

Opportunistic Behavioural Patterns in Privatisation Process of Central European Transition Countries

*Schapour Zafarpour**

Wirtschaftsuniversität, Vienna

Abstract: This paper points out a few specific features privatisation process, which seem to have escaped the attention of policy-makers in Central European Transition Countries, and which must be taken into account by all those considering the choice of their privatisation methods. Though most of these newcomers are often criticised for delaying it. They can now benefit from this delay as they have the opportunity to learn not only from the successes, but also from the failures made by these countries.

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A Typology of Privatisation Methods

Today, it is acknowledged, that not in a single country in transition the conditions for launching a large-scale privatisation were propitious in the early 1990s, for the sum-total of the savings of their population reached only a fraction of the value of their state-owned assets at that time, and foreign investors,—who might have acquired state-owned enterprises—were still reluctant ‘to come in’. The will of the governments of some of these countries to launch their privatisation process—in spite of this situation—as rapidly as possible, was underlying the emergence of several

* Schapour Zafarpour is the Director of Studies Abroad Centre, Wirtschaftsuniversität, Vienna, Austria.

unprecedented privatisation methods, which had many identical, but also a few important specific features. In order to remind the reader of the latter, for the sake of simplification, we can differentiate various privatisation methods merely with regard to the manner, in which property-rights to state-owned enterprises were changed (though each of them has also a wide range of other specifics):

Already in the late 1980s the so-called 'spontaneous privatisation' was launched in Hungary. This was, in fact, a type of management take-over, undertaken case-by-case with the consent of the authorities and the employees of the respective enterprise, which was effected by the payment of a 'symbolic' purchase price.

Since the beginning of the 1990s in the 'new lands' of the Federal Republic of Germany the privatisation of state-owned enterprises was launched under the auspices of the 'Treuhandaanstalt', which was expected to sell soonest possible all these enterprises, preferably to west-German or foreign entrepreneurs. Though the principle was accepted, that these sales would be undertaken 'for a fair market price', many of them were sold for a symbolic price and some even for a negative price.

In the early 1990s the Hungarian government changed its privatisation method. It established a 'State Property Agency', which was in charge of negotiating the take-over of individual state-owned enterprises (bilateral), mainly by foreign investors, selling them at the highest achievable equitable price. If such a price could not be achieved, the Agency desisted from selling the respective enterprise. Such an attitude not only explains the delay in some privatisations, but also the relatively high yields of this process. In the second half of the 1990s a new scheme was launched, whose main aim was to speed up the privatisation of medium-sized state-owned enterprises, by selling them for a 'fair market price' to any suitable investor, irrespective whether foreign or domestic. The State Property Agency was, again, involved in the enactment of this scheme.

In the former Czechoslovakia the sale of state-owned enterprises to foreign investors, or to domestic bidders was envisaged, the new owner had to be chosen in the framework of a public tender. Some of the smaller state-owned enterprises were privatised by their restitution to their former private owners. But the bulk of the privatisation was undertaken in the framework of the so-called 'voucher privatisation', which represented a specific form of distributing state-assets to the population (to all citizens who were 'of age' at that time) 'for free' (gratuitously).

The method of 'voucher privatisation' behaviour was subsequently applied in a more-or-less modified manner in other transition countries, for it seemed to be the only possible way as to how to conclude the privatisation process at maximum speed in the face of a lax demand of foreign investors for the state-assets and the inability of the population to acquire them for a fair market price.

In the Russian Federation the voucher privatisation was chosen as the main privatisation method (besides the possible direct sales of state-owned enterprises to

domestic or foreign investors for an agreed price). But, in this case, the vouchers were distributed mostly to the employees of the respective enterprise, sometimes also to officials of the local governments.

In Poland at the very beginning of the 1990s five well-performing state-owned enterprises were sold directly to local and foreign bidders at 'a fair market price' (which was subsequently criticised by the public as having been too low.) In the next 4 years the privatisation of state-owned enterprises proceeded mainly by closing down the non-viables ('privatisation by liquidation' was massive), while the spectacular increase of the share of the private sector in the formation of the GDP of Poland, was due mainly to the establishment of hundreds of thousand of new small and medium-sized private enterprises .

