

# Populism and Privatization

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Economic policy, particularly when implemented in a country which is changing its entire economic system, is never pure technology. It is a combination of knowledge (science) and political will, a compromise between varying interests and the results of power relations, which can nevertheless succeed only on the wings of strong public support.

Of all of the segments of economic policy, privatization is the most subject to the influence of populism. Decision-makers often decide according to the criteria of the virtual reality of the media. They need to estimate how a given move will be received by the public, whether or not it will threaten acquired rights and impose a distributive inequity, so that the complete picture seems fragmented and indecisive, without even a framework of clearly recognizable strategy.

The definition of populism used in this text is activity which is completely subordinated to plebiscitary public support. Populism is a negation of technocratic activity which moves within the limits of the imperatives of the optimum feasibility of a given action. In practice, populism consists of a combination of powerful rhetoric (concern for the public good), actual non-action (tactical waiting which avoids mistakes and hasty actions) and unrealistic goals (which are not meant to be achieved anyway), as well as a large part of every public decision which is motivated by electoral votes. In a certain sense, every modern politician is by definition a populist, and all decision-makers who manage people show a certain dose of populism, even in the world of business. Here it can even be said that many management techniques include populist impulses. However, such a definition is too wide and populism will herein be considered as only that activity which is inspired by public support that contradicts technical optimum feasibility. Populist activity utilizes the propagandistically understood dimension of the future (its subject is promises, not results), but at the same time requires the absolute domination of the present and short historical memory, so that it can hide the fact of unfulfilled promises. This is a noisy projection of the future in a permanent present.

The relation between populism and popularity (the successfully attained popular support for some goal and activity to attain this goal) is by no means single-faceted and even less proportional. Populist activity may more frequently provoke public dissatisfaction. From the standpoint of a final motive or causality (appraisal of some action not according to its components, good intentions or its course, but exclusively according to the outcome), populism is very unpopular, as it necessarily results in disappointment of that same public with which it tries to curry favor. That is why we say that it is short-lived, that it does not even achieve its own goals, and that in the end it always turns into its own nemesis. Populism is the fastest and shortest way to a final failure.

## The question of consensus

It is often said that privatization is that segment of economic policy which requires public support. In a more intense form, this standpoint declares that a broad national consensus on privatization is necessary. As it is very difficult to attain general agreement on any issue of interest, it leads to the question of the strictness of this demand. Namely, is the "consensus" a metaphor for the critical mass of social mobilization for some problem? In the case of privatization such a weakened form of consensus would be made up of people in the process in sufficiently massive voluntary participation, as well as a favorable stance toward the enrichment of some fellow citizens and toward foreign investments.

Mobilization is not just a matter of a propaganda campaign, for it is necessary to establish values which will be suitable to the majority. This can be seen quite well in the strategy and program of Croatian privatization, which was conceived in 1991 and subsequently amended by technical mechanisms which were meant to be the legislature's response to new circumstances.

In determining the strategy of privatization, from day one Croatia had to satisfy three, not always mutually compatible, goals: the economic, the political and the social. The economic goal was to increase the overall efficiency of the country's economy, and to achieve this we had to enlarge the role of private entrepreneurship, that is, speed up the process of privatization along with the involvement of foreign capital, since domestic financial and technological resources were insufficient for successful restructuring. The political goal was twofold: on the one hand, to create an image of a country open to foreign investment on one of the most favorable business locations in the new Europe, and, on the other, to avoid giving grounds for domestic criticism of bargain sales of enterprises and to compensate the citizens for the consequences of an unnatural regime imposed on them for decades. The latter goal, a manifestation of a historic and political justice of sorts, justice for certain categories of the population in particular, substantially overlaps with the social goal, which was intended to produce mass participation in the privatization process. The underlying principle was that the national wealth had been created through the efforts of generations of Croatian citizens, which ought to be proportionately represented in privatization.

These abstract and principled goals probably do not differ much from the goals set by other countries in transition. However, Croatia was in a very specific situation which had a profound impact on the basic philosophy of privatization:

1. Self-management socialism and the corresponding concept of social ownership.
2. War and the ensuing burden on the state budget.
3. Large numbers of displaced people, war disabled people, war widows and other people who had lost all of

their private property due to war, and who all needed to be approached in a special manner.

