December 6, 1991.

[8] *Neue Zürcher Zeitung*, October 23, 1991.

[9] Katharina Belwe, "Zur Beschäftigungssituation in den neuen Bundesländern. Entwicklung und Perspektiven", *Aus Politik und Zeitgeschichte. Beilage zu Das Parlament*, July 12, 1991, pp. 27–39.

[10] For a critical analysis, see Raimund Dietz, "The Impact of the Unification on the East German Economy", *WIIW-Forschungsberichte*, no. 172 (Wien: Wiener Institut für Internationale Wirtschaftsvergleiche, 1991).

[11] A conversion rate of 2:1 for wages and pensions was recommended by the Deutsche Bundesbank (central bank of Germany) in March 1990. *Neue Zürcher Zeitung*, April 4, 1990.

[12] Wolfram Schrettl, "Economic and Monetary Integration of the Two Germanies", *Economic Systems*, 15:1 (April 1991), p. 5.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


Before the Economic and Currency Union was set in force, East and even some West German economists had suggested keeping the GDR as an independent national entity with its own currency and trade policy for a transitory period of several years. According to these advocates of a "soft landing," the Ostmark should have been devalued heavily to allow East German enterprises to compete on domestic and foreign markets, in spite of their high production costs. Additionally, imports from West Germany and other countries could have been curbed by tariffs and quotas. These methods were to offer time to restructure the East German industry and to prepare it for the integration into the world market.

In retrospect, however, the beneficial effects of this scheme seem doubtful. A heavy devaluation of the East German currency was apt to raise import prices. In an economy heavily dependent on imports, this must affect commodity prices in general. Together with price liberalization in monopolistic production structures, the devaluation would have set in motion an inflationary spiral. Inflation might have wiped out the cost advantage of East German enterprise or forced the currency to precipitate, creating considerable unrest and speculation against the Ostmark. Strict budgetary controls and high interest rates would have stifled any economic recovery.

Furthermore, the DM had been a symbol of wealth and purchasing power for the population of the GDR. Thus, it was a much demanded second currency even before the Currency Union. A booming black market in currency and the final removal of the weaker by the stronger currency could hardly have been avoided, not even by strict border controls – an absurd idea in itself.

Protected by devaluation, tariff, and quota barriers, the huge and inefficient state trusts of the GDR, still managed by the old-boys network, would have resisted any substantial change of the system that might have endangered powerful positions. A government of inexperienced amateurs, eager to avoid social tensions, had dragged along with the useless old economic system, wasting aid and capital imported to cover growing budget deficits. Nobody could have prevented mass emigration of labor and, finally, the collapse of the East German economy. Fortunately, politics had decided in favor of an immediate unification with West Germany.

## Emergency Measures

Considering the deteriorating economic situation in eastern Germany, the German government has taken several emergency measures. In order to improve the chances of dismissed workers to find new jobs, government agencies are offering training facilities free of charge. In general the eastern German labor force is well trained, but they lack knowledge and experience in using most modern machinery and equipment. Additional training is supposed to prepare them for high-tech jobs, yet the demand does not meet the full capacity of training facilities. Generous unemployment benefits, short-term work contracts, and a widespread attentism if not fatalism seem to keep many workers from taking advantage of this opportunity.

In regions with a particularly high rate of actual and expected long-term unemployment, laid-off workers are being absorbed in "employment promotion companies" (Beschäftigungsgesellschaften), which are supposed to slow down the growth of un-

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


employment in the new Länder (federal states) and, for the individual worker, to bridge the months or years till he has found another job. These companies are run by the government, pledging to continue the full payment of the wages received before being laid off. Charged with pulling down closed factories, cleaning up polluted sites, and other services, the employment companies are criticized for competing with other new private enterprises. Taking the pressure off the unemployed, they are said to keep them from looking for secure jobs in regions and branches with better prospects.

Other government measures to curb mass unemployment in eastern Germany are also widely discussed. Investors purchasing former state enterprises in eastern Germany must guarantee a minimum number of jobs for at least two years.[13] The risks involved in this pledge have allegedly kept many potential investors away so far. A particularly delicate issue is the continued provision of virtually bankrupt enterprises with state-guaranteed liquidity credits in order to postpone their collapse and liquidation.

Economists are worried by the growing interference of Länder governments to safeguard jobs and industries in regions with high unemployment. An outstanding example is the takeover by the state of Thüringen of Zeissoptik Jena, the biggest eastern German producer of lenses. This firm is losing 1.5 million DM per day. With the financial aid of the federal government – a 3.5 billion DM credit was guaranteed – this industry could become a "bottomless pit" as a result of a shortsighted regional policy.[14]

## Promotion of Private Enterprise

In order to reanimate the eastern German economy, private enterprise and the privatization of the state sector is promoted by the government, and the reason is simple. Private ownership of the means of production is regarded as a constitutive element of the western German economic order. Private enterprise has been the principal cause of West Germany's economic success in the past four decades. Politicians and economists are convinced that only private entrepreneurship is able to raise economic efficiency and labor productivity in the new Länder to western German levels. Above all, medium-sized and small private firms are held to be important for changing the production structure and increasing the demand for labor. In the old Federal Republic almost 80 percent of all jobs have been created by enterprises with fewer than 500 employees.

Only private enterprise will be able to raise the investment capital – estimates run from 500 to 800 billion DM – needed to modernize obsolete production plants and to produce new competitive goods. Only private entrepreneurs have the experience and capacity to restructure old and to run new profitable firms.

The inadequate eastern German infrastructure is regarded as a major impediment to the reconstruction and privatization of the economy. Therefore, considerable

---

[13] According to the chairman of the Treuhandanstalt, Birgit Breuel, purchasers will have to pay conventional penalties up to 100,000 DM ($ 60,000) for each promised, yet not created, job. *Frankfurter Allgemeine Zeitung*, July 19, 1991.

[14] *Frankfurter Allgemeine Zeitung*, June 13, 1991.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


amounts of public funds are invested in the improvement of telecommunication, roads, railways, schools, and hospitals, in the retraining of public servants and the setting of a modern administration, in the restoration of monuments and in the removal of ecological damages.[15]

Most of these expenditures are being charged to the federal budget. Its growing deficits are covered, excessively, by credits, and since 1991 also by raising additional taxes. In 1991, 153 billion DM (about $90 billion) were transferred to the new Länder as financial aid, but only about 40 percent of these public funds are earmarked for investments necessary to improve the conditions for private enterprise in eastern Germany. Approximately 60 percent of this amount was needed for social purposes, for example, subsidies for state enterprises, public insurance companies, funds for unemployment benefits, retraining facilities, and employment promotion companies.[16] Given that these transfers of budgetary means will be necessary for several years to come, the share of investment will increase with economic recovery in eastern Germany.

Private investment and the establishment of private enterprises are promoted explicitly by the federal government. Generous investment allowances and tax exemptions, cheap credits and export guarantees – particularly for deliveries to Eastern Europe – are granted for newly founded firms and privatized former state companies.[17] Since 1990, hundreds of thousands of mostly young entrepreneurs seized the opportunity to establish enterprises in eastern Germany, above all in the service sector. Many of them are one-man or family enterprises, so they have just a minor effect on the eastern German labor market. The bankruptcy rate among these newcomers is high. On the other hand, these small firms are rather important for training managers by "trial and error." In eastern German industry, however, the share of these newly founded establishments is tiny.

## Problems of Privatization

For that reason, the privatization of the state sector, particularly industry, is given priority as the most important condition of the economic reconstruction and recovery in eastern Germany. A state agency run under the auspices of the ministry of finance was assigned the task to restore private property in the almost completely nationalized East German economy. Founded in East Berlin in the spring of 1990 by the Modrow government, the *Treuhandanstalt* had to start virtually from scratch. Burdened with incompetent eastern German employees and a poor and unreliable information system at first, it has developed to become the most successful privatization agency in the world.

---

[15] F. Neumann, "Bestandsaufnahme und Perspektiven der Direktinvestitionen in Ostdeutschland", *ifo schnelldienst* 3/91 (München: ifo Institut für Wirtschaftsforschung, 1991), p. 8 f.; "Umweltschutz in den neuen Bundesländern", *ifo schnelldienst* 11/91, p. 9.

[16] *iwd Informationsdienst*, 17:26 (Köln: Institut der deutschen Wirtschaft, 1991), p. 4 f. In 1992 these budgetary transfers to eastern Germany will increase to 170 billion DM (about $ 100 billion). *iwd Informationsdienst*, 17:43, p. 4.

[17] *Wirtschaftskonjunktur* 4/91 (München: ifo Institut für Wirtschaftsforschung, 1991), p. A 11.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


Equipped with a staff of 3,000 employees, supervised by experienced managers from western Germany, Treuhandanstalt has sold approximately 20,000 service establishments and about 5,000 former state companies, or parts of those, to private investors in less than one and a half years. Until the end of 1991, purchasers had pledged to invest more than 100 billion DM (about $60 billion) and to secure about 900,000 jobs.[18] West German banks, insurance companies, and chain stores have taken charge of the respective branches in eastern Germany. Almost all formerly state-run service establishments as retailers, carriers, inns, and restaurants have been privatized. West German power plants meet the eastern German demand for electricity. They are planning to invest 50 to 60 billion DM in order to reorganize inefficient eastern German lignite-burning plants, modernizing their obsolete facilities, improving their safety standards, and reducing excessive pollution.

Likewise the eastern German construction industry has been sold, mostly to western German contractors benefitting from huge public orders to build roads, railways, and bridges, renovate buildings, repair water supply and sewerage systems, develop telecommunication networks, restore monuments, and remove the worst ecological damages. The private construction industry has become the most booming branch of the eastern German economy.

The Treuhandanstalt has been encountering major difficulties in privatizing other industrial branches. To facilitate the sale of the state industry and to break open the monopolistic production structure, it had started out with splitting up 316 huge state trusts, the so-called "Kombinate," into 8,500 independent companies that were given the legal status of corporations or limited liability companies. With almost all eastern German enterprises placed under its control, Treuhandanstalt became "the world's largest industrial holding."

Originally the Treuhandanstalt was not to act as a holding company, but to make itself superfluous as soon as possible. In order to achieve its goal to privatize the eastern German economy, it has sold former state companies in direct negotiations with individual purchasers, by inviting tenders in international journals, for example, and by public auctions. Of the almost 5,000 industrial enterprises sold before the end of 1991, about 5 percent were handed over to former managers or other employees in "management" or "employee-buyout" schemes. About nine-tenths of the purchasers are western German firms, and only now have foreign investors become increasingly interested. Their growing number is inciting hitherto hesitant western German competitors into trying to secure the most profitable investment opportunities.

Despite these obviously successful operations of the Treuhandanstalt, the impediments to privatization are manifold. It turned out to be extremely difficult to evaluate the assets and to estimate the future profitability of eastern German enterprises. Western valuation methods, for example, to derive the capitalized value of future profits, are in most cases impossible. Future financial burdens, caused, for instance, by the need to remove ecological damages, can hardly be calculated.

---

[18] According to the chairman of Treuhandanstalt, Birgit Breuel, 6,200 enterprises were then still held by the Treuhandanstalt. *Frankfurter Allgemeine Zeitung*, December 19, 1991.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


In some cases, necessary information was withheld by the old managers fearing for their jobs. Opening balance sheets, to be prepared by all former state companies after the Currency Union, were often based on poor and unreliable data or they painted too favorable a picture. No functioning real estate market has developed yet in the new Länder. Almost all of the enterprises to be sold lack the prerequisites for admission to the stock market. The Treuhandanstalt is widely criticized for attempting to hedge the risk of selling eastern German assets under value. Purchasers are liable eventually to pay the difference between the contract price and the real value of the real estate to be stated by a future market.

In many cases the value of eastern German enterprises is reduced by their heavy indebtedness inherited from socialist financing policies. Hasty sales at low prices demonstrate the insecurities and inadequate knowledge of Treuhandanstalt employees. Sometimes they fail in tough negotiations with clever Western businessmen. Rare cases of outright corruption show the high amount of temptation involved. For lack of sufficient capable personnel and for fear of making mistakes, negotiations are delayed until the potential purchaser jumps off.

## The Property Question

Pending property claims are a decisive impediment to the privatization of former state assets. The question of original property needs to be clarified. Most of the land, buildings, and plants in eastern Germany had been privately owned till the end of World War II. Between the end of the war and the foundation of the GDR in 1949, large landed properties and industrial assets owned by so-called "Nazi activists" and "war profiteers" – virtually all of big business – were expropriated under the auspices of the Soviet Military Administration in its occupation zone.

On request of the East German government under Communist prime minister Hans Modrow, the Soviet government made it a point for its approval of German unity that these "achievements" be kept up.[19] Thus it was stipulated in the Treaty of Unity concluded between both German states before reunification that these assets will not be restituted to former owners.[20] In these cases, the persons and companies concerned can claim indemnities only from the federal government. Thousands of lawsuits are to be expected regarding the actual value of these properties.

Until now about 1.5 million western and eastern German citizens have applied for the restitution of their property expropriated and nationalized by the government of the GDR after its foundation in October 1949.[21] Due to fragmentary records and the lack of personnel in eastern German administrations, only a tiny part of these assets have been returned to their former owners so far. Since the GDR had refused to com-

---

[19] *Texte zur Deutschlandpolitik*, series III, vol. 8a–1900 (Bonn: Bundesministerium für innerdeutsche Beziehungen, 1991), pp. 134–38.

[20] *Gemeinsame Erklärung der Regierungen der Bundesrepublik Deutschland und der Deutschen Demokratischen Republik zur Regelung offener Vermögensfragen*, June 15, 1990. *Bulletin no. 104* (Bonn: Presse- und Informationsamt der Bundesregierung, 1990), pp. 1119 f.

[21] In many case there are several applications for the same object, as many as 46 in one case. Siegfried Utzig, "Economic Policy Challenges in the United Germany", *The World Today*, 47:12 (December 1991), p. 209.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


pensate for assets formerly owned by Jewish citizens and expropriated during the Nazi period, property rights have to be traced back to 1933.

In order to cope with the ownership problem and to facilitate privatization, the German government passed the so-called Investment Law in March 1991.[22] Though giving priority to restitution in principle, it permits the sale of former state enterprises to investors ready to reorganize the firm and to safeguard jobs. These sales cannot be contested regardless of pending restitution claims by former proprietors. Even if the legitimate owner or his heirs should wish to carry on production, the Treuhandanstalt can refuse restitution if another investor seems to have the better prospects. In these cases the former owners will be compensated once their claims are resolved, but prospective legal proceedings against the Treuhandanstalt's decision will scare away potential purchasers.