Only in the mid-1990s in Poland a 'mass-privatisation' scheme of joint-stock companies was adopted, which had already led to the transformation of numerous state-owned enterprises earmarked for this type of privatisation. The shares of these companies were to be eventually (at or shortly after the turn of the century) handed over to Polish citizens 'for free' in the framework of the voucher privatisation, i.e. Polish citizens having the opportunity at that time to 'invest' their vouchers into a state-owned enterprise of their choice .

After the efforts of the Bulgarian authorities to sell off most of their state-owned enterprises to foreign investors failed in 1998, the application of voucher privatisation scheme is under consideration at present. Also in Romania and in the Baltic States the enforcement of the 'voucher privatisation scheme' is under consideration (or is already in operation).

In the Slovak Republic, the voucher privatisation was discontinued by the government in 1993. After the privatisation process was resumed in the second half of the 1990s, it was conducted at first mainly by the sale of individual state-owned enterprises (some of them of huge size) to their managers or to a chosen person, for 'a symbolic price'. Only under the new government (since 1998) increased efforts were made to sell individual enterprises to foreign investors for a 'fair market price'.

The Privatisation Method and its Effect on the Performance of the Economy

The outcome of the privatisation process, which has been conducted by one or the other of the above mentioned methods, had already been analysed in detail by many economists, each of them explaining the successes or failures which occurred in the course of the implementation of these schemes. With some of these explanations one can agree, while with others not. One doubts the tenability of each of these methods, by referring to macroeconomic and industrial output data; thereby assessing the

performance of transition country under our observation (for industries have been the primary target of privatisation).

Table 1a.: Changes of industrial output in Central European transition countries (Index, 1989 = 100)

	Czech Republic	Hungary	Poland	Slovakia
1989	100,0	100,0	100,0	100,0
1990	96,6	90,7	75,8	94,0
1991	75,7	74,1	69,7	73,1
1992	69,8	66,9	71,7	66,1
1993	66,1	69,6	76,3	62,5
1994	67,4	76,3	85,5	66,8
1995	73,3	79,8	93,8	72,3
1996	74,8	82,5	101,6	74,1
1997	78,1	91,7	113,3	75,3
1998	79,4	103,2	118,6	48,8

Table 1b.: Changes of industrial output in the Baltic transition countries (Index, 1989 = 100)

	Baltic states	Estonia	Latvia	Lithuania
1989	100,0	100,0	100,0	100,0
1990	99,0	100,0	100,8	97,4
1991	95,7	92,8	100,2	94,0
1992	64,5	59,8	65,6	65,8
1993	44,8	48,6	44,6	43,2
1994	37,6	47,1	40,1	31,7
1995	38,1	48,0	38,7	33,4
1996	39,9	49,4	40,8	35,0
1997	43,6	56,0	46,4	36,2
1998	45,2	56,5	47,3	38,7