#### 4. Large public debt on the basis of frozen foreign exchange deposits (FFED)

The first factor, the tradition of the economic and political system in power prior to democratic changes, gave rise to an important feature of the Croatian model of privatization: the autonomy of transformation. In other words, during the reign of self-management socialism, enterprises were relatively independent from the central government and did not produce according to centralized planning, while the employees were being told that they actually owned the enterprises they worked in.

The result of several decades of such a political system was a widespread belief that no one could take away from the employees what was theirs, that it made no sense to buy out something they owned, and that in any kind of further redistribution of capital they could only lose. Exactly because of this it was only logical to let the enterprises autonomously propose the manner of their privatization, to carry out the evaluation of their assets and total value, and to authorize the state institution in charge of privatization only for the approval or rejection of the submitted transformation programs, thus preventing it from forcing any privatization model (no matter how economically or technologically superior it may be) on any enterprise.

The autonomy of transformation favored the incumbent managements, who became the sole interpreters of transformation and used it according to their own interests. Hence the pronounced tendency, in Croatia, toward the development of managerial capitalism in which the executive community has a disproportionately stronger role than the owners of capital, except in cases where the owner takes over a controlling interest and, consequently, all executive authority. Another legacy of self-management socialism was the advantage granted to employees, former employees and retired employees who had priority in subscribing to the shares of their enterprises, under the same financial terms of payment, however, as the rest of the population, with a discount calculated on the basis of years of employment.

If we can say that self-management socialism caused the autonomy of transformation, then we can also say that social ownership determined the process of transformation of ownership as the first stage of privatization. The argument went as follows: If the main goal of privatization as the cornerstone of an overall transition of our society is to increase economic efficiency, then privatization cannot be carried out without a prior transformation of ownership from social capital, as a form of non-ownership, into private ownership. For this reason we had to eliminate the indeterminate category of social capital at any cost, since it provided no foundation for further development.

The first stage of privatization coincided with a period of enormous public spending on defence and displaced and refugee populations, which precluded mass privatization through a free distribution of vouchers, that is, the would-be shareholders had to buy their shares. In this, the workers' past contributions to the enterprises were compensated for by the granted priority in subscription to shares and by substantial discounts, while the process also took into account the legitimate interests of the owners of nationalized property. Owing to war

circumstances, privatization was also understood at the time as a major source of income for the budget. Nonetheless, the other important argument for the sale rather than free distribution of equity was of a conceptual nature: responsible management can be expected only from someone who has paid for shares and, therefore, has a vested interest in the good performance of the company. The practice of free distribution of vouchers to the population implemented in some countries was emulated in Croatia by substantial discounts on the par value of shares (from 20 to 60 per cent, depending on years of employment), which discount was available to the shareholder immediately after the payment of the first yearly instalment of 5% of the total payable portion of the contract, regardless of possible later cessation of payments, as determined in amendments to the Law passed in early 1994.

The third determinant was the uneven burden of war, which made a linear distribution of shares to the general population an unfair solution. Thus, disabled war veterans and widows of fallen soldiers remain the only categories who have been awarded free shares of par value ranging from DM 5,000 to 20,000, and a similar scheme is being planned for the displaced population and those whose entire property has been destroyed in the war.

The fourth factor determining the privatization model was the large public debt, that is, the foreign exchange deposits of citizens which were drained from Croatia's banking system prior to the war to the amount of DM 4.6 billion. In an attempt to save the banks and restore public confidence in the banking system, the newly-founded state of Croatia converted these deposits into public debt and offered the holders a possibility to collect, at first, the interest on their deposits and, after June 1995, to withdraw the principal amount. The banks were obliged to pay out foreign exchange to certain categories of holders (displaced persons, the seriously ill, the socially disadvantaged, pensioners, etc.) from their own resources, and later charge the amount against the state budget. Since the government did not really have the necessary funds, it came up with a strategy aimed at reducing the public debt according to which the certificates of frozen foreign exchange deposits (FFED certificates) could be used as a means of payment in the purchase of equity and socially-owned flats. Thus, small shareholders have been able to pay their instalments with FFED (their own or bought at the secondary market), while the practice has been somewhat more restrictive toward foreign strategic investors, who can pay in FFED only if the company in question has failed to find a buyer for cash. The weekly trading of shares for FFED started in April 1994 at the Zagreb Stock Exchange (ZSE).