## Treuhandanstalt at the Crossroads

East Germans complain that only a few of their enterprises remain independent. Most of the privatized firms become subsidiaries of western German companies. East German industry, they fear, will end up as "extended work-bench" of the western German economy. Many purchases of eastern German firms are allegedly made by Westerners to eliminate competitors.[23] However, Treuhandanstalt has been getting into trouble when it kept old managers and made them run their enterprises in competitive markets. Used to highly centralized command structures, most of the eastern German managers are unable to adjust to new conditions requiring initiative, independence, and taking risks.

The Treuhandanstalt has fired hundreds of eastern German managers for political reasons, but thousands for sheer incompetence.[24] Up to 20,000 managers are needed urgently in eastern German enterprises for production, marketing, controlling, accounting, and the like. Even western German corporations encounter difficulties recruiting managers for their eastern German subsidiaries among their own employees. Living conditions in the new Länder are hardly attractive, problems of reorganizing are enormous, and adventurous young people are rare in saturated western Germany.

The lack of capable managers also hampers Treuhandanstalt's second assignment to reorganize viable state enterprises in order to facilitate their privatization. The rapidly deteriorating economic development in eastern Germany has roused doubts about "privatizing at any cost." A rising political pressure has been exerted on the Treuhandanstalt to refrain from driving firms into bankruptcy if they cannot be sold. According to politicians in East and West, it should attempt to restructure the enterprise, raise its efficiency, and save as many jobs as possible.

---

[22] Gesetz zur Regelung offener Vermögensfragen, *Frankfurter Allgemeine Zeitung – Dokumentation*, March 27, 1991.

[23] Volkhart Vincentz, "Privatization in Eastern Germany. Principles and Practice", *Working Papers*, no. 146 (München: Osteuropa-Institut, 1991), pp. 14 f.

[24] *Frankfurter Allgemeine Zeitung*, August 1, 1991.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


Thus, many companies that ought to be liquidated because they are overly indebted, noncompetitive, and losing money every day, are kept going by "liquidity credits" guaranteed by the Treuhandanstalt. The prospects of such enterprises are gloomy. Treuhandanstalt is a state agency. If private investors are refusing to consider an engagement in an obsolete and run-down state company, how could the Treuhandanstalt be successful? Its employees lack the experience and the information necessary to reorganize enterprises. Scarce capital will be misled and wasted in the worst "socialist" manner. Workers are kept in the wrong jobs and are deceived about their chances to keep them. Private enterprises are pushed from the market by heavily subsidized competitors underselling them. The eastern German production structure is kept from adjusting to world market conditions.

If Treuhandanstalt is forced to focus on subsidizing instead of liquidating firms that cannot be privatized, it will end up as a state holding administering thousands of unviable enterprises at taxpayers' expense. It would be a grave mistake to content oneself with a "mixed economy" including a large inefficient state industry.[25] Only the market can determine an efficient production structure for eastern Germany, not the state. If state interventions in the economy are necessary for social reasons, they must be temporary and handled with care. Privatization must remain the principal objective and legal mandate of the Treuhandanstalt.

## The Benefits of Unity

Despite the considerable financial burden caused by the economic and social integration of the former GDR, German unity has all the prerequisites of a success story. East Germany has become part of a well-functioning market economy. The costs of transition, though higher than expected, are borne by one of the wealthiest countries in the world. Modernization of the eastern German economy is initiated by a technically most advanced partner. Privatization can rely largely on western German capital and know-how. The new Länder are integrated in a politically stable state with a high-grade welfare system. As part of Germany, they have obtained full membership in the European Community.

Public expenditures for renovating the eastern German infrastructure, for the professional training of labor, and for improving the living conditions to reduce social tensions are worthwhile investments. They will increase the efficiency and crisis-resistance of the whole German economy. As in the Federal Republic after World War II, a most modern industry is being constructed upon the ruins of the old system that will urge western German and foreign producers to become more competitive. The principal asset of eastern Germany in this reconstruction process is its modest, adaptable, and industrious population.

---

[25] Such a "mixed economy" strategy is recommended for the sake of "safeguarding the east German industrial capacity against further destruction" by Harry Maier, "Integrieren statt zerstören. Für eine gemischtwirtschaftliche Strategie in den neuen Bundesländern", *Aus Politik und Zeitgeschichte. Beilage zu Das Parlament*, July 12, 1991, pp. 3–12.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


Economic unification with western Germany caused the collapse of whole industries and mass unemployment. Yet the extinction of unviable enterprises turns out to be an advantage over the involuntary maintenance of an inefficient and costly state industry. Unemployment is a heavy blow for workers who had been convinced that they had a life-time job. On the other hand, there is a large German labor market offering many opportunities for well-trained and daring young people. Moreover, the European Community will remove its last barriers to professionals from member countries before long.

These and other privileges make the transformation and the privatization of the eastern German economy differ totally from the much slower and much more painful restructuring of the formerly socialist economies in Eastern Europe. Nevertheless, there are lessons that can be drawn from the German experience. None of these countries will be successful in implementing a functioning market economy without foreign aid. The International Monetary Fund, the World Bank and its institutions, the G 24 and other regular conferences of industrial countries, and the European Community are called upon to offer financial, technical, and organizational support and to coordinate these activities in a comprehensive program. The receiving countries have to be ready to create legal, social, and economic conditions favorable to the best possible use of this international assistance.

Because of the lack of domestic capital, a large-scale privatization of the economies will require international investment. Any measures to limit or curb the inflow of foreign equity capital and the participation of international corporations in domestic industries will delay the process of economic recovery. Protectionism and nationalism proved to be most harmful to the economic development of eastern European economies in the interwar period. Such blunders should not be repeated.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

# Lessons

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371



MARIE LAVIGNE

# Denationalization and Reprivatization in the East, West, and South: Are Comparisons of Experiences Relevant?

## Introduction

Other papers presented here at the Conference on Transforming Economic Systems in East Central Europe explore the issues of the privatization process in East Central Europe, assess what has been achieved in Hungary, Poland and the Czechoslovak Republic, and put forward propositions concerning future developments in ownership transformation.

In this context, one may ask whether experiences of privatization conducted in other countries are relevant. Because of the uniqueness of the East European case, the answer might be negative from the outset. When privatization is realized in market economies, by definition there are already market institutions, policies, and units prior to the privatization process; the problem is then to return to private property a small share of the economy's assets. In the former centrally planned economies one needs to change the management and property rights system of an overwhelming proportion of the economy, even in the case when there was a small private sector in the old system. This is true of the experiences of privatization in Great Britain (the most often cited case to show that the privatization process can only be slow), France, Italy, West Germany, Austria, Canada, and Japan, and also of the Third World countries and their experiences. The only really comparable case to the East European situation is that of the developing, formerly "socialist-oriented," countries that are now rejecting the socialist/communist system, Ethiopia being the latest case; but here again we find substantial differences with the East European case. In these countries there was a significant foreign-owned sector, and the small-scale domestic activities were dominantly private as well, at least in the service sector. In addition, the East European countries share a marked reluctance to admit a similarity between the processes going on in the least developed countries (such as the once "socialist-oriented" countries) and in their own situations.

This paper is part of a study in progress based upon an assessment of the privatization process in Western Europe and in the developing countries. We have selected France and Mexico as "success stories" of privatization conducted in the 1980s in these two nations. We have added the Portuguese case as a case-in-progress, particularly significant as Portugal may be considered a developing economy within the group of developed market economies, thus being close to what the East European countries aim to become. The main conclusions of the study, relevant to the East European case follow.

*The Process of privatization has been slow.* In the developed market economies, France is certainly the case for the quickest privatization process. Between November 1986 and January 1988, fourteen large state corporations, controlling 1,359 enterprises, have been privatized, out of the sixty-five state corporations that had been earmarked in 1986 for privatization over a five-year period. In comparison, in Great Bri-

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

tain about two dozen big state corporations were privatized in eleven years, from the end of 1979 to 1990, under Mrs. Thatcher's government. In the developing countries, a study of the World Bank identified in ninety of them only 530 cases of privatization by the mid-1980s. Though Mexico reduced the number of its public entities by two-thirds by the end of 1989 (beginning in 1982) the state-owned companies still accounted for about 20 percent of the GNP in 1989.

*Slowness of privatization has been the rule despite the existence of institutional conditions that are not found in Eastern Europe.* East European countries still lack market institutions – a genuine commercial banking system, a significant financial market, a convertible (at least internally) currency; entrepreneurship mentality is also absent.

*As the French case shows, privatization is definitely not a way of getting rid of the "lame ducks."* Successful privatization is to be found in the case of enterprises that were not in the red. This would support the strategy to restructure first, then to privatize.

*Macroeconomic and microeconomic policy conditions must be met to ensure the success of a privatization program.* These include a whole range of policies (a stabilization program, liberalization of prices, demonopolization, and the like). This requirement does not necessarily mean a rigorous sequencing of the measures, but it does mean that such measures must be unequivocally announced and put in operation from the outset.

*The Mexican case (and more broadly, that of many developing countries) clearly show that the public sector cannot easily disappear altogether, and even that such a disappearance is undesirable.* Hence measures have to be taken to ensure a *market-type, competitive management* of state-owned enterprises in the long run.

*A social safety net must exist to alleviate the social impact of privatization.* It must be put in place despite the marked reluctance of the authorities. The most obvious use of the proceeds from privatization is to reduce the domestic government debt. The next one is to subsidize the remaining public sector. Neither in developed market economies nor in developing ones has privatization been used for expanding the social welfare system; other more urgent priorities were an excuse.

Are comparative institutional economics relevant to the transition to the market in East Central Europe? Privatization is a case in point. Why should one compare the privatization process in developed market economies, in developing countries, and in the East Central European countries in transition? If it is only a classroom exercise, to stress the differences and the similarities of the process, one should stop rather soon, as the similarities, both in aims and in means, are very thin. In the developed West, the move toward privatization emerged as a political reaction against welfare state policies unable to deal with the recession of the 1970s, and as an economic remedy for the inefficiency of the state-owned sector. In the developing market economies, privatization was an assault on the state-controlled structure inherited from colonialism, as well as a condition for foreign aid meant to cope with the burden of foreign debt. In the first case, stock exchange institutions were mainly used in the context of well-developed capital markets. In the case of the Third World, external assistance and direct foreign investment supplemented the commercialization of state enterprises in a situation where little domestic capital was available.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

F 063371


In East Central Europe, and perhaps soon in the former USSR, privatization is an essential part of a political process of overthrowing all the legacies of the Communist regime. It cannot be compared to denationalization in the West, where only a part (be it substantial) of the domestic assets were public property, and only a part of these state assets were public monopolies allowing them to disregard the market signals. In addition, the Western privatizations occurred through sophisticated capital markets, which do not exist at all in the East. Nor can the East Central European situation be compared to that of developing countries because of the existing potential for development in human resources and industrial capacities. At any rate, in East Central Europe such comparisons with the Third World are highly offensive. Is this a reason for abstaining from comparisons? The question has to be answered once the aims for a comparative study are clarified. Clearly, comparisons may be useful only if they lead to good advice (and stressing that they are not relevant may be a useful conclusion in this respect). The policymakers in East Central Europe at the same time claim that they need advice and that their case is unique. Thee only way to check this assumption is to look at the experiences gathered so far.

## Privatization in the West: The French Case and Some Others

I have chosen the French case not just from *chauvinisme*. Compared to other Western experiences, the French privatizations display some features that seem to turn them into good examples for the East. They occurred in a highly politicized context (even more so than in Thatcherite Britain) when a right-wing government was eager to erase quickly what it considered a disastrous legacy of the (then seemingly short-lived) first Mitterrand governments. They were indeed carried out very rapidly, in some eighteen months from November 1986 to January 1988 (the Central European policymakers are all insisting on the need for a quick process). Finally, they were successful in so far as they brought substantial sums to the state budget, and because the privatized stocks behaved very well on the capital market despite the "crash" of October 1987.[1]

### *False Comparisons in Aims*

These similarities are misleading. There is no comparison between the end of the Communist rule in Eastern Europe after over forty years of existence and the change of the government majority in a democratic society. In France, the law on privatization in 1986 had earmarked sixty-five large state enterprises to be turned back to private capital in five years. The experience was interrupted in 1988, because of the return of the left to power after fourteen state companies, employing 333,150 wage ear-

[1] Wladimir Andreff, "Techniques et expériences de privatisation: la "success story" des privatisations en France et les besoins actuels des pays de l'Europe de l'Est." (Paper presented at the Davos Conference on Economics of Decontrol and Marketization in Europe, Fondation Européenne pour la science, Davos, September 22–26, 1990.)

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


ners, had been privatized. The policy of the socialist government was then to stick to a "ni-ni" (neither-nor) stance: no new nationalization, no privatization. In fact the similarities in management between the French private and public companies belonging to the non-monopolistic sector (i.e. other than utilities and the like) are quite striking. In addition, most of the French state companies either have shares in foreign public or private companies, or have themselves private minority shareholders; Renault is an example of both.[2] It may well be that a new change in government will be followed by a resumption of the privatization program. This will basically mean better finance for the relevant firms, rather than an overall change in structure and policies.

Second, the privatization process aimed at being swift and comprehensive. But quick as the privatizations have been in France, the public sector still represents 12 percent of the economy, and privatization dealt with only 2 or 3 percent.[3] In Great Britain, between 1979 and 1985, the public sector diminished by 40 percent, but privatization applied to only 5 percent of the economy. In the case of Central Europe, one has to deal with a much larger share of the economy, with a much greater gap between the expected private sector and the former state sector.

Finally, the very criteria, or signs, of success are far from similar in a market economy like France and in the former Communist countries. What was considered in France a substantial achievement was that privatization brought large revenues into the state budget (in sixteen months, as much as the cumulated deficit of *all* the public sector in 1984 and 1985, or 40 percent more than all the subsidies to the industrial state-owned enterprises from 1982 to 1985). Another sign of success was that the stocks of the newly privatized companies were not, on average, more severely affected than other stocks during the crisis of October 1987; no massive sale of these new stocks took place. Did privatization improve the financial and economic indicators of the companies? Andreff argues that this was not the case, and that in 1985, with the exception of the steel industry and of three cases outside this industry, all the industrial state companies were making profits, a strong improvement over the situation in 1982.

Let us sum up. In France (and for this matter, in Great Britain and, since April 1991, in Italy), the impulse of privatization has been undoubtedly political, but however harsh the political struggles between majority and opposition, it could never be likened to the change of regime in the East. We must evaluate the relative speed of privatization against the rather small share of the privatized sector, and of the public sector itself in the West (even in Italy it is less than one-fourth of the economy), whereas in the East, the aim is to privatize more rapidly, if possible, a much larger share of the national economy.