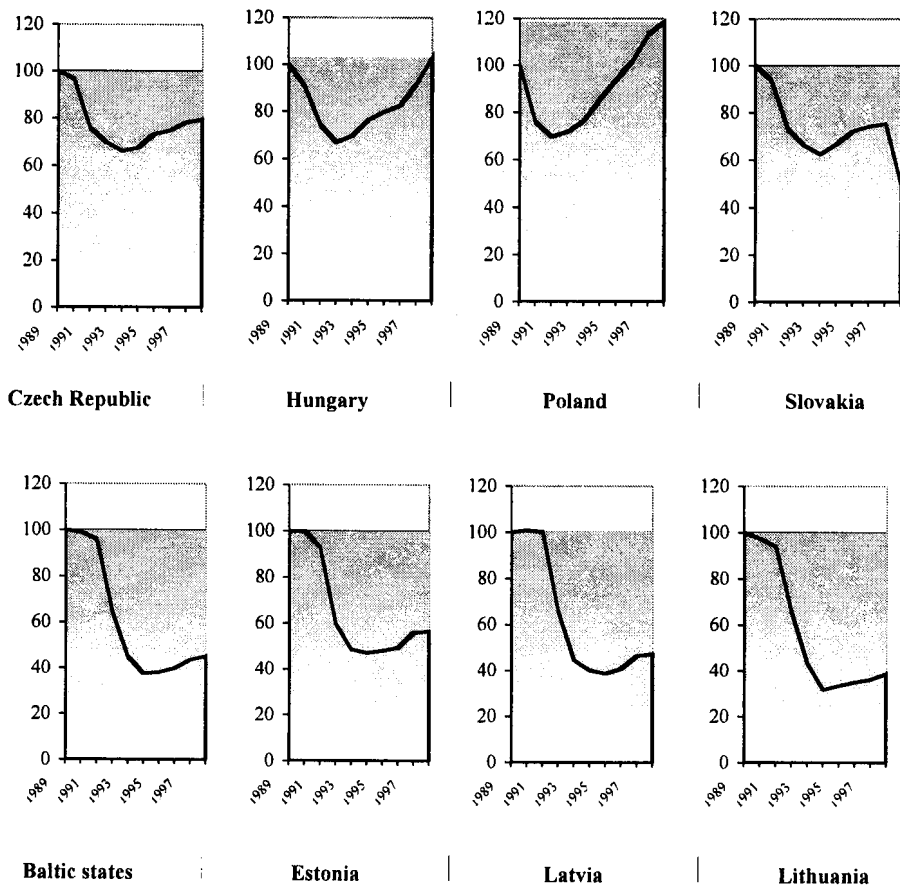
Table 1c.: Development of industrial output in selected Balkan transition countries already 'associated' to the EU (Index, 1989 = 100)

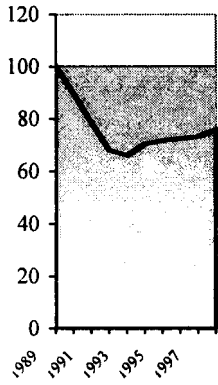
	Slovenia	Bulgaria	Romania
1989	100,0	100,0	100,0
1990	89,5	83,2	81,9
1991	78,4	66,4	63,3
1992	68,1	54,2	49,4
1993	66,1	48,8	50,1
1994	70,4	54,0	51,7
1995	71,8	56,4	56,6
1996	72,5	58,6	60,1
1997	73,2	52,6	55,8
1998	75,9	47,7	46,3

Table 1d.: Past changes in industrial output of Balkan countries which had been most exposed to the consequences of the Kosovo crises (Index, 1989 = 100)

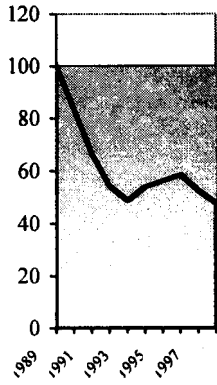
	Albania	Bosnia and Herzegovina	Croatia	Macedonia	Yugoslavia
1989	100,0	100,0	100,0	100,0	100,0
1990	86,7	101,0	88,7	89,4	88,0
1991	50,4	76,9	63,4	74,0	72,5
1992	35,2	25,5	54,2	62,3	57,0
1993	31,7	2,0	51,0	53,7	35,7
1994	25,8	1,7	49,6	48,0	36,2
1995	23,9	2,8	49,7	42,9	37,6
1996	27,2	5,2	51,3	44,3	40,4
1997	25,7	7,0	54,8	45,0	44,2
1998	28,2	8,7	56,8	47,0	45,8