The following question arises immediately: on which of these elements is it possible to achieve a consensus? Or: would it be easier to achieve social mobilization for such a strategy, or within its defined goals, than it would be with another strategy with differently formulated goals? The other question is: who is the authorized interpreter of the consensus?

Political will likes to legitimize goals by showing that a consensus exists on some idea, and that it actually represents the common public interest. In this it is disputable whether the common public interest has ever in history been attained through a consensus.

Croatian privatization began with transformation, an expensive and complex procedure for the abolishment of social ownership as a form of non-ownership and the identification of new owners in the spirit of the market economy. To commence privatization through transformation is not an idea on which a consensus could be obtained, even among a much narrower public consisting of experts. Some experts proposed either a one-time nationalization (a less expensive solution, after which either commercial privatization or some form of distribution would commence) or leaving the companies to their employees (i.e., the ownership consequence of self-management). Thus, the reasons for this solution were not to gain public support or to cater to populist impulses. Rather, they had a more technical-political nature: to take stock of all existing resources in unstable times, in the midst of a war, as well as to slow the possible uncontrolled transfer of ownership into unwanted hands. The justifiability of this expense is still being debated today. My personal opinion is that it would be difficult to find another reason which could compel such a mass of companies to make their history, inventory of property, operations and development plans open to the inspection of a public institution. Despite the imprecisions and strictly formal satisfaction of some inquiries, the entire action resulted in an archive of historical significance, which would not exist in a less expensive single act of registration.

However, other elements of the transformation procedure were certainly designed to obtain public support, or they promised the maintenance of acquired rights in a new form. This primarily refers to the tactful relationship with the most powerful participants in the process: former and current managements, former workers/"self-managing employees" who became small shareholders, as well as those underprivileged groups who have borne the burden of the war more than others.

The use of frozen foreign currency deposits as a payment instrument is identical to the use of bonds on the basis of external and internal debt in other countries and was at the time more an issue for which public support was still to be attained than one which would have supplied the same for the privatization program. However, the previous creation of the category of "frozen foreign currency deposits" could be exposed as a public decision with strong populist overtones should the government abandon its obligation to pay after the expiration of the period which it established itself only several years before.

Not a single one of the strategic courses of Croatian privatization is a result of consensus, and the question is whether any type of coherent concept could have been attained by consensus. It can be said that a consensus existed only on the question of basic values, i.e., on the need for privatization to be carried out. In contrast to some other countries in which there are still proponents of a state form of ownership, in Croatia there were no serious political forces or individuals who supported the preservation of non-private ownership.

This section showed that the question of consensus is a pseudo-question of mere rhetorical power, as a subject of a propaganda campaign which tells people that it will impose upon them that which they have actually always wanted. Consensus can be obtained for basic values, but not for individual implementation techniques or segments of some complex program. Instead of unproductive poll-

type investigations asking "what would the largest number of people like to see", public support should be sought in another way: through a rationally and technically mature installation of a model which will be realized in a confirmed period and will guarantee a good portion of support through its success. The rest is just the stuff of propaganda anyway.

### **The popularity of good implementation**

In addition to the ownership transformation which is still in progress, Croatia also had to face the much more urgent task of monetary stabilization. In view of the long-lasting hyper-inflation, the initial situation looked much more unfavorable than did the prospects for the speedy and elegant implementation of privatization.

The stabilization of the monetary system is not directly involved in the distribution of the national wealth in the same way that privatization is, so it looks much more like a purely technical issue. This means that its designers were in a somewhat better position than those involved in privatization, as they were less subject to populist pressure. However, populism in the monetary sphere is not at all unimaginable. On the contrary! It was in precisely this segment that communist economies behaved in a particularly populist manner, and many Third World countries are not far behind in this.

When Croatia began its monetary stabilization, many foresaw a short future for this program. It was known that a restrictive supply of money would provoke non-liquidity, and that this could become reflected in the purchasing power. From the start, the program was not very popular. However, the government could have chosen another way - it could have promised the monetization of losses, raised salaries to the level attained during Marković's term of office, and utilize an entire series of populist techniques which by now would certainly have crashed a hundred times. Instead, the government chose the method of a technical optimum and in the end gained great popularity based on the results of this program. Polls show a significant partiality to these results, although few people could say what has changed for the better in their individual lives or whether their purchasing power has risen at all. But instead of this they saw that one promise was fulfilled, that uncertainty was defeated, and control was established over events which are no longer as inevitable as natural disasters. At the same time, they were given the gift of belief in the value of domestic currency for the first time.