---

[2] Volvo entered Renault in 1990 as a big minority shareholder. Renault has joint ventures in Colombia, Turkey, and Yugoslavia. See William Dawkins, "France Fights Temptation of More State Aid to Industry", *Financial Times*, February 12, 1991; and Nicolas Simon, "State-owned Companies and Direct Investment Overseas." (Paper presented at the Conference on Contrasting Views on Conditions for Foreign Investment in Eastern Europe, European Studies Center at Stirin, Czechoslovakia, July 3–6, 1991.)

[3] The percentage is calculated on an average of value added, employment, and gross capital formation. See William Dawkins, "Breakdown of the Old Frontiers", *Financial Times*, July 23, 1991.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


Finally, apart from the political aims of reversing the action of the previous government and reducing state control, economic aims are different. Although in the West the right-wing political discourse insists on improving the efficiency of the economy through privatization, the main concern of the policymakers is to decrease public spending; we have seen that the French achieved this. In the East, the proclaimed economic aim of privatization is to create the conditions of a market economy that do not yet exist, and to induce greater efficiency. However, it is not easy to assess the economic benefits. Therefore, and also because of political reasons, privatization becomes an aim in itself, which eliminates the need to assess its economic and financial outcome. The process is generally not thought of as a way for the state to increase its revenues, but as a way for it to save on subsidies; but, in systems in which the most visible part of the budget subsidies went to support prices, the liberalization of prices is a more radical instrument for cutting subsidies. In addition, the governments have to worry about the restitution of property to former owners, a principle that has been recognized in different ways in the three East Central European countries. One reason for the minimization of the financial aim of privatization is in the lack of capital to pay for the state assets, which in turn suggests that these assets should just be given away, as in the "voucher" schemes.

### *Real Differences in Methods*

In any privatizing country one has to find new capital to buy out the former state capital. There are two main sources of capital: foreign and domestic.

Foreign ownership has great appeal. It is, however, politically questionable because it is open to the usual objection to "selling out" the country. In open market economies it might seem obvious to let foreign capital in as domestic firms are invited to invest abroad, but, in fact, domestic assets are always protected. In France, foreigners were allowed to buy up to 20 percent of the privatized enterprises. Moreover, to prevent foreign capital from buying into these companies later on, the state kept a "golden share" which allowed it to oppose undesirable foreign participation exceeding 10 percent of the assets. In Portugal, the new privatization program, which was launched in 1991, allowed foreign investors to buy only up to 5 percent of the shares of the *Banco Espirito Santo e Comercial de Lisboa,* one of the first big enterprises to be privatized.[4]

In the countries in transition, the new legislation on foreign investment is increasingly liberal. In the three countries under review, foreigners can own up to 100 percent of domestic enterprises. However, licenses are usually required to own more than 50 percent of the capital. The privatization law in Poland provides that when state enterprises are offered for sale, foreigners can buy only 10 percent of the shares without license; more requires a special permit. In Hungary, for the first twenty state enterprises offered for sale in September 1990, the law limits non-Hungarian ownership to a proportion of 30 to 50 percent of the shares as a rule. Czechoslovakia plans the sale of

[4] See Patrick Blum, "Great Portuguese Sell-off Shakes Off Its Lethargy", *Financial Times,* June 6, 1991.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


some part of state assets in the framework of "large-scale privatization," but the main source of capital will be domestic. The attitudes of the policymakers are ambivalent in this respect; at the same time the governments are seeking foreign partners and expressing concerns about excessive sell-offs. In fact, the search for foreign capital is bound to be difficult, and the concern about foreign control is mainly meant to reassure the public as to the value of the domestic assets. It is doubtful that even with proper incentives (tax exemptions, full right of profit repatriation, currency convertibility) foreign capital would rush to Central Europe. We forecast that a maximum of 10 percent of national assets might be owned this way, as the example of open developing countries has shown.

*Domestic capital is scarce everywhere.* One usually assumes that a major obstacle to quick privatization in the East is the lack of financial market institutions. True, a developed network of commercial banks, insurance companies, other institutional investors, and full-fledged stock exchanges would help. But to believe that this would solve all the problems reminds one of a small child's attitude after having seen his mother cashing a check in the bank: "Mummy, let's go to the bank and buy some money!" Money has to be available; propensity to save and to invest savings in turn depends on many factors, as Keynes, now sadly forgotten, has shown.

How did the developed market economies succeed in securing capital for privatization? The denationalizations realized in the 1980s greatly benefited from the expansion of the financial markets – a circumstance no longer possible since the "crash" of October 1987. In France, the largest share (about one-half) of the assets were sold on the Paris Stock Exchange; and the number of small potential shareholders as the demand for shares greatly exceeded the supply, because, again, of the exceptionally favorable conditions. Employee participation was also limited, to 10 percent of the shares; here, too, demand exceeded supply. One of the major problems encountered in the French case (as prior in the British case, and subsequently in the Italian case) was how to prevent, in the conditions of an open and largely deregulated market, an excessive concentration of capital in the hands of a small number of big shareholders, who could easily buy out the shares from thousands of small, uninformed new capitalists. The French achieved this goal through the policy of "hard core" stable shareholders, selected outside of the market by a specific procedure administered by the ministry in charge of the privatizations.

Thus it can be said that in the French case, and more generally in developed market economies undertaking privatization, that the problem to date has not been where to find capital but *what* kind of capital to use. Letting the market do the job can lead to unwanted concentration of capital. Establishing "hard core" shareholders can give rise to harsh political disputes, if it is shown that the government in charge of privatization favored its friends, as was the case in France. In the future, new constraints may be put on further privatizations, if access to finance becomes tighter on a world scale. France has sought a way out through "indirect state privatization": in July 1991 it was announced that two state-owned banks (Crédit Lyonnais and Banque Nationale de Paris) were taking equity stakes in two public companies in search of capital, Usinor-Sacilor (steel industry) and Air France. This bank involvement is a way of supporting the public sector by using state-owned institutional investors that themselves resort to private funding – a *capitalisme à la francaise* that might be of some rele-

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

90063371


vance to economies in transition, but only once the prejudices against the public sector are dissipated and a financial sector emerges.[5]

The situation is radically different in the East. There is simply no available capital. Citizens are more likely to invest in housing, land, or small businesses than in shares of former state enterprises, even when they are employees of them. To bypass this obstacle, the Polish and the Czechoslovak laws provide for free or discount distribution of assets to the population, in the form of "vouchers" exchangeable for shares. Western observers usually frown at such practices, on the grounds that it would leave power in the hands of the managers, or would allow for monopolies to be recreated if the shares are transferable.

Let us briefly mention the method of employees share ownership, which had been rather widely discussed in association with various schemes of "market socialism." A modest tribute to this method is present in the privatization schemes actually put in place, with no role whatsoever in Czechoslovakia and a limited one in Poland and Hungary. Was it successful in the West? A poll in a British privatized utility company shows that share ownership has not created a better motivation for the workers.[6] In France, the ministry in charge of privatization offered shares of the privatized enterprises to their employees as a form of participation in the revenues rather than as a plan for "people capitalism."

In any case the voucher plans will provide only a partial solution. In Poland the upper limit of discount sales to the employees of any state enterprise was initially set at 20 percent of the assets, then reduced to 10 percent in the June 1991 Mass Privatization Plan. The proportion of vouchers to be issued to the public free is contemplated in a range of 10 to 30 percent of the assets to be privatized. The Mass Privatization Plan selects 400 medium-sized to big state enterprises (with 25 percent of total industrial sales) to be quickly privatized. For these enterprises, certificates of participation in specially formed investment groups will be distributed to all adult citizens for about one-third of the assets.[7] The investment groups themselves will hold 60 percent of the assets. More than one-half of these assets (that is, 33 percent of total assets) will go to "lead shareholders" to provide the "hard core" in each privatized company. The state itself will retain 30 percent of the total assets. Thus the Polish plan tries to deal with several constraints at once – the lack of capital (through free distribution of shares, not in the companies themselves but in the investment funds); the control by the state; the protection against unwanted concentration in domestic or foreign hands. But the ultimate source of finance for the investment funds themselves is still open, and will have to involve foreign assistance.

In Czechoslovakia, it is assumed that no more than 40 percent of the assets are to be distributed through a voucher scheme which is to be put in place in 1991. How to deal with rest? The state enterprises will be turned into joint stock companies whose shares will be owned by institutional investors: mutual funds, possibly with foreign participation or with the involvement of such agencies as the International Finance

---

[5] Claire Blandin, "Capitalisme à la francaise", *Le Monde,* July 19, 1991; Dawkins, "Breakdown".

[6] Theo Nichols and Julia O'Connell Davidson, "It Is Still ,Us and Them'", *Financial Times,* March 7, 1991.

[7] *Mass Privatisation Proposed Programme,* Warsaw, Ministry of Ownership Changes, June 1991, 9 pages.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


Corporation or the EBRD, banks or insurance companies, and/or special agencies comparable to the Industrial Development Agency in Poland. This arrangement amounts to an acknowledgement that in addition to a large state sector that is bound to remain, the so-called "privatized" sector will be in fact controlled by public agencies. How is this sector to be managed? How is it to evolve? Through inter-enterprise arrangements? Mergers? Equity participation? Assuming that an active capital market is to develop, who – be it private persons or legal entities – is actually to operate in this market? These questions are just beginning to be asked. Have they been satisfactorily answered in developing countries?

## Privatization in the South

Although privatization policies in the West are generally not offered as examples to the East (maybe through an unjustified feeling of superiority), those conducted in the South are offered quite explicitly. Nankani discusses the policies of Malaysia, Chile, and Sri Lanka.[8] Many other policies are also cited, those of Turkey, Egypt, Tunisia, and of Latin America at large. Many in the West believe that Eastern Europe might learn from these experiences, including their failures, but the arguments quoted are precisely the reasons why East Central European countries do not readily acknowledge these similarities.

The only real "systemic" similarity in the situations of East Central Europe and of some developing countries occurs not in developing socialist countries such as Cuba or North Korea, but in those "socialist-oriented" countries that were close enough to the socialist system to be observers in the Council for Mutual Economic Assistance: Afghanistan, Angola, Ethiopia, Mozambique, Nicaragua, and South Yemen.[9] All but Afghanistan have declared their intention to shift to a market economy, but the troubled political and economic conditions in these countries have up to now prevented any program being put in place.

It is doubtful, however, that a similarity in initial conditions can be derived. More generally, East Central European countries do not like to be compared to developing countries, precisely because the latter belong to the Third World. Even when the governments and the public in East Central Europe are ready to admit that their economies are in shambles, that there is a lag of many years between them and the developed market economies, and even that some developing countries are technologically more advanced and more competitive than any East European country, they contend that their problems are specific as are the required solutions. In particular, they claim to be European, with the aim of integrating sooner or later into Western Europe. They see the advice to look at the developing countries' experience and the recommendations to aim at developing intraregional trade and cooperation as devices to delay this integration. For the West, it is politically improper to underline similarities with the Third World, even assuming that they actually exist.

---

[8] See also S. Stanley Katz, "East Europe Should Learn from Asia", *Financial Times*, April 24, 1991.
[9] See the chapter by Dominique Don in *East South Relations in the World Economy*, Marie Lavigne, ed. (Boulder, CO, 1988).

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


Similarities do exist, but this fact does not necessarily mean that the road to privatization should be similar.

It is true that East Central European countries *are less developed* than West European market economies. But they are so for systemic reasons, or through a specific accident of history (the consolidation of Communism for over forty years), not because of a colonial/decolonialization past, or because of climatic/geographic constraints. Differences in the degree of development among and within these countries, also exist, exactly as in the case of Western Europe.

The *political context* of privatization also shows some similarity. This is not to say that privatization always, or even generally, occurs when there is a change in government orientation. Earlier we noted that in Western developed democracies, the turn to privatization occurs when a right-wing free market-oriented government comes into office after a leftist, more interventionist government. The Third World countries do not evidence that pattern. True, one may quote the experience of Chile after Allende, but also Argentina where privatization is being implemented by the military government that had first strengthened state intervention, and Mexico where the rather left-oriented de la Madrid government is implementing a privatization program to be continued by his successor.[10]

The main similarity, then, lies in the political obstacles to privatization. As in East Central Europe, in the Third World large bureaucracy with strong vested interests supports state ownership. This bureaucracy can easily win public support by insisting on the social consequences of privatization; the bulky, inefficient public sector is indeed the main source of fixed (be they small) and guaranteed incomes for a large share of the population well beyond the public enterprises or public administration proper.[11] One could even find some analogies between ethnic disputes hampering privatization programs in Africa and some East European cases.[12]

Third World countries often launch privatization as a part of an overall stabilization program aiming at reducing government subsidies, restoring budgetary equilibrium, and controlling inflation; privatization has also emerged as a condition for financial assistance. Although East European leaders claim that the drive toward privatization is a logical component of a purely national policy of dismantling all Communist legacies, the building of a private sector is a strong recommendation of the international

---

[10] The assessment of the political drive in privatization is far from clear. Commenting upon the Latin American case at large, William Glade writes: "the driving force in these cases is essentially structural, not political." (Glade, ed., *Privatization of Public Enterprises in Latin America* (San Francisco, 1991, p. 130.) A French journalist evaluating the Turkish case thinks that "the question of the privatization is essentially political." (Nicole Pope, "La querelle des privatisations", *Le Monde*, June 20, 1991.)

[11] "Apart from fears of social unrest there has been the difficulty of overcoming vested interests. The old system has proved difficult to uproot, for it was based not simply on the supremacy of a rich elite but on a mutual support system involving political leaders, trade unions, and low income people." This comment was made about the difficulties of privatization in Tunisia, but could be applied also to many an explanned economy. Francis Ghiles in the *Financial Times*, April 19, 1991.

[12] This analogy, of course, may be felt as insulting in East Central Europe. Let us then cautiously state that in a country where a national minority also belongs to the less developed part of a country with a higher unemployment rate than is average for the country, privatization as a policy of the national (federal) government might be opposed by that local government. Obviously Slovakia in 1991 is a case in point.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


organizations and Western national governments assisting the countries in transition. As the same organizations and governments also assist the Third World to this effect, it cannot be surprising that the same packages are offered, with similar measures and similar sequencing.

The *lack of capital* is also a feature common to the two groups of countries. The Latin American and Asian developing countries (and some African countries) have capital markets, with operational stock exchanges. But the capitalization basis is narrow, and the number of companies quoted on these exchanges is small.[13] More generally, domestic capital is scarce, and foreign capital is not ready to invest in loss-making sectors. This is why, much more than is the case in the developed West, Third World countries have resorted to various forms of "semi" or simulated privatization (the Mexican concept of "disincorporation"), including contracting out of services or operations of state enterprises and transferring them to local governments or noneconomic entities such as trade unions. An often used scheme is to "commercialize" the management of state-owned units by turning them into joint stock companies and transferring their shares to holding companies controlled by the state.[14] This may well be the most likely profile of privatization in Eastern Europe (perhaps coupled as in Poland with a large public distribution of the shares of such holding companies)[15] once it is acknowledged that foreign capital will not invest beyond certain rather low limits, that the domestic capital market is narrow, and that the citizens are unready to become capitalists, practically even for free. This points to the main challenge facing both Third World and East Central European countries: the problem is not primarily how to get rid of state ownership, but how to manage the new entities that are to be born from this process (in addition to those that are not privatized at all, which have a large share in the Third World countries' economies). Many of these entities will not be "standard" private enterprises; many will still remain under the control of the state, or of former (or present) state officials while the government will be claiming that it does not want to intervene in market operation. Therefore, the selection and the control of the managers of the "destatized" companies are critical, to pretend that the market will take care of it is wishful thinking, but the question of how to do it leads into uncharted waters.