Figure 1.: Changes in industrial output

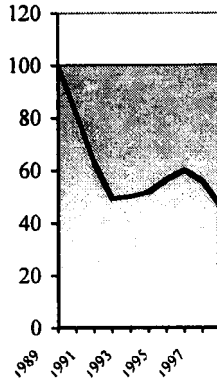




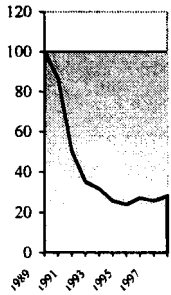
Slovenia



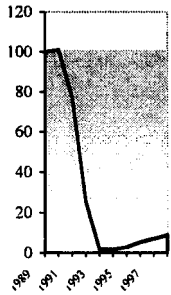
Bulgaria



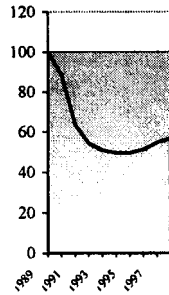
Romania



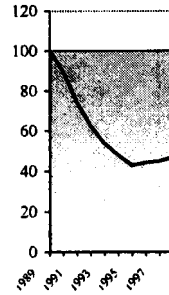
Albania



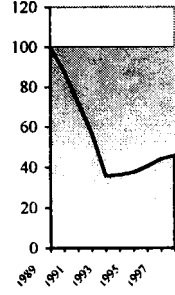