Had the program catered to the "people in the street" and promised them a dramatic increase in purchasing power, had it catered to companies and guaranteed them compensation of losses, it probably would have been popular for a few months, but it would not have succeeded or maintained popularity for a few weeks longer. Populism is the best guarantee of unpopularity in the long run.

### **Why this is an important issue?**

The introductory thesis holds that of all the segments of the economic policy of a country, privatization is perhaps the most subject to the influence of populism.

The issues such as distributional justice, the sensitive issue of foreign investment and the "sale of the family silver", the problem of objective value and fair prices, advocacy of the market while fearing its consequences, particularly in terms of redundancies and social stratification in which privatization stands out as an extremely anti-egalitarian process (thus a possible reason for the loss of votes in elections, and this after both successful and unsuccessful privatization efforts), have so much influence on decision-makers that they often consciously make technically incorrect moves, simply to ward off public criticism or to gradually prepare the public for the acceptance of rational decisions. Here the function of time is very important: namely, from the technical standpoint it is desirable to go at maximum speed, by which a new state of affairs is established, i.e., the basis for a new order which has good prospects for further development; however, from the standpoint of public reception, time is a function of a collective cognitive process, which requires duration.

This can be compared to the bankruptcy procedure. The practice of developed market economies is to carry out bankruptcy in as short time as possible. Figuratively speaking, on Friday, so that by Monday the factory would continue working, relieved of all debts, with a new owner, etc. To be sure, this happens only if there is any sense at all in continuing with commercial activity, for if such is not the case, then the remaining property is sold to satisfy creditors. However, it is by no means advisable to maintain the *status quo ante* in the form of long-term agony, or support the gradual and unavoidable erosion of the remaining assets.

However, the majority of countries in transition are opting for exactly this alternative, as bankruptcy and liquidation are still concepts with an extremely negative connotation. The public accepts them with reluctance, and workers tend to react to them with particular agitation. Decision-makers know that prolonged agony along with occasional repair work under the conditions of an already introduced budgetary stringency (pliant budgeting can prolong the life of an unsuccessful company, but at the expense of the survival of the entire economy) is the worst possible solution, but they do not dare provoke the odium of the public and assume responsibility for a very unpopular measure. Thus they allow the situation to worsen to such a degree that those who were previously ready to rebel against rational therapy then accept any sort of solution. However, the basic flaw in this is that by that time there is nothing left to salvage.

The above example of bankruptcy describes a typically populist conduct with extremely harmful consequences and a catastrophic outcome. However, from the standpoint of a decision-maker this is still rational, for maybe - in assuming the role of executioner - he would threaten his own political existence. Such examples can be listed by the dozen. At one point, the general public and the political elite in Croatia went livid with rage over a bid for a majority interest in a local textile giant to be paid with frozen foreign currency deposits, which at the time, as a public-debt bond and payment instrument, was valued at more than half the par value of the company's shares. This meant that any decision-maker who accepted such an offer would have signed his own death sentence. However, less than two years later the value of this company's shares dropped to only seven per cent of their

par value, so that the one-time bid seems incomprehensibly generous from today's perspective. This shows very explicitly the dual function of time: its destructive as well as its cognitive/educational (perhaps even pedagogic) effect.

What makes possible such an absurd, Catch 22-like situation? The basic difficulty arises from undefined ownership issues and the concept of the public domain. Namely, the position of the decision-maker is very weak. He does not represent himself or the employer with a clear-cut interest, rather he represents the metaphysical "public domain", whose interpreter is the divergent political elite subject to the momentary pressures of the public mood. On the other hand, his position is very comfortable, as his existence does not depend on results, but rather on the tactics of avoiding the critical mass of political peril. He primarily runs a slalom between the crags, each of which represents a painful and, in the short run, very unpopular but therapeutically rational decision.

How can such a situation be overcome? Solely with the strong political support of the highest authority, which will oblige the executive to pass technically rational decision. The negative effects of short-term unpopularity should be warded off through a public-awareness campaign and the constant interpretation of the significance of the goal. If the public perceives that the goal makes sense and that it is being realized at the same time, support will take the place of wrath, and painful cuts will be interpreted as necessary and temporary sacrifices.