The last similarity between Third World countries and East European ones is *the inadequacy of the social policy.* In the Third World this is a result of structural and developmental factors; in the East, the mediocre but all-encompassing Communist welfare system must be revamped in total, including its most significant aspect, job guarantees for all. Is privatization a way to deal with social demands? When coming to power in Mexico in 1989, President Carlos Salinas very generously suggested that the government could improve the social sphere through disincorporation or outright

---

[13] Hence there are difficulties in floating new companies on the stock exchange. In Indonesia, the first introduction of a state-owned company's shares on the Jakarta Stock Exchange in July 1991, a cement producing company, resulted in an immediate slump. Claire Bolderson, "Privatisation Adds to Indonesia's problems", *Financial Times*, July 17, 1991.

[14] The new law on the public sector in Egypt, drafted in June 1991, provides for such a scheme. See Tony Walker, "A Layer of Overseers", *Financial Times*, June 24, 1991.

[15] See the Polish Mass Privatisation Programme quoted in footnote 7.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


privatization.[16] But this would mean that proceeds from privatization could be specifically allocated to social expenditures. As privatization generally happens in a difficult financial environment, such prospects are not likely to occur; the revenues from privatization generally go to alleviate the public debt or to cover other urgent expenditures. Only if the financial situation of the state improves will there be funds for social needs and they will come from sources independent of the privatization process.[17]

## Conclusion

One would like to conclude with the French motto *"Comparaison n'est pas raison."* Comparisons do not explain the reasons for processes. They help us to understand and to learn from other people's mistakes. They also point to unavoidable issues and difficulties. We have noted here the most important issues, and left aside a host of more technical or even more substantial ones: how to deal with the debts of the privatized enterprises? how to value their assets? is it advisable to restructure them before privatizing and how to do that? The most obvious conclusion is that privatization has nowhere been a success story across the board. But then, what would such a success story have been? Is the criterion "as little public ownership as possible?" There seems to have been a direct correlation between a large public sector and economic mismanagement, but was this due to the public sector itself, or to the regime (a "systemic" reason), or to development conditions (a "structural" reason)? In other terms, is there a tolerable or even desirable amount of state involvement, including that of local governments and communities in economic activities? How should such activities be managed to be efficient? Theory and experience have yet to provide a convincing answer to these questions.

## REFERENCES

Durupty, Michel (1988), "Les privatisations en France," *Notes et Etudes Documentaires,* no. 4857.
Glade, William, ed., *Privatization of Public Enterprises in latin America,* International Center for Economic Growth, Institute of the Americas, Center for US-Mexican Studies (San Francisco: ICS Press, 150 p.).
Nankani, Helen B. (1990), "Les lecons de la privatisation dans les pays en développement," *Finances et Développement,* mars, p. 43-45.
OECD (1990), *Promoting Private Enterprise in Developing Countries,* Paris, 103 p.

[16] Vera Ferrer and Oscar Humberto, "The Political Economy of Privatization in Mexico", in Glade, *Privatization,* pp. 35–57.
[17] This occurred in Czechoslovakia in June 1991, when the government decided to use an unexpected budgetary surplus for increased expenditures in the health and education sector. At that time large-scale privatization had not yet begun; the government did not make further commitments in the social sphere.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


Ott, Attiat, and Keith Hartley (1991), *Privatization and Economic Efficiency: A Comparative Analysis of Developed and Developing Countries*, Aldershot: Edward Elgar, 1991, 288 p.
Shirley, M. (1988), "The Experience of Privatization," *Finance and Development*, vol. 25, no. 3.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371



*Ivan T. Berend*

# The Role of Non-Economic and External Factors in East Central European Economic Transformation

The difficult transformation from state socialism to a market economy entails a well-defined set of economic, institutional, and legal changes. Liberalizing prices and imports, privatizing an almost totally state-owned economy, destroying restrictive regulations, and creating a proper legal environment of free enterprise and a free market, all this, on the basis of a macro-economic stabilization, is the essence of a transformation that has already begun in almost all the countries of East Central Europe. Most of the expert committees working out plans for transition, including the first one, which I headed in Hungary in the fall and winter of 1988 (with presentation of proposals in the spring of 1989), concentrated on these basic issues.

Transformation is not only marketization and privatization, i.e. – not only an economic process, but a delicate complexity of sociopolitical and psychological change, a switch of values and "public spirit." History is driven by "hard" economic and "soft" mental-spiritual factors that are directly or indirectly interrelated.

For students of European history of a century ago, it is commonplace that the dramatic transformation was both heralded and accomplished by a complete replacement of values and attitudes. Benedetto Croce has identified an emerging new age from the 1870s on because the "public spirit," in the broadest sense of the term, changed spectacularly. This was the age when the young French poet, Rimbaud, stated wildly and proudly: "I am immoral ... I do not know morals and religion." The German philosopher, Nietzsche, declared: "God is dead," the ideals of the Enlightenment no longer exist. These were the decades when artists in revolt destroyed real colors, real forms, accustomed harmony, and accepted meanings of words, when they began to construct a new abstract, supremacist "reality," presented the irrationality of the world, replaced harmony with harsh, atonal accords, and used meaningless text with unfinished sentences. Without this destruction and creation, a new twentieth-century Europe would not emerge.

May we speak of such dramatic change of public spirit in East Central Europe today? From a certain point of view, definitely yes. The deep crisis of East European state socialism in the 1970s and 1980s, realized eventually by the total collapse of the Soviet-type economic modernization model, was a crisis of declared "socialist values," and a crisis of legitimacy as well. Reform economists, dissident writers, and even the average man in the street began to speak out about what they had seen and experienced. Substituting the term of the historian and philosopher Croce with that of the writer and politician Vaclav Havel, East Central European intellectuals and workers no longer accepted to "live in the lie" and sought to "live in the truth." Havel's greengrocer (in his *Power of the Powerless*) no longer formed empty slogans with fruits and vegetables in his shop window. Public spirit definitely began to change, and it played a determinant role in the miracle of 1989 and the ongoing transformation since.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


Public spirit, however, is rather confused today in East Central Europe, and confusion is much more characteristic than change. Old and new values, and old and new ways of thinking, are not only equally present (which would be quite natural in a period of transition) but amalgamated into odd, contradictory "new ideas." The "odd couples" of "egalitarian market economy," "privatization based on social justice," and new entrepreneurs with "clean" moral backgrounds, in an age of a belated "primitive accumulation," plans to integrate to Europe accompanied with heightened nationalism, and a determination of marching towards a twenty-first century society under the banner of an early nineteenth-century Catholicism as a kind of state religion or ideology, all illustrate deep contradictions.

Furthermore, the "new society" is going to rise with a tremendous burden of "recycled" ideas and ideologies, which means that a lot of old garbage has suddenly filled the ideological vacuum that remained after collapsed Communism. Not only is the strange coexistence and merger of ideas of an attempted modern Western society with a surpassed state socialism typical, but it parallels the idea of twenty-first-century Europe oddly fainted with the values and attributes of nineteenth-century laissez-faire capitalism, combined in some cases with the views of "Social Darwinism."

In spite of a definitely changing public spirit, it is doubtful what kind of new-old public spirit is in the making. Quiet and clarifying debates and deep scholarly analysis would successfully help to hammer out a modern European public spirit in East Central Europe, but this would be more an exception than a rule. Arguments instead of emotions, essential debates instead of labeling and hatred, and systematic scholarly, journalistic, artistic work and public education were all important prerequisites of successful transformation.

To illustrate the role of public spirit and the lack of an adequate correlation between this confused spirit and the given reality, let me draw attention to that peculiar and evident field of economics. Economic ideas and policy have the most direct role in transition. Economics of transformation ("transfonomics"), however, is strongly influenced by the "spirit of the age." The forceful emotional stream of political reaction to half a century of "statism" and centralization, coupled with the influence of the highly successful Western model, generated a U-turn to laissez-faire non-interventionism. In this religious way of thinking, state ownership became as devilish and dangerous a phenomenon as private ownership was in state socialism. There are hardly any economists involved with the new governments who are trying to go against the stream, and there are very few who would challenge the new taboos. Privatization, therefore, must entail the most complete elimination of state ownership, and as soon as possible. Of course, we hear rational explanations: state-owned firms, controlled by "firm councils" (Hungary and Poland) or worker's self-management (Yugoslavia), embody a complete lack of responsibility; their management is highly dependent and extremely short-term in outlook, and with these public firms, that are much less efficient than private ones, transition would be unthinkable. As privatization is not an easy process, an immediate and total change is necessary to achieve a real turning point. Yet state-owned public sectors exist in some of the most successful Western countries, including Italy, Austria, and France, and a pretty strong state interventionism, even five-year planning, characterized the last half century in Japan.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

b0063371


It could hardly be argued that public firms cannot be efficient or that there is no potential in such a sector. The real question is the proper market environment as well as the managerial system of public firms. If "factory councils" and the self-managerial system are causing poor performance, total and immediate annihilation of the public sector is not the only logical and practical conclusion to be drawn. Another alternative might be a much smaller public sector, reorganized, put into the proper market environment, and privatized by and large which is possible. Forced, speedy privatization may cause serious long-run damages. A mixed economy with an ever growing private sector would be more realistic and "natural," than distributing shares free of charge among citizens, selling out the majority to foreigners, or even creating "bogus" private companies owned by different public institutions, pension funds, and the like. All these measures are important and adequate and should certainly be used, but not in an exaggerated, forced, all encompassing way. Furthermore, working out methods and techniques for efficiently operating public firms (at least analyzing international experiences and examples) is equally important. This public sector may exist for a long time and may represent 15 to 25 percent of the economy.

For the prophets of laissez-faire policy, state intervention is useless and mistaken. The ideal of consistent de-statizations, however, conflicts with differing experiences of quite a few successful countries of the post-war world economy, not to mention some formerly less developed countries that are rising spectacularly today. The role of the state has a special importance in the history of this region as well. A. Gerschenkron based his theory on this fact and wrote about the substituting role of the state in East Central European modernization in the nineteenth century.

Privatization is the nucleus of marketization. Inspiring and assisting a free and rapid formation of new service and industrial enterprises, small-scale and big, is essential. The privatization of oligopolistic retail, wholesale, and service chains and oversized industrial firms is crucial, but this process cannot be a cheap or brief sell out or a privatization without inflow of capital and modern technology.

It is critical to carry out a realistic privatization and count upon the existence of a public sector for a relatively longer period, not in the present form but in a fully modernized one. An imported neo-liberal religious belief and its exclusive dominance blocks the road of debate and consideration of other views whose representatives are easily labeled as apologists of communist values.

The "totalitarian" privatizers follow a psychologically understandable, but still ambiguous path, and the real debate is not about "shock therapy" or "gradualism."

Each transition is both shocking and gradual, with differing concepts of how to transform and what kind of "model" or "blueprint" to follow. Is it possible to copy American capitalism, Scandinavian socialism or West European welfare society in closing a chapter of East Central European history and opening a new one that follows a different way than the failed "detours" of former decades? Is it possible to adopt an ideal system or endure existing realities?

An "unfinished", confused, and contradictory state of a new East Central European public spirit, which may be "materialized," may be transformed and become an economic factor in influencing public attitudes and governmental actions. Another important example of the lack of adequate correlation between public spirit and real hi-

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


storical processes is the political arena of the region. In Western societies, the different spheres and layers of the society are more or less adequately interrelated as a result of centuries-long economic, social, political, and national development. This is not the case in East Central Europe, for just the opposite is true: a freshly emerging parliamentary democracy is in conflict with the lack of civil society, which is the real basis of Western parliamentary systems. Political parties, appearing quite suddenly, are either the reincarnation of former parties (such as the Rumanian Liberal party of the Hungarian Smallholder's party or very many others) or, in most cases, were born from the opposition to Communism. The Polish Solidarity, the Czech Civic Forum, the Hungarian Free Democrats, and even the ruling Democratic Forum were all formed as a kind of monolithic opposition to the monolithic political system. After the collapse of the latter, and in the process of building up new political structures, the East Central European political arena is not yet well structured; political structures, ruling and opposition parties, are often "accidental" formations and cannot reflect the structure and real interest of the society. Huge social layers do not have political representation, and leading parties are ad hoc coalitions embodying only a limited opposition and negation of former Communism, but embracing all different trends from populism to liberalism.

A newly emerging new political elite in several cases represents sociopolitical trends that cannot adequately express the aims and interests of the society; there are strong political groupings that, in opposing a half-century of Communism, seek not to go ahead, but return back to pre-war conditions. They want to rehabilitate and restore the spirit of the Horthy or Pilsudski regimes, and reintroduce a dominating role for the Catholic church.

While most of these political trends are not genuinely present among the population, but only in a newly formed political elite, the most vital aims and interests of large masses of people are not expressed and represented in politics at all. The unavoidably painful transformation generates major needs and requirements of the bulk of the population, but their interests are not represented in politics, for the most striking, paradoxical phenomenon is the lack of modern social democracy in East Central Europe.

Because of the gap between politics and the stratification and interests of society, there is an immense danger that the new political elite would want to lead and direct society according to its firm belief, or messianic "mission." If the masses do not understand their long-run interests or political goals, then transition would be easier if done in a more autocratic way. A year ago, the Scandinavian model was often mentioned, and today we hear more often about South Korea. The irony of history – as it was formulated by a colleague and friend of mine, Ivan Szelenyi – is that a few years ago most of the opposition forces in East Central Europe stressed: "Democracy, yes; Capitalism, no." "Nowadays, it has been turned upside down, and certain populist and conservative groups are ready to say: Capitalism, yes' Democracy (at least right now) no."

The historical trend of transformation – and this is another built-in absence of correlation – is, in some cases, not combined with a rebuilding of a social contract, the importance of which is crucial. State socialism represented a social contract based on an egalitarian idea of full employment, a low level but general social insurance, and free health care and education. A great part of social policy measures, especially sub-

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


sidized prices, were built into the economic system. That social contract failed. Not only was it a permanent contradiction to the poor general conditions that generated corruption, bribes, and bad services, but it also sacrified efficiency on the altar of egalitarianism. Consequently, in the long run the system undermined itself. In the 1980s this became more and more evident and contributed to the crisis and collapse of Communism.