Bosnia and Herzegovina



Croatia



Macedonia



Yugoslavia

Source: Data from tables 1a-1d

Figure 2a.: Growth scenario in respective transition countries

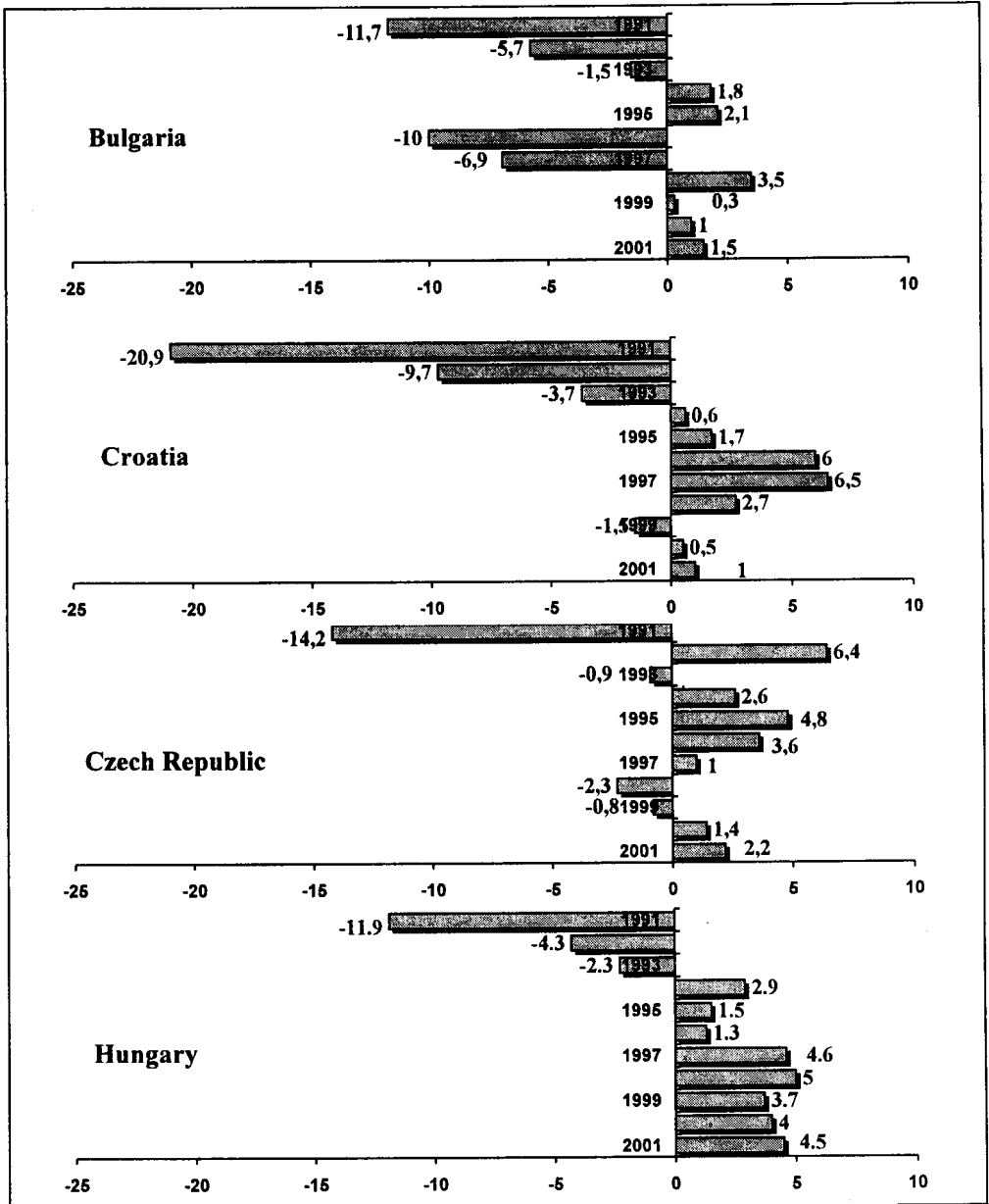


Figure 2b.: Growth scenario in respective transition countries

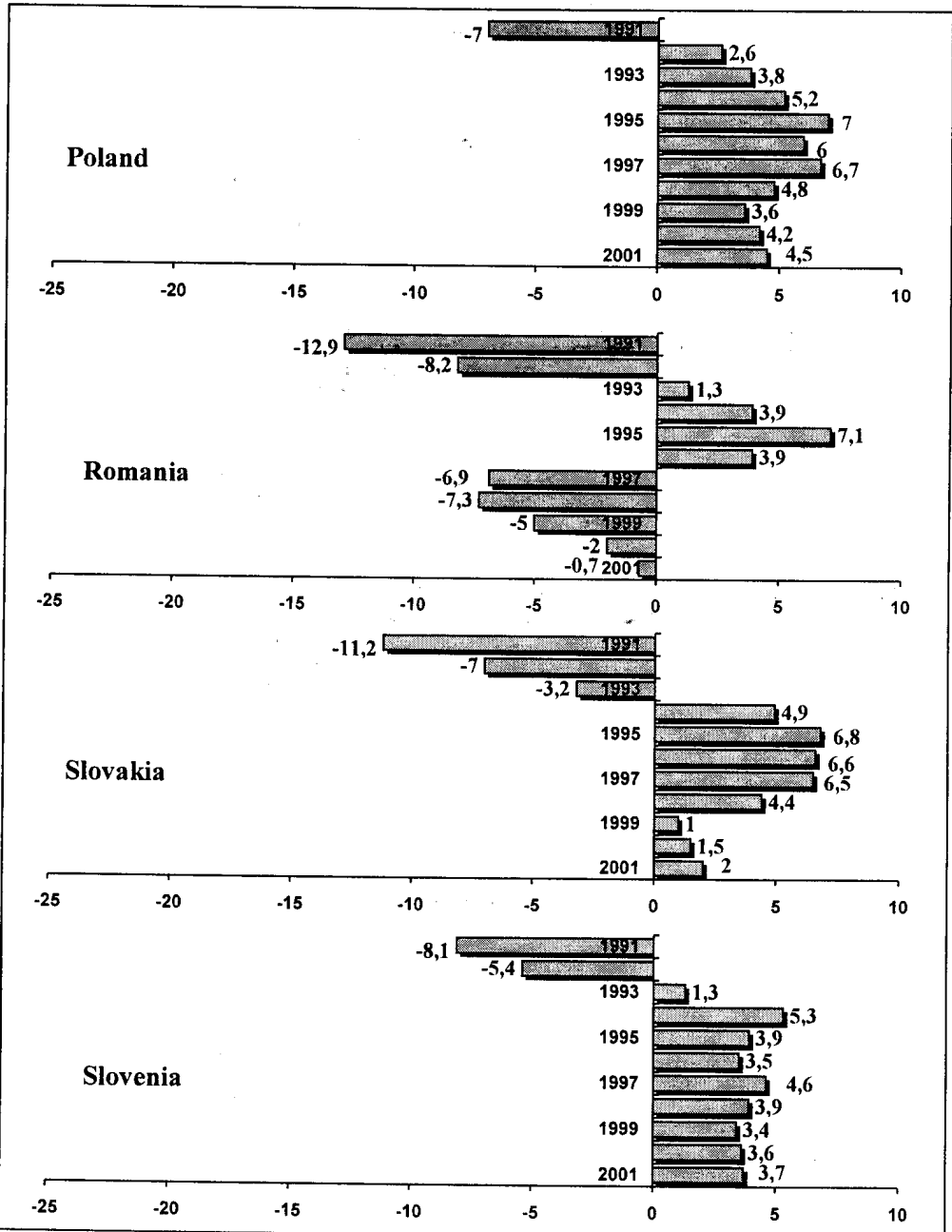
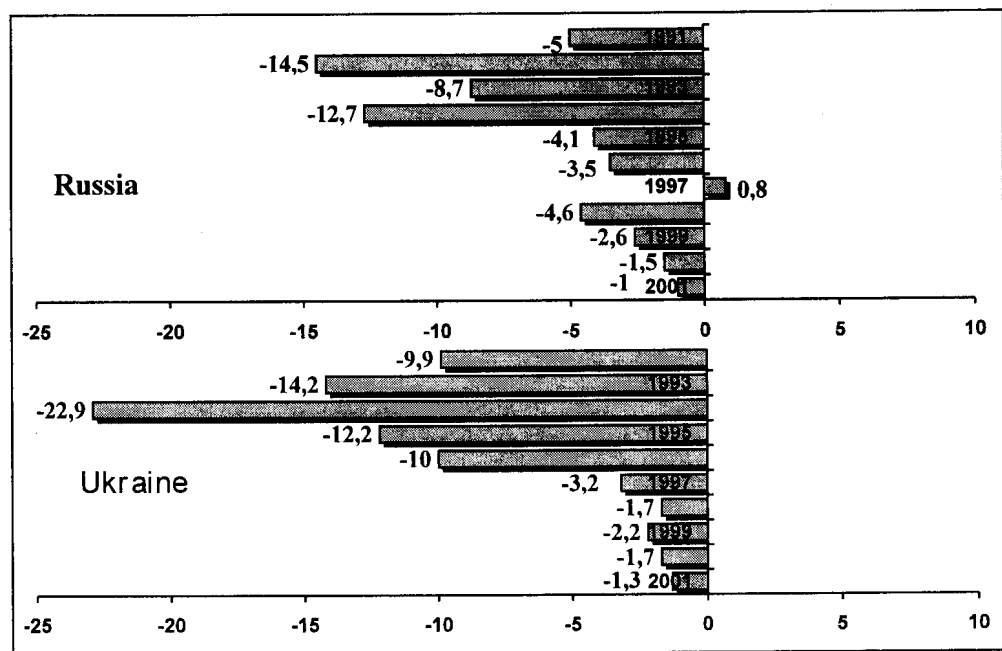