However, an added hardship lies in the fact that the highest political authority feels that it depends in large part on the public mood. It does not want to place its own position in jeopardy, particularly if it has not yet grasped the full significance of the goal itself. Only the fundamental understanding of the significance of the goal by the highest authority may contribute to the discarding of populist in favor of technical arguments.

Officials who are involved in privatization rarely express their feelings on such dilemmas, although they are present in all countries in transition. In the annual report on privatization for 1994, Manfred Balz, today one of the partners in the Berlin branch of the well-known law firm of Wilmer, Cutler & Pickering, spoke very clearly on this. He mentions the problem of the relationship between populism and the technical optimum in a chapter entitled "Political Control of the Privatization Process": "The day-to-day operations, and especially the large organizational measures and transactions of the THA, have been supervised by a special department of the Federal Ministry of Finance with a few dozen officials, as opposed to more than 4,000 THA employees and hundreds of consultants. The Parliament had previously set up a subcommittee of the Budget Committee which later became a separate THA committee where the finance minister and the THA board reported at regular intervals. The Federal Comptroller's Office (Bundesrechnungshof) commented on specific aspects of THA practice, such as a bonus system for managers which tied their income to the speed and success indicators of privatization and, as already mentioned, the efficiency of the management holding companies. Obviously, the administrative and parliamentary supervision of THA activities was very loose. **The privatization process could not possibly have been conducted at its actual speed had it been exposed to**

**the political and administrative controls which are standard in parliamentary democracies.** The very construct of the THA with its monopoly on privatization, with its cumulated ownership and decision-making function, with its staff drawn from private enterprise and - last but not least - **with headquarters in Berlin, far from the Bonn political decision makers, was designed to exempt a largely technocratic process from the classical methods of legitimizing important public decisions.**<sup>1</sup>

I hold this statement by Manfred Balz as very significant and I believe that it not only expounds the problem dealt with in the present paper very well, but it also provides an answer to many questions, although it does not define the "process of passing public decisions" as a technique of populism. The text contains several key views which can serve as direct instructions to policy makers in countries in transition:

1. Speed is an important factor for the successful implementation of the privatization process.
2. The process of passing public decisions is slow and inefficient.
3. Transition is not the normal and standard situation in a democratic society and it requires management with extra-constitutional authorization, which therefore should not last too long, for this should lead to deformations of the democratic system. Privatization as a key element of transition needs some time of speedy enlightened absolutism, after which a sort of zero hour of normality comes into effect.

In the above quoted text from the German privatization report there was no mention at all of populist-motivated conduct, but the attempt to initiate it appeared in parliamentary demands formulated at the end of 1993, and which Balz also listed in several points at the end of

the same section.<sup>2</sup> From this it is apparent that the German political elite was no less sensitive to the domination of operational/technical logic in the passage of key decisions on privatization than politicians in the post-Communist countries. The powerful effort to put privatization under direct political supervision, to "investigate criminal activities in privatization and the Treuhand's response to such activities", whose rhetoric and type of demands reminds one of a similar attempt by the Croatian parliament in 1994, consists of the desire to replace the technical imperative with the imperative of the "public good", which has much more populist motives. These motives loyally maintain the beliefs, prejudices and fears of the extensive electoral body, i.e., the so-called small people in whose name the political elite raises the issue.

Germany had the good fortune to succeed in carrying out the lion's share of privatization in the operational/technical manner before the inert mechanism of political will found its bearings. Also, the high professional quality of the people active in implementing the process was a guarantee of a successful result. Other countries have as slim a chance of repeating this privatization blitzkrieg as of earmarking DM 300 billion in their budgets for privatization.

It is precisely for this reason that it is even more important that the political elites and highest political authorities of countries in transition give conscious support to the technically-led process and not to kindle populist fears. This certainly does not mean that the executive level should be freed of all responsibility. Their responsibilities should be made as rigorous as possible, but connected exclusively to success in attaining clearly defined and scheduled goals. Only in this case will it be possible to carry out privatization with a minimum of social expense.

<sup>1</sup> Privatization in Central and Eastern Europe 1994, CEEP Annual Conference series, No. 5, Ljubljana, Slovenia, 1995, pp. 177-178.

<sup>2</sup> Ibid, p. 178.



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