A market economy is essentially alien to the social contract of former state socialism. In 1989 and early 1990, there was a lot of talk and highly advertised party programs and slogans about building up a new social safety net. Scandinavian social democratic models or West European welfare states were often mentioned as ideals. All of these, of course, were far from reality, for in practice, very little or nothing happened. Even debates and competing concepts are now lacking. The profile of a new social contract is less and less visible and has disappeared in the increasingly more heated laissez-faire drive. Both a prepared extermination of the old social system and the introduction of a new one is lacking. The worst combination, is that of a market transition and price liberalization gradually destroying the old social contract without building up a new one. Poverty jumped from a small fraction to one-half or two-thirds of society.

The long or even medium run political danger of this neglect is evident and may unleash political trends that can undermine a successful transition.

Having dealt with the role of non-economic factors in transition, let me turn to some external prerequisites. Transition, restructuring, with economic and non-economic factors, is an internal affair, and the task must be executed in East Central Europe by Czechs, Poles, Rumanians, Croats, and Hungarians who are ready to go along the road.

This is not a local, domestic issue. It is the matter of European security and peace, the stabilization of the twentieth-century "crisis zone of Europe", the chance to create a united, prosperous Europe, a stable pillar of a new world order.

From the beginning, it is evident that the crisis ridden, backward countries of East Central Europe are unable to realize a macroeconomic stabilization, a difficult marketization and privatization process, as well as a restructuring of their economies on a new technological basis which exploits their own poor resources and low accumulation level. Beyond this, they are unable to restructure and reorient their foreign trade, which, for more than four decades, was built upon the autarkic regional agreement of Comecon and an import substituting industrialization policy with a high level of self-sufficiency.

There are two vital external prerequisites without which a successful transformation of the region is flatly impossible: an acceptance by the European Community and an organized Marshall Plan-type assistance program for financial stabilization and consolidation of debt crisis, critical to generate cooperation and restructuring. (It should not aim, of course, at elimination of backwardness or to close the gap between East and West, such as in Germany, and thus it would not need hundreds of billions to be invested). Financial stabilization in East Central Europe was already promoted by the League of Nations after World War I. The Marshall Plan after World War II successfully helped West European economic consolidation and generated cooperation in Western Europe. A new international reconstruction plan would not differentiate

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


among the countries of the region nor delay integration to Europe by one or two decades, but would start to organize a united prosperous Europe as a whole.

The existing practice is disgusting and humiliating. Some of the great powers are grading the countries of the region and, in a rather paternalistic way, giving bonuses for good behavior. Because Polish shock therapy was very sympathetic and popular, they cut a part of Polish debt. Because the Hungarian government is not active enough, they are judged by another standard, to say nothing about the poor Bulgarians or Rumanians.

The inertia of forty years of the Cold War, or an old "international public spirit," is still with us. Today differentiation and grading would not be the proper method but, instead, a unified, organized, general program for the whole region. In the Cold War confrontation in a bipolar world system, everything that was good for me was bad for my enemy. Today if we really are ready to build a new world order, a new public spirit is needed: everything that is good for me is good for my partners and neighbors, their stability and prosperity help my growth and development.

If Cold War confrontation was a decisive reason to accept and integrate Turkey, Greece, and Spain into a Western alliance and European community, then the possibility of creating a secure and prosperous East Central Europe should be a determinant reason to accept and integrate East Central Europe as well. An acceptance after ten or twenty years may be too late, and Europe and the world will have lost historical momentum. A general plan to integrate and help East Central Europe, with a certain gradualism, is needed, and an immediate start is important. Those who are so enthusiastic for "shock therapy" in domestic issues are strong "gradualists" in international affairs. Why? If a post-war United States sacrificed thirteen billion dollars to finance the marshall Plan, entirely from her own resources, a turn-of-the-century highly developed Western world could find the resources for an efficient program. It would not be a mere sacrifice: the integration of such a huge market will generate sufficient – let me introduce the term – "cooperation dividend" for the developed world as well. As is well known, the Marshall Plan technique worked out certain guarantees of good usage. Conditional help and forced cooperation would create adequate insurance for a successful transition.

If Europe will be satisfied with lip service and rhetoric, if organized contribution remains out of question, if non-economic internal prerequisites will not be created, then even the best privatization plans and most ambitious programs for convertibility cannot lead to a successful transition.

A poor, anachronistic, nineteenth-century, peripheral capitalism will re-emerge in East Central Europe, and crises, revolts, and confrontation between neighbors will be reproduced time after time. This is a lesson of history for us to learn.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371



*Werner Gumpel*

# The Mentality Problem in the Transition Process from Centrally Planned Economy to Market Economy

The transformation of a socialist planned economy to a market economy is hampered by many obstacles. One of the most important is the way of thinking, something like a special socialist mentality, created during decades of communist rule and ideological manipulation.

One of the aims of the ruling communist party was to create a "new man". In the communist language it was called a "human being of the new type". In contrast to the homo oeconomicus of Adam Smith this man is conscious of his responsibility to the communist party and the society, he endeavors to build the socialist society and a powerful socialist state.

Communists did not succeed in creating a human being like this. But they worked hard to reeducate the people to get supporters of the marxist ideology who believe in the leading role of the communist party as the "avantgard of the working class". One of the most impressive slogans of the communists was the sentence: "The party is always right", or, with other words: "What is done by the party is well done, you have to believe in her." That means people should not think and act by themselves but according to the commands of the party. Independent thinking and acting was not welcome and often led into the jail.This extended to all parts of life, particularly to the economy.

One of the main principles of the socialist state and economy was the "principle of democratic centralism". It served as the justification for an excessive centralisation of the political, social and economic life in the socialist countries. As applied to the economy it meant that economic activity should be guided by the centre but that some responsibility was delegated and enterprises kept some leeway to engage in their own activities. However this extended to little more than business organisation and was thus very limited indeed. This was the case also in all units of administration. State economic plans determined meticulously what should be produced and in what quantity. The plan did not only determine what and how much to produce, but also the suppliers of the necessary inputs, the customers to whom the outputs were to be sold and the quality of these outputs. Even profit was a centrally planned target. Hence the directors of the enterprises have been mere puppets.They have no idea what independent acting entails.

The socialist command economy was the consequence of the expropriation of private entrepreneurs. Communist ideology opposes private property over the means of production because it leads to exploitation of the workers. People were taught that private property is an evil and that it has to be abolished. In some of the formerly socialist countries small private enterprises were allowed, particularly craftmen's establishments, but they were the exception rather than the rule.Trade was considered as shady. Even socialist traders were under the suspicion that they engaged in speculation which is something very bad in communist ideology.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


Pricing and price fixing was entrusted to a central price adjustment board. Supply and demand did not influence pricing, hence prices have not been scarcity prices. Price formation was arbitrary. Prices were normally frozen for a long time. Consequently they were unable to fulfill their information and allocation function properly. Many enterprises ran at a loss and depended on governmental subsidies. The prices of some of the most important foodstuffs like bread, milk, meat etc. were kept artificially low by means of subsidies. People have become used to cheap food and expensive industrial consumer goods. Housing was also cheap and people expect that this will continue in the future. Prices generally did not express production costs and scarcity but the intentions of the central government. This was one of the reasons of enormous misallocations and wastage. An accounting system like in the western countries was unknown.

Foreign trade was a monopoly of the state. This comes as no surprise: In a country in which all economic activities are planned foreign trade can hardly be left alone. State enterprises were not entitled to conduct their own foreign trade transactions. Most of them lacked any experience how to manage foreign trade and how to act on foreign markets.

The centrally planned economy was imprinted by ideology. This ideology was created by Karl Marx in the last century. But, one cannot solve the problems of the 20th century with a doctrine from the 19th century. In the Soviet Union three generations were educated in terms of this ideology, in Eastern Europe and East Germany two generations. Now they experience the collapse of the centrally planned economy and the ruin of their national economies. They made up their mind to introduce a democratic political system and a market economy. But the transition is hampered by old thinking.

The experience of Eastern Germany provides valuable insights about what is to be expected in the other formerly socialist countries and the Soviet Union. It reveals the following mentality problems in the transition to a Market Economy:

Different from the Soviet Union and some Eastern European countries the Eastern German population does not take a very unfavorable attitude towards private property over the means of production. But a minority does. More than forty years of communist propaganda have taken some effect. A market economy can hardly work with state owned enterprises, especially if this is combined with central planning. In state owned enterprises nobody feels really responsible. There is no private owner who wants to maximize the net value of his capital. Hence funds and resources were wasted. Especially in the Soviet Union many people do not recognise this. They see entrepreneurs as capitalists, exploiting their workers. They are afraid of entrepreneurial behavior which includes the possibility the workers are fired. The "right to work", which is guaranteed in all socialist constitutions, cannot be warranted in a market economy. The experience of the formerly socialist countries shows that the "right to work" causes low productivity of labour and prevents investments for increased efficiency. In a capitalist enterprise workers have to work harder and better than in a socialist one. Since they are used to the socialist jog-trot they find it difficult to acquire the work habits needed in a modern industrialised society. Average labour productivity in East Germany is one third of the Westgerman.

If discharged from their job workers are waiting to be placed elsewhere. They maintain a passive attitude. Their own initiative is mostly very limited. Even the opportuni-

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


ties for vocational retraining are rarely used although millions of people have to shift the occupation if they want to get a new job. Many people get used to be unemployed and to live like a pensioner because unemployment benefits are high. The active part of the Eastgerman population prefers to migrate to West Germany where it is relatively easy to find a better-paying job or they commute daily from their Eastgerman homes to Westgerman enterprises. They accept distances of a hundred and more kilometers. This creates the danger that the most active and qualified people leave Eastgermany forever while the less qualified and active stay. Hence it becomes more and more difficult to invest into East Germany.

On the other hand most of the Eastgerman managers (the same holds for the other formerly socialist countries) do not know how to manage an enterprise in a free enterprise economy. They are not able to decide as quickly as necessary and are unready for a cooperative management style. They are unprepared to engage in some venture and lack the necessary drive. According to the results of a German management consulting firm only 10 percent of the Eastgerman Managers are up to western standard. An impressive example how they work is the shipyard "Deutsche Maschinen- und Schiffbau AG", located at Rostock at the Baltic Sea. There are orders on hand for 103 ships. But the shipyard is not going to earn money at one single of them. In contrast: The expected losses amount to 1.8 billion DM.[1] In the past the government covered these losses by subsidies. The old thinking and many prejudices are a huge barrier on the way to a free enterprise economy and a recovery of the Eastgerman economy.

The same takes place in agriculture. The communists forced the farmers to become members of socialist cooperatives. Now they have the opportunity to leave these cooperatives and become independent farmers again. But only very few of them are able and willing to take this opportunity. Until August 1991 only around 3.600 out of 184.000 members of the cooperatives decided to get independent.[2] This is less than two percent. There are manifold reasons for this. The collective farmers fear responsibility and entrepreneurial risk. For the members of the cooperative daily working time is limited and until now the state guaranteed the survival of the collective farm.

Another momentuous mentality problem in East Germany is that the population distrusts their own produce and refuses both consumer goods and investment goods made in East Germany. They don't want to buy goods from the formerly socialist countries either. In particular they prefer goods made in West Germany or Japan. Unemployment increases and many Eastgerman factories have to close down due to the lack of markets in Germany and in Eastern Europe: The citizens of the Eastern European countries act similarly as the Eastgermans and ask for goods of western production. About 70 percent of Eastgerman foreign trade was settled with the former CMEA (Comecon)-countries. Understandably Westgermans are not inclined to buy Eastgerman products either even though some of them are not worse than Westgerman ones. Since the middle of 1991 the critical attitude of the East German population towards its own produce has been declining. This concerns for most foodstuff. Pres-

[1] See *Frankfurter Allgemeine Zeitung*, February 2, 1991.

[2] See *Süddeutsche Zeitung*, August 12, 1991.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


umably efforts to make East German products more attractive, to improve their quality and design, have helped a lot to bring about this change of attitudes. This observation indicates, that outright rejection of domestic products tends to be temporary phenomenon.

The Eastgerman government administration is ponderous and inefficient if not unfit to work. To get licences and affirmations usually takes a long time. Applications pile up but are not processed. The clerks are genuinely unable to act like the Westgerman administration but there is also the mental and practical resistance of the former communist party members who want to cause trouble and hinder the transformation-process. Unfortunately many former communist party and secret police members are still working in their old jobs. Pervasive corruption is a heritage of the past. It has influenced the mentality of the people in East Germany and creates a lot of difficulties both in administration and the production sector. On the other hand the people in East Germany like in all totalitarian countries believe in administration and bureaucracy. They fulfill uncritically the orders of the authorities and wait for advice. It will take a long time to reeducate them. Instead of relying on their own resources and the market forces Eastern German Citizens tend to expect aid from the government. Since the very beginning of socialism they have been told, that the government is responsible for everything.

After 45 years of socialism people do not understand the interrelation between productivity and wages. They are used that money does not play any role. If you need it – print it. A Soviet economist characterized this kind of mentality by the sentence: "Money is the only thing where we have realised communism." The prevailing attitude can be characterized by some polling information. According to a poll organized by the German weekly "Spiegel" 51 percent of the Western German population supported limitations on public debt, but only 29 percent of the Eastern German population.[3] A large number of employers in the former GDR were not actually doing any productive work, but were simply on the payrolls. Hence people were used to work little, but to get a salary and to pay low prices for food and nearly no rent for their flats. Heating was free or very cheap, the same holds for electricity.

Nevertheless the Eastgermans realize that the Westgermans have a higher living standard. They want to keep up with them. This is understandable: Eastgerman wages were 50 to 30 percent of Westgerman ones. Now they demand wage equalization. By now most branches of Eastgerman industry have increased wages to about 61 % of the Westgerman level. This would be acceptable if industrial production had increased. But this is not the case. In contrast, production drops. That means that an inflationary potential is developing in Germany. In addition production in East Germany becomes more expensive. Incentives to invest and to produce are diminishing. East German labor is highly unattractive at the wage levels now emerging, especially while administrative log-jams, disputes over property rigths and poor infrastructure remain on the agenda. Under these condition unemployment will fail to decline and maybe even increase. With the support of their unions Eastgerman workers effectively throw themselves out of work. A team of US economists from Berkeley estimate that at prevailing wages

---

[3] Der Spiegel, 1991:31 (July 29, 1991), p. 44.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

0063371


less than one in 10 East German companies can stay afloat in world markets.[4] According to recent estimates the workforce in the former GDR will be reduced from 9.5 million in 1989 to 5.5 millions.[5]

On the other hand workers cannot or will not understand that the government abolishes subsidies. This is especially the case in the housing sector. As already mentioned the rent, which workers pay for their flat and for central heating, is near zero. Rent for one square meter was until now 1 DM. After October 1, 1991 it will be 2 DM. In Munich it is up to 24 DM and even more. Eastgermans pay about 4 to 5 percent of their income for rent, Westgermans twenty percent and more. The wellknown newspaper "Frankfurter Allgemeine Zeitung"[6] gives an example for heating costs in an Eastgerman city. During wintertime the costs of district heating are 350 DM per housing unit but the renter pays a lousy 70 DM lump-sum remuneration for heating and hot water. Beginning in October 1991 it will be 150 DM. Because of the low rents repair and modernisation were and are impossible. The mansions are in a very bad shape and frequently according to Western standards unfit for human habitation. Most of the Eastgerman cities look like after a war. Many apartments are without central heating, without bath-rooms and very uncomfortable. There was no reconstruction for fifty or even a hundred years. People know the reasons but they are unwilling to accept higher rents. They do not want to recognise that they consumed the substance, that they have wasted resources, because it has been the official policy of the socialist government for decades.