Figure 2c.: Growth scenario in respective transition countries



Source: UN/ECE data base

From the above data it can be inferred, that so far only in Hungary and in Poland the volume of industrial output, which was reached here at the time these countries embarked on their transition to market economies, was surmounted. It had been ascertained by many that in Hungary the success had greatly been due to the fact, that the majority of privatisations of state-owned enterprises effected, had been undertaken by the sale of these enterprises to foreign investors. Thanks to this privatisation method, the penetration of the foreign capital in Hungarian economy is the highest in the world. It is obviously this strong inflow of foreign direct investment, that underly not only in the robust growth of the economy of Hungary, but also the spectacularly rapid restructuring of its industry. As a convincing proof of the rapid progress in this restructuring is the fact, that machinery products have at present already a 55 per cent share in Hungarian exports to the EU, whereas in the past the majority of its exports targeted at this region were made of consumer goods, chemicals and base materials.

In Poland, as one of the most important recognised cause of the success had been the robust growth of the so-called 'grass-root economy', i.e. the emergence of hundreds of thousands of viable small and medium-sized private enterprises, some of

which had been newly established, while others were given the opportunity to operate formally still state-owned enterprises in the framework of leasing contracts. To this success had certainly contributed also the fact, that Poland's manufacturing industry had been 'cleansed' of numerous non-viable state owned enterprises, which had been 'privatised by liquidation', while potentially viable ones has been given life to restructure.