The same is the case with other sectors of the Eastgerman economy. Factory buildings, roads, railways, electric power plants, power lines and, last but not least, the telecommunication system are in a very poor shape. Public transportation, electricity and telefon calls have been very cheap. The government implemented a policy of "reduced capital investment". To reach Western standards hundreds of billions of DM need to be invested. IMF-experts estimate the capital requirements for the modernization of the enterprises (without infrastructure) at 1.5 to 1.9 trillion DM. For the housing and the transportation system East Germany in addition needs 500 billion DM, cleaning up the environment will cost 200 billion DM etc.[7] These are figures for a country with 16.5 million inhabitants. Maybe they are somewhat exaggerated but they still provide some idea of the dimensions. Only in 1991 West Germany will transfer more than 153 billion DM to East Germany, 9.600 DM per capita. Major donors are the federal government which provides 128 billion DM, the states and communes which provide 6 billion DM, and the federal agency for unemployment insurance which provides 19 billion DM. Private investment is estimated at 20–30 billion DM.[8] This amounts to roughly two thirds of the national income produced in East Germany. These funds are used for purposes such as social programs, starting-up of an ef-

---

[4] see Financial Times, March 21, 1991

[5] see Deutsche Bundesbank, Auszüge aus Presseartikeln, Nr. 20/1991, March 21, 1991

[6] s. "Frankfurter Allgemeine Zeitung", 1991, Febr. 22

[7] s. "Wirtschaftswoche", Vol. 45, 1991, 9, page 29

[8] s. IWD, Informationsdienst des Instituts der deutschen Wirtschaft, Vol. 17, Nr. 26 (1991, June 27), p. 4–5.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


ficient public administration and public investment. Private sector activities are supported by a multitude of programs[9]. A discomforting feature of the transfer programs is that 60 percent of the funds available in 1991 are earmarked for benefits such as unemployment compensation etc. while only 40 percent are available to finance investment[10]. Even though these figures should not be used for any direct inferences on the capital needs of the Soviet Union with its 290 million inhabitants they still allow the conclusions that they are enormous.

The Eastgerman population, who is faced with the Westgerman standard, understands the importance of a rethinking but it doesn't want to lose its privileges. It is hard for them to understand that in West Germany all these services are not free and that people have to pay to make their provision profitable. It is probably the most serious mentality problem for people in East Germany and the Eastern European countries, to understand that capitalism is not the paradise which it seemed to be when they lived isolated behind the iron curtain, but that it implies hard work in order to reach a high standard of living and that everybody has to pay for everything. Only very few things are free or subsidised. People have to learn that capitalism has disadvantages too. There is no jobguaranty, people can be hired and fired, they can gain a lot of money but they can lose it too. People in East Germany are thrown into confusion: everything is new and beyond their imagination. They have to start from scratch. This is not so much of a problem for the young generation but it is difficult for the people who are in the fourties and older. Many of them get a feeling of inferiority and unsafety. According to the Spiegel-poll quoted above 44 percent of East German women and 31 percent of East German men are afraid of the future. The shares of timid Western Germans were 25 resp. 23 percent[11].

Numerous defrauders go East and exploit the inexperience of the Eastern people to make money. They take advantage of the credulity of their clients who are not used to this kind of business. Generally criminality in East Germany is increasing. It was relatively low under the communist dictatorship. A democratic system is much more liberal and the Eastgerman police cannot work under normal conditions until now. As a former tool of the communist party it lost most of its authority. There are not enough policemen available and, last not least, policemen are paid very little. All of this creates a feeling of unsafety and confusion among the population. It is really a period of transition and it is difficult to get accustomed. The German government and especially chancellor Helmut Kohl are convinced that this period will last not more than three to five years. But this is still a long time for people confronted with the better life and living conditions in West Germany.

No wonder that many people in East Germany become sick. The number of psychosomatic deseases and suicides is increasing. Many people suffer from fits of depression. People have to unlearn most of what they were brought up with.

People in East Germany staged a peaceful revolution against communism and achieved the reunification of its country. But the unification also brought numerous problems. Nobody had quite expected them, e. g. it is a bad surprise that unemploy-

---

[9] See Monatsbericht der Deutschen Bundesbank 1991:7 (July) p. 18–30.
[10] IWD op. cit. p. 5.
[11] op. cit. p. 41

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

063371


ment will go up to 50 percent until the end of this year. On the other hand it is clear that the transition from a communist political and economic system to democracy and free enterprise is bound to create difficulties after 45 years of socialist mismanagement. Late but not too late the German government started a program for the development of the Eastgerman economy under the name "Reconstruction Program East". This year about 104 billion DM are available for economic and social purposes. The reconstruction of the telecommunication system, of highways and railroads has already started. Thousands of new enterprises have been founded. Investments of Westgerman and international firms increase. Hopefully first results will be visible at the end of this or the beginning of next year. The mood of the population will then improve fast. Meanwhile they become more and more used to the capitalist system. Vocational retraining programs improve their qualification. We have to be a little bit patient. The prospects are bright. The construction of new factories will take three to five, the construction of a new infrastructure about ten years. Afterwards East Germany will have the most up-to-date factories of the world. Next year hopefully a vigorous recovery will be on its way.

October 3rd 1990 was only the beginning of the reunification of Germany. Reunifications is a process which takes years. It changes not only the economy and political life, but especially the minds of German people in East and West. The Germans were a divided nation for forty years. We cannot remove the after-effects of this long period within one year. As an economist and as a German I am optimistic that we will succeed.

The situation in the Soviet Union and the Eastern European countries is worse than in East Germany. These countries don't have a wealthy brother who is ready to help. Particularly the Soviet Union needs astronomic amounts of capital and a large transfer of know-how and human capital to recover. Changing the mentality will be more difficult than in East Germany because socialism lasted there more than seventy years. Germany is willing to help and maybe the IMF is too. But whatsoever capital aid the USSR will receive – it is a pill to cure an earthquake. The great religious reformer Martin Luther used to say: "Help yourself than God will help you." Accepting this truth is a prerequisite to master the crisis.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

i 00063371



*Peter Murrell*

# Conservative Political Philosophy and the Strategy of Economic Transition*

Social science, especially economics, does not center its efforts on the processes of socioeconomic change, for its concern traditionally has been on end points: how to achieve the first-best Pareto efficient outcome rather than deciding which problem to solve first; the implications of behavior under rational expectations rather than the study of learning processes. This lack of emphasis on change has become increasingly apparent as scholars apply existing theories to the most momentous economic changes of our times – the Eastern European economic revolutions.

There are a few scholarly traditions that have placed the analysis of change at the center of concern.[1] Important among these is a set of works that might be grouped under the rubric "conservative political philosophy" or, perhaps more appropriately in the present context, "principles of democratic social reconstruction." The leading works are Burke, Popper, and Oakeshott.[2] They offer lessons of conservative political philosophy applicable to the process of economic change in Eastern Europe.

The immediately ensuing pages lay out the central assumptions of philosophical conservatism and explore the important distinction, due to Popper, between utopian and piecemeal social engineering. Then I use this distinction to examine policies for the Eastern European economic transition in two important areas: the place of workers' management in the transition and the relative properties of different schemes for privatization. The analyses of these two policy areas are provided as examples of the application of the conservative philosophy of reform, which can in principle be brought to bear on all the major policy decisions in the economic transition from socialism.

A central concern of conservative political philosophy is the way societies use the knowledge that is available to them, a concern arising from two interrelated assumptions. First, there is the view that a large part of socially useful knowledge is acquired

---

* I thank the Wilson Center and Center for Institutional Reform and the Informal Sector (IRIS) at the University of Maryland for support in the writing of this paper, and Norbert Hornstein for his key suggestions that led me into the literature on conservative political philosophy.

[1] In economics, there are the sets of somewhat related theories called evolutionary economics, Schumpeterian economics, and Austrian economics. Peter Murrell, "Evolution in Economics and in the Economic Reform of the Centrally Planned Economies," in Christopher C. Clague and Gordon Rausser, eds., *Emerging Market Economies in Eastern Europe* (forthcoming) examines the implications of evolutionary economics for the design of policies in the Eastern European transition.

[2] Edmund Burke, *Reflections on the Revolution in France* (1790); Karl Popper, *The Open Society and Its Enemies* (Princeton, 1971); and Michael Oakeshott, *Rationalism in Politics and Other Essays* (New York, 1962). In classifying these three authors together, there is no implication that there are not important differences between them. However, the similarities are obvious when one reads these works in the light of developments in Eastern Europe and particularly in contrast to the current works on the changes in that region.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


in the context of the prevailing set of socioeconomic arrangements and is usable only in a narrow domain of that set. Second, there is the hardly controversial notion that politicoeconomic systems are vastly complicated constructs, especially when viewed in the light of limits on human intellectual capacities.

In almost all societies, the socioeconomic framework has been built up in a gradual process of accumulating small changes.[3] As each new institution arises, it is fitted into a larger pre-existing structure, and the functioning of each institution cannot be understood as an isolated phenomenon. One might be able to understand and predict the effects of small changes or the marginal consequences of the presence or absence of a particular institution, but one cannot hope to break down the major elements of a society's socioeconomic processes into separate components and then understand how the whole society works.

A society's institutional structure is an organic whole – the result, in successful societies, of a long historical process. The human capacity for understanding is small in relation to the complexity of such organisms, and in political matters, "we can never walk surely but by being sensible of our blindness."[4] According to Popper, "it is not reasonable to assume that a complete reconstruction of our social system would lead at once to a workable system."[5]

At the center of conservatism is an extreme skepticism concerning the workability of any blueprint for a new society. Implicit in this view is the assumption that a vast number of rearrangements of society's institutions would produce worse outcomes while only a few would result in improvement. Since the present state of knowledge on socioeconomic processes is so limited, policy-makers are not able to discriminate between workable and disastrous theoretical blueprints for new social systems. This might be called the "bad bet" argument against radical change.

The preceding argument requires the assumption that the existing structure of society has been built by a process that selects those arrangements that, at least partially, take into account social welfare. If today's arrangements are randomly chosen – or worse, inimical to welfare – then a bad bet on a new blueprint might still be one that is worth taking. But this is a minimal requirement. This assumption does not imply that the present arrangements are anywhere near first best; the insistence is solely on some attention to human welfare in existing arrangements. This minimal amount of attention to the functional needs of society is unlikely to be present in a society that results from the implementation of a blueprint.

A distinct, but related, argument for conservative change begins with observations on the nature of a society's stock of knowledge and especially on the association between this knowledge and existing socioeconomic arrangements. Following Oakeshott, one might distinguish between two types of knowledge.[6] The first is technical

[3] Moreover, it is assumed that this gradual process of change has been the case in *all* successful societies, as discussed later in the paper.

[4] Edmund Burke, *Burke's Politics: Selected Writings and Speeches of Edmund Burke on Reform, Revolution, and War*, Ross J.S. Hoffman and Paul Levack, eds. (New York, 1949), p. xiv.

[5] Popper, *Open Society*, pp. 167-168.

[6] Oakeshott, *Rationalism*, pp. 7–8. The distinction between the two types of knowledge has been offered by many authors, most notably Michael Polyani, *Personal Knowledge: Towards a Post-Critical Philoso-*

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


knowledge, the set of explicit rules and articulable procedures that are used in undertaking an activity. This is the type of knowledge that can be conveyed by lecturers and systematized in textbooks, the type of knowledge that knows no borders and no boundaries.

In contrast, one has practical, or personal, knowledge, that inarticulate knowledge that is required in the effective performance of any activity and that can be acquired only by direct acquaintance with the activity. It is the knowledge of the scientist who has an instinct for the correct experiment to make; it is the knowledge of the experienced businessman who senses opportunities through a cloud of disparate facts. Because personal knowledge is acquired through activity, it is inherently specific to particular contexts. It can be communicated between individuals only by the sharing of experience and activity, as, for example, in apprenticeship.

All activities – whether science, art, politics, or economic policy-making – use both types of knowledge. To the extent that one type of knowledge is missing or inappropriate, the resulting outcome will be that much poorer. This point is hardly worth stating for the first type of knowledge; we all know, for example, that it would be inadvisable to have judges and lawyers who have not studied the law. But the value of the second type of knowledge is often overlooked. It is frequently suggested, for example, that legal codes can be transferred between countries, replacing existing codes and practices wholesale. What this suggestion fails to recognize is the practical knowledge that is essential to the interpretation and use of a legal code. Without this practical knowledge, which exists only in the working arrangements of a set of lawyers and judges, there is no reason to suppose that the transplanted legal code will have positive value.

Practical knowledge – of an economy, of legal arrangements, of a political system – is always acquired in a particular institutional context. Hence, the knowledge possessed by a society is most fully applicable within that society's present context. Practical knowledge loses much of its value when applied far from the framework of an activity in which it was acquired. It is hardly likely to be productive in deliberating the consequences of implementing some radical blueprint for a new society.[7]

Recognition of the existence of personal knowledge suggests that the productivity of small changes will be much greater than that of large changes. The ability of policymakers to identify good policies decreases rapidly as those policies move society further from its existing position. Moreover, the nature of personal knowledge suggests that societies cannot quickly acquire the knowledge required to implement a blueprint. Many years of practice and, in the meantime, poor and very costly decisions are required to acquire the practical knowledge that is needed if the plan is to be im-

---

*phy* (Chicago, 1962). It is also the basis of much economic theorizing on the nature of organizations, see, e.g., Richard Nelson and Sidney Winter, *An Evolutionary Theory of Economic Change* (Cambridge, MA, 1982) and Oliver E. Williamson, *Markets and Hierarchies, Analysis and Antitrust Implications: A Study in the Economies of Internal Organization* (New York, 1975).

[7] For those preferring a somewhat mundane example of this principle, the variance of forecast error of regressions increases with the distance from the mean of present observations.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


plemented.[8] Thus, we have reached a second argument for conservative change – this might be called the "use of knowledge" argument.

The distinction drawn by Popper between utopian and piecemeal social engineering is helpful here.[9] Utopian social engineering begins most often with a radical critique of the existing arrangements of society, a denial that there is anything worth preserving in these arrangements, and a picture of what a better world would be like. The driving force of utopian policies is a vision of the end state of society, which usually has little in common with present arrangements. Policy measures en route are always framed in terms of this destination, rather than as departures from the initial situation, which contains nothing of worth. Since the existing institutions of society are so different from, so incompatible with, those that are in the target blueprint, and since these existing institutions are presumed to have no value, the initial phases of utopian engineering always center more on destruction than on creation.[10]

Of course, there can be some institutional construction at the beginning of reform, but the sheer complexity of creating workable social arrangements argues that the whole blueprint cannot be created quickly. Moreover, implementation of the blueprint is in principle impossible due to its inevitable inaccuracy and imprecision. Those positive measures that occur in the early phases of a utopian project will inevitably involve planting in place one of the pieces of the jigsaw, even though the remaining pieces are not yet to be found.[11]

This emphasis on final destination and the willingness to throw away existing arrangements lead to policies that are inevitably irreversible. In the utopian approach, reversible policies are harmful. for those with faith in both the blueprint and the ability of a society to implement it, the tenacity and intrinsic worthlessness of the old mean that irreversible policies have much benefit. Policy-makers must ensure that society can never go back because that island in the storm is simply a temptation not to advance to more fertile shores.

---

[8] The use of foreign advisers, who are experienced in the workings of a society similar to that envisaged in the blueprint, might seem to be one way to solve this problem of implementing the blueprint. There are reasons why this is not possible, however. First, the number of policy decisions is much too great compared to the number of foreign advisers that would be available. Second, many of the existing institutional arrangements will remain before the blueprint is implemented. The foreign advisers suffer from lack of the practical knowledge of these arrangements in much the same way that the domestics lack the knowledge of the blueprint society. Therefore, foreign technical assistance must be implemented through a meeting of the minds of foreign experts and domestic policy-makers.

[9] It is interesting to note here that Popper did not shrink from the use of the phrase "social engineering" when discussing the types of reforms that should be implemented in a democratic society. He does not argue against social engineering *per se*, but rather against specific types of social engineering. In particular, his arguments are addressed against reforms based on a utopian ideal.

[10] There is one philosophy in which destruction is all that is needed. This is the philosophy that derives from primitive economics – perfect competition, with a dash of the Coase theorem – emphasizing that the market is simply the freedom to engage in the propensity to truck, barter, and trade. That is why a belief in a crude laissez-faire doctrine interacts most unfortunately with the utopian approach.

[11] A perfect example of this occurs when reforming countries implement currency convertibility under the assumption that a working private sector will follow quickly from privatization. This assumption shows all signs of being incorrect for two reasons. First, the privatization process is obviously a very slow one. Second, privatized firms will not necessarily behave in the fashion of classical private sectors, which have been created in an evolutionary process.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

90063371



A conservative perceives grave dangers in the utopian approach to social change, for the "use of knowledge" argument stresses that a radical move destroys much of the valuable knowledge in society. Dependent as it is on a specific configuration of society's arrangements, practical knowledge is only useful for judging the effects of small changes. Hence, individual policy-makers will have little ability to construct new arrangements that will lead society reliably to the destination laid out in the blueprint.[12] In the process of trying to get to the destination quickly, one destroys the knowledge of how to get there certainly. Then the "bad bet" assumption becomes relevant – unanticipated consequences become a major determinant of the outcome and there is every probability of finishing up in a worse position than at present.

The following are the main ways in which the critique of the utopian approach can be challenged: (1) One might believe that existing arrangements really have no utility (presumably compared to those that can be easily established at the beginning of a move to a final blueprint), an argument that was made very strongly by socialist revolutionaries in the early parts of this century and is heard frequently in today's Eastern European context. (2) It might be claimed that we really do have a good understanding of how societies work and that this understanding is relevant outside the specific historical context in which it was acquired.

In the present context, this means that economists really do know how capitalist societies work and that this knowledge is relevant outside developed capitalist countries. Keynesian economists – the majority in the 1960s – of course frequently used this argument against their conservative critics. 3. One might maintain that these understandings can be communicated quickly to the policy-makers who will be implementing the new policies, the Eastern European banking officials, legislators, politicians, and the like who can be relied upon to acquire quickly the skills that are relevant to their new roles in the market economy.

Suppose, though, that one believes that these three claims are incorrect. Utopian social engineering will then be unproductive at best and thoroughly dangerous at worst. What alternatives are there? Popper advocates piecemeal social engineering. In this approach to "democratic social reconstruction" the emphasis is not on a blueprint for the end state, but rather upon identifying the worst problems of the existing set of arrangements. Intellectual efforts are primarily focused on solving these problems in the specific institutional context in which the solutions will be implemented.

Piecemeal social engineering places an emphasis on reversible changes, to the extent that these are possible, since one cannot necessarily expect society's limited knowledge of socioeconomic processes to produce even small changes that are necessarily beneficial. Finally, there is a preference for policies that have been used in a similar institutional context or for widening the scope of experiments that have worked on a smaller scale within the existing system.[13] The risks in the introduction of the new are then minimized.

---

[12] The use of knowledge argument also implies that the blueprint itself will inevitably be flawed.

[13] Interestingly, this is a characterization of what is arguably the most successful reform that has yet been implemented in countries moving from central planning. The Chinese reforms began, not with a grand plan on the part of the leadership, but rather with the leaders validating and spreading experiments that had been conducted under the initiative of the leadership of some localities.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


The emphasis is on gradual change for a variety of reasons. First, the larger the number of institutional changes that are implemented simultaneously, the harder it is to design a workable set of arrangements. Second, reversibility is enhanced by making changes slowly. Bad policies can be stopped midstream. Third, with gradual change, society can accumulate practical knowledge of the new arrangements as this knowledge is needed. There is a chance to experiment on a smaller scale and to provide usable feedback about which policies work and which do not.

The arguments in the distinction between utopian and piecemeal engineering are summarized in Table 1. These arguments for gradual change are offered in the present context not with any sense that they are obviously correct, but rather with the suggestion that they are worth considering in the context of the massive changes in Eastern Europe. They do derive from an important tradition – one that has given insights into the problems caused by massive socioeconomic changes in the past.

Perhaps the best capsule summary of the arguments is provided by Oakeshott, who lists the implications of the conservative temperament for matters of innovation and change:

> First, innovation entails certain loss and possible gain, therefore, the onus of proof, to show that the proposed change may be expected to be on the whole beneficial, rests with the would-be innovator. Secondly, [the man of conservative temperament] believes that the more closely an innovation resembles growth (that is, the more clearly it is intimated in and not merely imposed upon the situation) the less likely it is to result in a preponderance of loss. Thirdly, he thinks that an innovation which is a response to some specific defect, one designed to redress some specific disequilibrium, is more desirable than one which springs from a notion of a generally improved condition of human circumstances, and is far more desirable than one generated by a vision of perfection. Consequently, he prefers small and limited innovations to large and indefinite. Fourthly, he favours a slow rather than a rapid pace, and pauses to observe current consequences and make appropriate adjustments. And lastly, he believes the occasion to be important; and, other things being equal, he considers the most favourable occasion for innovation to be when the projected change is most likely to be limited to what is intended and least likely to be corrupted by undesired and unmanageable consequences.[14]

This summary leads us to one final observation, that the term "conservative" is much misused in many parts of the reforming socialist world. This term does not denote those who are against change itself, as seems to be assumed in the Soviet Union, for conservatism is about types of changes, not their existence. Nor does the term apply to those who advocate radical measures to implement capitalism overnight, as is the case in Czechoslovakia, for conservatism eschews ideological blueprints. Nor is there any necessary association between conservatism and the various positions that one might take on such matters as the proper size of government, the role for income redistribution, and so forth. One can be a liberal in the American sense or a liberal in the European sense and still be a conservative, for conservatism is about how societies should change, not about where they should finish up.

---

[14] Oakeshott, *Rationalism*, p. 172.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


## On Piecemeal Privatization Versus Mass Privatization

There seem to be two basic models for the privatization of large state enterprises in Eastern Europe.[15] The first model is one of piecemeal actions: waiting for groups of interested parties to arise with sufficient funds; seeking out foreign buyers; constructing ad hoc lease-purchase arrangements; and perhaps giving away some enterprises when there is only one potential "buyer" at a zero price. Above all, this approach to privatization is signified by patience, a heavy emphasis on traditional forms of the market mechanism to exchange ownership rights, and the search for traditional types of owners. These three features are of course interrelated. The need to wait arises from the search for a variety of arrangements for privatization, each identifying a buyer willing to risk his or her own resources in undertaking ownership.

The alternative model stresses the need for speed, a large number of privatizations carried out simultaneously using a single method. Because privatization on such a mass scale has not been accomplished before, this method requires the creation of wholly new procedures and institutions (voucher trading schemes, new mutual funds, and the like). Not only are these institutions and procedures new to the country in question, but there are no close models from other countries on which to base their design. The foundation of this mass privatization method is pure theory, and the builders of the huge institutional structure are primarily technocrats, whose stake in this process is necessarily trivial compared to the amount of resources that their schemes affect. In contrast to the usual mechanisms of markets or pluralistic democracies, the mass of the population and important economic interests have limited influence on this process.

The critique of the two methods of privatization is given in summary form by using the structure of Table 1 to contrast the two schemes. The resultant comparison is provided in Table 2.

## On Workers' Management in the Transition

It is common to find the argument that there cannot be a third way – between capitalism and socialism – in the transition. Most notably this argument is targeted at those who advocate some form of workers' ownership of enterprises during the transition to a market economy. This argument is ultimately end point based. When emanating from Western economists, it is usually driven by two familiar pieces of logic. The first is the theoretical analysis that implies that several perversities result from workers' ownership in a competitive economy. The second element in the argument is the observation

[15] Of course, this is a gross simplification, again for expositional purposes. See David Stark, "privatization in Hungary: From Plan to Market or from Plan to Clan?" *East European Politics and Societies,* 4:3 (1990), pp. 351–392 for an excellent discussion of the various dimensions of privatization.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


**Table 1:** Characteristics of Utopian and Piecemeal Approaches to Policy

| Utopian | Piecemeal |
|---|---|
| 1. *End Point Driven.* Choice of initial policy determined by the goal for the final outcome of the process. | 1. *Focus on Immediate Problem.* Identifies worst problems, trying to solve them largely ignoring the effects of today's decisions on some long-run equilibrium. |
| 2. *Clean the Slate.* Emphasizes the interrelatedness of society's problems and therefore the need to make a decisive break with the past, with the necessity of institutional destruction in the first stages. | 2. *Use Existing Institutions.* Recognizes that new structuress can be created only slowly and accepts that existing institutions are usually better than either none or hastily constructed alternatives. |
| 3. *Large Leaps.* To make a decisive break from the constraints of the past, advocates bold policy steps that involve packages of many new institutions. | 3. *Small Steps.* Emphasizes the risks from going too fast and the impossibility of successfully creating a network of interrelated institutions anew. |
| 4. *Faith in the New.* Willingness to trust in theoretical reasoning as the primary input for the design of society's new arrangements. | 4. *Skepticism.* Search for existing models and methods to help in the formulation of institutional changes. |
| 5. *Irreversibility.* In the weak form, willingness to accept large irreversible changes. In the strong form, emphasizes the need for them. | 5. *Reversibility.* Advocates policies that facilitate feedback on their effects and that can be stopped or even reversed. |
| 6. *Design and Theory.* The most important intellectual resource for policymakers is the knowledge held by theoreticians and technocrats. | 6. *Judgment and Practice.* The most important intellectual resource is the practical experience accumulated in the context of a particular set of institutional arrangements. |

**Table 2:** Characteristics of Two Privatization Approaches

| Large Scale | Gradual, ad hoc |
|---|---|
| 1. *End Point Driven.* Attempt at immediate implementation of ultimate goal of reform – capitalist economy. | 1. *Focus on Immediate Problem.* Unclear property rights can be solved without immediate privatization; solution to lack of competition necessarily lies outside the existing enterprise structure (in the creation of an environment where entry of new firms is easy). |

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

[0063371



| Large Scale | Gradual, ad hoc |
|---|---|
| 2. *Clean the Slate*. As soon as possible, erase all non-capitalist ownership forms. | 2. *Use Existing Institutions*. Validate and strengthen some existing property rights; rely on state control during the lengthy period before all enterprises can be privatized. |
| 3. *Large Leaps*. Many privatizations handled simul-taneously. | 3. *Small Steps*. Each privatization is an individual decision involving different actors. |
| 4. *Faith in the New*. Theoretical reasoning establishes the nature of the voucher schemes, the new forms of mutual funds, and new managerial incentive schemes. | 4. *Skepticism*. Rely on the tried and tested features of market processes. |
| 5. *Irreversibility*. Once the scheme is launched new property rights are issued, the revocation of which would destroy the whole reform. | 5. *Reversibility*. Each separate privatization is, of course, not reversible. However, the general policy can be amended and changed easily. |
| 6. *Design and Theory*. Relies on the skills of technocrats and standard intellectual approaches for the design of new institutions. | 6. *Judgment and Practice*. Uses decentralized judgments of many participants on the forms and scale of privatization and the post privatization structure of ownership and corporate control. |

that there are few successful economies in which workers' management has been prominent, and given that this ownership form was perfectly legal in most developed economies, its lack of use shows its inefficiency.

I do not take issue with either the theory in the first line of argument or the empirical interpretation in the second. Moreover, I would agree that these arguments, especially the second, imply that it is unlikely that there will be workers' management at the end of a very long transition. But this does not mean that these two pieces of logic sustain the conclusion that workers' management cannot begin the transition. This conclusion relies too much on the notion that initial policies should be guided by the target blueprint, the utopian view.

The piecemeal approach would first ask a series of questions about the importance of workers' management in the economy undergoing reform. It would ascertain whether the principle of worker's management, and its organizational embodiment, is a deep part of the country's tradition. If the answer to that question is in the affirmative, then the short-term productivity of society's practical knowledge will be intimately tied to the continuation of workers' management. In such a situation, the knowledge of how to organize enterprises is contingent on the existence of workers' management, as is the intuitive knowledge that policy-makers possess about the economy's

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


responses to exogenous events and to policy changes. A quick move away from workers' management would destroy this practical knowledge, which cannot be replaced even by the instantaneous and complete acquisition of foreknowledge of the new system. Consequently, the productivity of enterprises and the effectiveness of policy-makers would be reduced greatly by the destruction of an existing system of workers' management.