It is important to note, that in the course of a long-lasting economic boom (which had persisted in Poland since 1992) Polish enterprises were able to finance their investments to a large extent from their own resources, making their restructuring less dependent on the availability of bank loans. They were thus able to avoid dependency, which had proved to be an impediment to a rapid restructuring in other transition countries.

Polish economists¹ are attributing this boom among others to the trade regime, which had been accorded to Poland by GATT at the beginning of the 1990s, which enabled this country to increase its import custom duties to an average of about 16 per cent and to apply an import surcharge for the duration of 6 years, giving thus to its industrial enterprises a certain degree of protection from foreign competitive pressures at a time when these enterprises were embarking on their restructuring.

The recent deterioration of the economic performance of the Czech Republic (where—after a robust growth in 1994 - 1996—increment of the GDP reached in 1997 merely 1 per cent, while in 1998 its GDP showed an absolute contraction by 2,3 per cent), had certainly a wide range of causes. But the choice of privatisation methods undertaken in Czech Republic and the stringent conditions with which domestic owners of newly privatised enterprises were faced, certainly belonged to them.

Possible Causes of Misadventures

The fact, that the above mentioned privatisation method—which had been conducted in the Czech Republic with an unusually wide scope and at a very high pace—did result neither in the anticipated improvement of corporate governance, nor in a rapid restructuring of the privatised enterprises, has been as yet attributed mainly to the strong involvement of privatisation investments funds—most of which were partly or fully owned by still state-owned banks—in the voucher privatisation. It is argued, that this indirect connection of newly privatised enterprises with the banks had enabled them to achieve 'soft loans', which made it possible to their management not only to continue in applying inefficient management practices, but also to desist from restructuring these enterprises.

But this delay in restructuring had also been observed in enterprises, which had been privatised by 'direct sale' to domestic entrepreneurs, or in those, which had been privatised by restitution. This indicates, that there were other reasons for this delay also. These companies started their existence as private enterprises burdened with old debts and in cases where the privatisation was effected by the sale of the respective enterprises to a domestic bidder, this enterprise was usually burdened with new debts, as domestic entrepreneurs had usually to borrow the obligatory initial down payment. The majority of the new owners had also to take over (and to pay for) existing inventories, most of which were useless and unsaleable.

This enormous initial debt burden made it impossible for most of these enterprises to achieve new loans, which in turn prevented them not only from restructuring, but mostly even from modernising their equipment. Even those enterprises, which, thanks to their above mentioned connections with banks, might have been able to make such loans available to them, were usually unable to use them, because in the early 1990s most banks were willing to grant only short-term credits (of a maximum duration of three years) and with those it was impossible to finance new investments. Besides, in the early 1990s there was an acute lack of liquidity, which reduced the volume of available bank-loans far beyond the needs of the enterprise sphere of the respective country. In later years, when this credit-crunch subsided, most privatised enterprises owned by domestic entrepreneurs still could not apply for bank-loans, for these were available at interest rates, much higher than expected yields of the contemplated investments. Thus most of the newly privatised enterprises big, medium-sized and small had to forego not only investments, but also numerous other measures, which might have strengthened their competitiveness not only on their domestic market, but also abroad.

Before long the new owners of these enterprises became aware, that under these conditions they are doomed, most of them began recuperating the money they had invested in the respective venture (or the reward, which they had assumed should have accrued from their efforts at making their enterprise viable, at operating it). This seems to be a rational procedure under these circumstances. Unfortunately, this behavioural pattern, which became endemic in the second half of the 1990s, speeded up the demise of numerous enterprises. And this became one of the important internal causes of the recession, which has engulfed the Czech economy in recent years.