In those societies in which workers' management is important, the piecemeal approach would then seek to determine whether workers' management is the principal cause of the society's problems. Such a determination could not rely on theoretical strictures concerning the behavior of a worker-managed economy compared to an idealized system, since that idealized system is exactly the one that reforming economies will not have in the near future. Obviously, then, ascertaining whether workers' management is really one of the crucial problems of the economy is not an easy matter. But that becomes a crucial point, since a conservative approach would require burden of proof to be the duty of the zealous reformer, when scrapping large elements of both society's institutional capital and society's stock of knowledge.

The preceding discussion implies that the decision on the role of workers' management in the transition must begin with a series of questions about the nature of the existing system in a specific country. I have some guesses concerning the answers to these questions and know that these answers vary between countries. In most cases, the answers would depend upon deep contextual knowledge about the country in question. This is perhaps the most important point to be made. That point makes it obvious that the blanket dismissal of workers' management as an element of transition policy is totally unsustainable, except in an approach that assumes that the institutions of a new economic system can be designed and reliably implemented instantaneously.

In countries such as Yugoslavia, and perhaps Poland, it is plausible that workers' management is deeply embedded in the existing economic fabric. In that case, there seems to be little justification for eradicating it at the beginning of the process of transition. This does not mean that workers' management is expected to survive the transition, nor, especially, that it should be helped to survive the transition. There will surely be rapid growth of the capitalist sector over the next few years. It is clear that fair competition between this sector and the workers'-management sector must be a vital element in the transition process. Competition for survival – the most important missing element under socialism – should determine the end state of the reform, not ideas about the ultimate nature of good societies that applied at the beginning.[16]

[16] Peter Murrell, *The Nature of Socialist Economies: Lessons from Easter European Foreign Trade* (Princeton, 1990) argues that the absence of competition for survival among economic units was the most important problem of Eastern European economies.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371

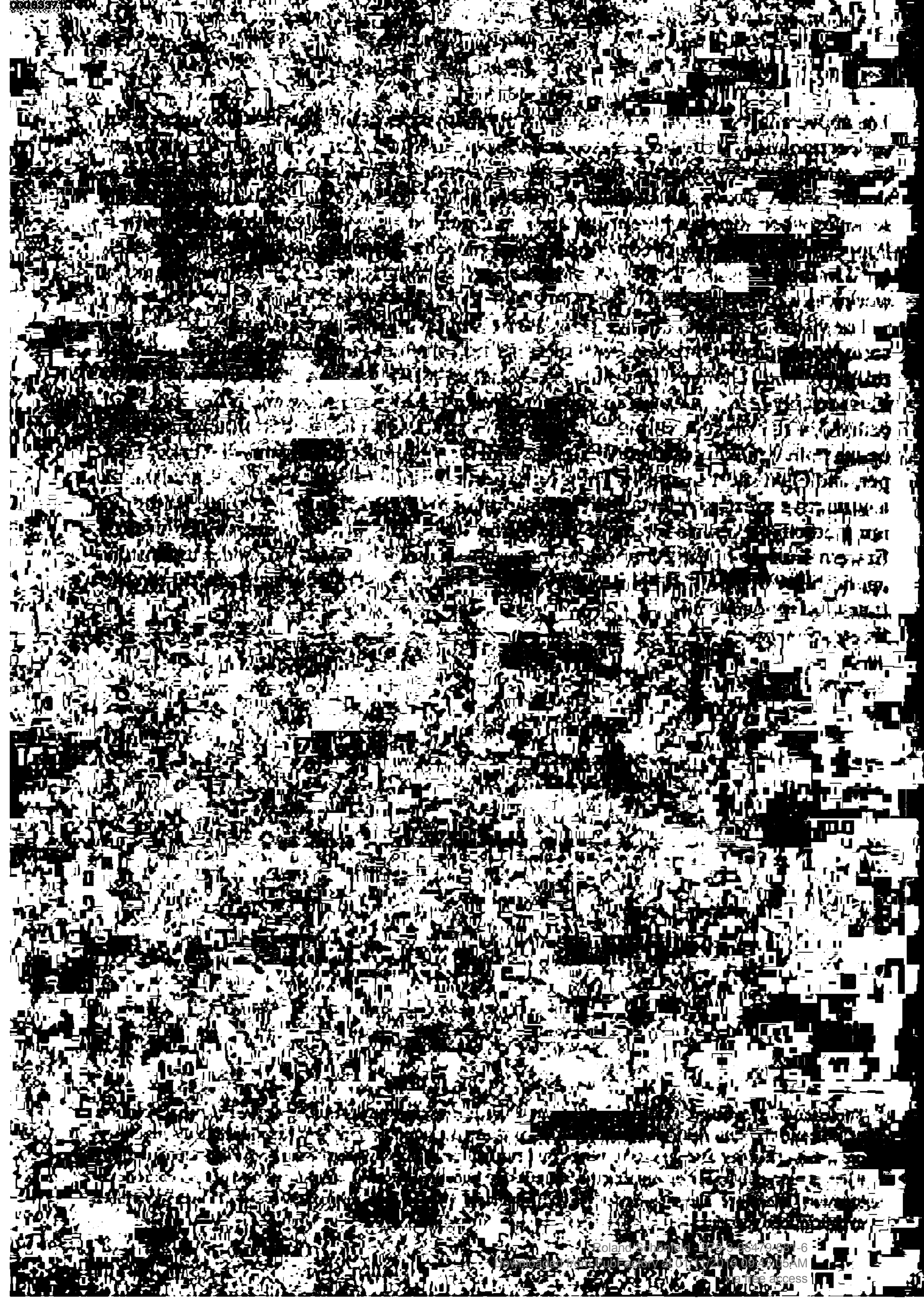

## Conclusions

The above analysis ultimately rests on a distinct vision of the way in which successful socioeconomic systems are created and the way in which some of the mostly costly socioeconomic experiments of history were generated. Those living in Central and Eastern Europe, above all, should need no reminding of the huge costs that can befall societies when utopian blueprints are implemented. It is surely no coincidence that Popper's distinction between utopian and piecemeal social engineering was developed in the 1930s and 1940s. (And indeed no coincidence that Burke's most famous work was written in 1790.)

The vision of socioeconomic progress presented above emphasizes that successful socioeconomic systems have seen their institutions build up slowly in a succession of relatively small changes. Revolutions against an existing system, intending to destroy it, invariably result in excess in another direction and failure in some other way.[17] Of course, in the present context, it is perhaps fruitless to hope that either East European policy-makers or their Western advisers would take the lessons of Burke, Popper, and Oakeshott seriously. Therefore, I do not hope to offer the above analysis as a normative exercise relevant to the development of East European policy. Rather, it is a predictive exercise for the events of the 1990s. The successes and the failures of Eastern Europe in the economic transition from socialism will provide a test of the applicability of a political philosophy that last had a burst of energy in reaction to the transition *to* socialism.

[17] Those tending to disagree with this statement would, I presume, most readily cite the English revolution of 1688 and the American revolution of 1776 as counter examples. This is not the place to discuss interpretation of history. But it must be noted that Burke, for example, interpreted both events as situations where a monarch was overstepping the bounds that had been created in a long period of historical development. Therefore, the majority of "revolutionaries" were in fact quite conservative in intent, as later events indeed showed.

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access



Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371


# AUTORENVERZEICHNIS
# LIST OF AUTHORS

Dr. Franz-Lothar Altmann
Deputy Director, Südost-Institut, München

Prof. Dr. David L. Bartlett
Vanderbilt University, Nashville, Tennessee

Prof. Dr. Ivan T. Berend
University of California, Los Angeles, University of Economics, Budapest

Prof. Dr. László Bruszt
Cornell University, Ithaca, New York

Dr. Zhiyuan Cui
University of Chicago

Dr. Janusz M. Dabrowski
Enterprise Adjustment and Labor Market Research Group, Warszawa

Prof. Dr. Werner Gumpel
Ludwig-Maximilians-Universität, München

Prof. Dr. Marie Lavigne
University of Pau, France

Prof. Dr. Peter Murell
University of Maryland, College Park

Prof. Dr. Kazimierz Z. Poznanski
University of Washington, Seattle

Dr. Roland Schönfeld
Executive Director, Südosteuropa-Gesellschaft, München

Prof. Dr. David Stark
Cornell University, Itahaca, New York

Dr. Ian Szomburg
President, The Research Center for Marketization and Property Reform, Gdansk

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371

# Veröffentlichungen der Südosteuropa-Gesellschaft

Eine vollständige Liste der bisher von der SOG herausgegebenen Publikationen ist über die Geschäftsstelle, Widenmayerstraße 49, D-8000 München 22, zu beziehen.

## SÜDOSTEUROPA JAHRBÜCHER

Band 17: **Die Völker Südosteuropas im 6.–8. Jahrhundert.** Hrsg. von Bernhard Hänsel. 308 S., München 1987. (DM 85,–)

Band 18: **Zwischen Zentralisierung und Selbstverwaltung – Bürokratische Systeme in Südosteuropa.** Hrsg. von Franz Ronneberger. 161 S., München 1988. (DM 34,–)

Band 20: **Die Moderne in den Literaturen Südosteuropas.** Hrsg. von Reinhard Lauer. 216 S., München 1991. (DM 44,–)

Band 21: **Wandlungen in der Eigentumsverfassung der sozialistischen Länder Südosteuropas.** Hrsg. von Georg Brunner und Dieter Pfaff. 111 S., München 1990. (DM 28,–)

Band 22: **Die Volkskultur Südosteuropas in der Moderne.** Hrsg. von Klaus Roth. 356 S., 31 Abb., München 1992. (DM 72,–)

Band 23: **Deutschland und die Völker Südosteuropas. Festschrift für Walter Althammer zum 65. Geburtstag.** Hrsg. von Hans Peter Linss und Roland Schönfeld. 416 S., München 1993. (DM 72,–)

## SÜDOSTEUROPA STUDIEN

Band 38: **Handwerk in Mittel- und Südosteuropa. Mobilität, Vermittlung und Wandel im Handwerk des 18. bis 20 Jahrhunderts.** Hrsg. von Klaus Roth. 236 S., München 1987. (DM 34,–)

Band 39: **Bayern und Ungarn. Tausend Jahre enge Beziehungen.** Hrsg. von Ekkehard Völkl. 133 S., Regensburg 1988. (DM 24,–)

Band 40: **Volksmusik und Kunstmusik in Südosteuropa.** Hrsg. von Cornelius Eberhardt und Günther Weiß. 193 S., München 1989. (= Schriftenreihe der Hochschule für Musik in München, Bd. 9) (DM 49,–)

Band 41: **Südosteuropa-Veröffentlichungen aus der Bundesrepublik Deutschland 1984–1988.** Hrsg. von Klaus-Detlev Grothusen. 128 S., München 1989 (DM 22,–)

Band 42: **Industrialisierung und gesellschaftlicher Wandel in Südosteuropa.** Hrsg. von Roland Schönfeld. 139 S., München 1989. (DM 22,–)

Band 47: **Südosteuropa in der Wahrnehmung der deutschen Öffentlichkeit vom Wiener Kongress (1815) bis zum Pariser Frieden (1856).** Hrsg. von Josip Matešić und Klaus Heitmann. 180 S., München 1990. (DM 34,–)

Band 49: **Politischer Pluralismus und Verfassungsstaat in Deutschland und Ungarn.** Hrsg. von Georg Brunner. 183 S., München 1992. (DM 36,–)

Band 50: **Von der Ost-West-Konfrontation zur Europäischen Friedensordnung.** Hrsg. von Günther Wagenlehner. 317 S., München 1992. (DM 49,–)

Band 51: **Transformation der Wirtschaftssysteme in Ostmitteleuropa (Transforming Economic Systems in East Central Europe).** Hrsg. von Roland Schönfeld. 211 S., München 1993. (DM 38,–)

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access

00063371

## SÜDOSTEUROPA AKTUELL

Heft 1: **Fragen des Handels mit Südosteuropa.** Hrsg. von Walter Althammer. 82 S., München 1987. (DM 7,–)

Heft 3: **Die Türkei und die Europäische Gemeinschaft.** Hrsg. von Werner Gumpel. 120 S., München 1988. (DM 12,50)

Heft 4: **Die jugoslawische Wirtschaft – Gegenwart und Zukunft.** Hrsg. von Werner Gumpel. 105 S., München 1988. (DM 10,–)

Heft 5: **Agrarwirtschaftliche Zusammenarbeit mit Albanien.** Hrsg. von Walter Althammer. 126 S., München 1989. (DM 12,50)

Heft 6: **Landesentwicklung und Umweltschutz im Donauraum.** Hrsg. von Karl Ruppert. 138 S., München 1989. (DM 15,–)

Heft 7: **Interkulturelle Kommunikation in Südosteuropa.** Hrsg. von Franz Ronneberger. 132 S., München 1989. (DM 15,–)

Heft 8: **Die Interessen der Anliegerstaaten am Rhein-Main-Donau-Kanal.** Hrsg. von Werner Gumpel. 72 S., München 1990. (DM 7,–)

Heft 11: **Europa und die Türkei in den neunziger Jahren.** Hrsg. von Werner Gumpel. 82 S., München 1991. (DM 7,–)

Heft 12: **Das vereinte Deutschland als Partner Ostmittel- und Südosteuropas.** Hrsg. von Walter Althammer. 120 S., München 1991. (DM 12,50)

Heft 13: **Die Agrarwirtschaft Südosteuropas im Wandel.** Hrsg. von Karl-Eugen Wädekin. 204 S., München 1992. (DM 17,50)

Heft 14: **Staatliche Einheit und Teilung – Deutschland und Jugoslawien.** Hrsg. von Klaus-Detlev Grothusen. 154 S., München 1992. (DM 16,–)

Heft 15: **Barrieren im Bereich der Verkehrs-, Energie- und Agrarwirtschaft in Ost- und Südosteuropa.** Hrsg. von Werner Gumpel und Peter Hampe. 130 S., München 1993. (DM 15,–)

Heft 16: **Integration des bulgarischen Verkehrs in das europäische System.** Hrsg. von Werner Gumpel. 90 S., München 1993. (DM 10,–)

## SÜDOSTEUROPA SCHRIFTEN

Band 11: **Mihai Eminescu 1889–1989. Nationale Werte – Internationale Geltung.** Hrsg. von Ioan Constantinescu. 150 S., München 1992. (DM 42,–)

Band 12: Schaller, Helmut Wilhelm: **Gustav Weigand. Sein Beitrag zur Balkanphilologie und zur Bulgaristik.** 149 S., München 1992. (DM 36,–)

Roland Schönfeld - 978-3-95479-681-6
Downloaded from PubFactory at 01/11/2019 09:43:05AM
via free access