'Opportunistic' Actions in Privatisation

As yet this 'tunnelling' of newly privatised enterprises had been attributed mainly to the opportunistic behaviour of their management and/or to an inefficient or lax supervision of the activities of their managers. But recently concluded investigations

had revealed, that it were often not (or not only) the managers, but the owners, who had initiated or conducted the withdrawal of funds from such enterprises. And this was done in most of the observed cases in a manner, which was legally incontestable. In some cases the decision of the owners to start asset-stripping or to 'tunnel' their enterprise by transfer-pricing or in another manner, might have been taken merely in order to achieve financial results of their entrepreneurial activities in the shortest possible time-span. But the fact, that the incidence of this behavioural pattern had achieved huge proportions in the Czech Republic in the second half of the 1990s, (after the major part of the privatisation process had been concluded, and the domestic owners of newly privatised companies had had the time to evaluate the perspectives of their entrepreneurial ventures), can be regarded as a convincing proof, that it had been merely due to the reaction to the unsustainable pressures and extremely unfavourable conditions, in which domestic entrepreneurs would have had to operate these enterprises. Mostly it was motivated by the effort of the owners of these enterprises, to 'stay afloat' as long as they were able to cover at least their initial expenditures, possibly also to an achieve a risk-premium for having embarked on such a venture.

The same behavioural pattern had been observed to spread recently also in some of the S. East European and East European transition countries, subsequently to the privatisation process having been launched here. Even in these countries it was adopted not only by entrepreneurs, who had become owners of formerly state-owned enterprises in the framework of a simile of the voucher privatisation, but also by many of those, who had acquired 'their' enterprises by 'direct sale', or in the framework of management take-overs. The fact, that a high and increasing share of new owners in all these countries is showing a pronounced preference to 'tunnel' their enterprises, rather than to operate them. This can hardly be regarded merely as a sign, that the first generation of entrepreneurs in these countries is incapable or unwilling to take a 'long-term view' on their activities. Neither can this behavioural pattern be regarded as inherent to the early stages of the privatisation process—for its incidence was only marginal, both in Hungary and in Poland. It has to be acknowledged, that it is due mainly to the fact, that conditions in which domestic entrepreneurs are expected to operate enterprises which they had acquired in the framework of the privatisation process, preclude their becoming prosperous—however excellent corporate governance applied in these enterprises might be.

Conclusion

In order to avoid further unfavourable developments there seem to be only two alternative lines of actions, which the authorities of countries launching their privatisation process at present might adopt.

Either they will have to adopt privatisation methods, which had proved to be more successful and less liable to generate 'opportunistic behavioural patterns', implying that they might focus more on privatising with the aid of foreign investors, as was the case in Hungary, or prior to their privatisation they might be willing to give their state-owned enterprises some time to restructure, as was the case in Poland. The conviction spreading at present even among experts of international organisations, 'not the speed of the privatisation, but its effects in terms of restructuring and introducing a viable corporate governance in newly privatised firms are the sign of its success'² signalises, that even this second alternative might find the approval of these organisations.

Should the privatisation need to be effected without delay and primarily by handing the enterprises over to domestic economic subjects (be it for whatever reason), the authorities will have to make sure, that the newly privatised enterprises will not be exposed to unsustainable pressures and that they will be operating in conditions, which will permit them to restructure and modernise. The 'best practices' applied in mature market economies in support of small and medium-sized enterprises, or in support of launching developments in their enterprise sphere which are of macroeconomic importance, might give a lead in this respect.

NOTES:

¹ It is well known, that in order to make the 'new owners' hold on to loss-making enterprises, they were often granted by the 'Treuhand' huge subsidies, some of which surmounted by far the purchasing price, which they had paid for the respective enterprise.

² It should be noted, that only domestic entrepreneurs were faced with these stringent conditions, while foreign investors who had acquired an enterprise through privatisation proves, conducted in the Czech Republic had neither to take over old inventories and old debts, nor did they have difficulties in availing relatively 'cheap' bank loans available to them, as they had access to western capital markets and most of them were 'serviced' by foreign banks, whose interest rates were far lower than those, which domestic entrepreneurs had to pay in local banks.

³ This opinion was voiced by representatives of international organisations at the spring seminar of the Economic Commission for Europe of the UN in Geneva in 1998.