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Barbara Lee and John Nellis

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Abstract

This paper looks at the past performance of SOEs in socialist countries, examines why so many of them are opting for fundamental reform of enterprises including privatization, and assesses reform experience to date and future prospects. The analysis is limited to seven socialist countries that are active members of the World Bank group: Algeria, China, Hungary, Laos, Mozambique, Poland and Yugoslavia.

These seven countries have long tried to improve SOE performance by restructuring--attempts short of ownership change--with meager results. Recent reforms in most of these countries broaden the choice of instruments by including privatization and liquidation. The path for, and intensity of, reform varies among the countries reviewed. The common denominator is that these seven governments have recognized the need to go beyond past, partial steps in their attempts to reform SOEs and improve their performance.

Acknowledgments

The authors wish to thank the many World Bank colleagues who provided information on enterprise reform and privatization efforts in the seven countries reviewed in this paper. As always, remaining errors should be attributed to the authors.

Table of Contents

ENTERPRISE REFORM AND PRIVATIZATION IN SOCIALIST ECONOMIES

I. Introduction

This paper reviews attempts of a group of socialist countries to reform their state-owned enterprise[1] (SOE) sectors. We look briefly at the past performance of SOEs in socialist countries; examine why so many of them are opting for fundamental reform of enterprises including privatization;[2] and assess reform experience to date and future prospects. The analysis is limited to seven socialist countries that are active members of the World Bank group.

II. The Problem

In all socialist economies[3] the state-owned enterprise sector is a major economic actor; in most, it is a dominant one. Reliable aggregate data are exceedingly difficult to obtain; but in all socialist economies the SOE sector accounts for a much greater percentage of economic activity than in industrialized Western countries. To illustrate: In the mid-1980s SOEs accounted for an average of 10 percent of GDP in OECD countries; rough estimates placed the figure at between 15 and 20 percent for the average less developed

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[1]. A state-owned enterprise is (a) a government owned productive organization that (b) is expected to earn a significant portion of its revenues from the sale of the goods or services it produces, (c) possesses an accounting system separate from any government agency that controls or supervises it, and (d) is a distinct legal entity. See Mary Shirley, Managing State-Owned Enterprises (Washington: World Bank Staff Working Paper No. 577, 1983), p. 2.

[2]. The term has many meanings. Privatization is the general process of involving the private sector in the ownership or operation of a state-owned enterprise. Thus, the term refers to the private purchase of all or part of a public company; and it also covers "contracting out" and the privatization of management -- through management contracts, leases, or franchise arrangements.

[3]. "Socialist economies" refers to:

* countries designating, or formerly designating themselves as "scientific" socialists; i.e., the Soviet Union and the countries belonging to the Council of Mutual Economic Assistance (CMEA);
* the non-European members of the CMEA; i.e., Cuba, Mongolia and Vietnam;
* countries referred to by the "scientific" socialists as "other socialist countries;" i.e., Albania, Cambodia, China, Laos and Yugoslavia; and -- least precisely --
* "aspirant socialist," or "socialist oriented countries;" i.e., Algeria, several countries in sub-Saharan Africa such as Angola, Mozambique, Tanzania and Congo.

country. No comparable figure is available for any sub-set, much less the entirety of socialist economies; but the few available statistics at least suggest the differences: Poland, as of 1989, had more than 8,000 SOEs accounting for more than 70 percent of total economic activity. Hungary is said to possess 2,000 SOEs. Their contribution to GDP is unknown, but their counterparts in the private sector on average accounted for less than 4.5 percent of GDP in the 1980s. China is reported to have well over a million public enterprises of all sorts: from large industrial units owned and operated by the central government, to comparatively smaller entities owned by the provincial and local governments. Roughly similar (relative) numbers could be found for SOE sectors from Algeria to Vietnam. The financial, economic and social importance of SOEs in socialist countries is incontestable.

Given the large number and differing circumstances of socialist countries, it is not surprising that their enterprise sectors vary, in terms of organizational and institutional arrangements, sectoral concentration and performance patterns. It will thus be seen that every generalization is advanced only at the expense of necessary nuance. Nonetheless, one can assert that the majority of socialist governments have over time -- some earlier, some later, some more intensely than others -- become dissatisfied with their SOE sectors. What are the causes of this dissatisfaction?

First, while at one point or another impressive production figures were reported for SOE sectors in most socialist economies, this production was frequently achieved to the exclusion of cost considerations. For reasons discussed below, the inefficiencies of previously used methods are no longer tolerable. Second, and related, the periods of reported high growth were normally followed by a slackening in the rate of increase, and in some cases absolute declines in productivity and levels of production. That is, command methods may have been responsible for early production gains, but the gains proved difficult if not impossible to sustain. Despite large amounts of investment and the forced allocation of resources to supposedly high payoff firms and sectors (which entailed reduced consumption), production rates have tended to stagnate.

Third, the quality of the items produced was generally poor. All sets of consumers -- export markets in capitalist countries, local purchasers and CMEA buyers -- are now demanding higher quality goods. Fourth, it has become evident that socialist SOEs, at least in the Soviet Union and Eastern Europe and reportedly elsewhere, have been heavy polluters of the environment, despite the planner's notion that only socialist enterprises could truly "internalize the externalities."[4] Fifth, despite massive investments in science education and technical training, socialist country SOEs have tended to be relatively poor technological innovators, and indeed they have tended to operate below existing technology frontiers. This is a function, some critics argue, of barriers

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4. This insight, and a number of other points and ideas discussed in this paper, comes from W. Brus and K. Laski, From Marx to the Market (Oxford: The Clarendon Press, 1989).

(imposed by undefined property rights) to their acting in an entrepreneurial fashion.

In sum, SOE sectors in socialist countries have never achieved the efficiency, productivity and related performance levels expected of them in the original socialist conception; and their performance has, in the main, deteriorated in recent years. The Polish SOE sector, for example, received subsidies -- composed of direct budgetary transfers and quasi-fiscal subsidies through the banking system -- amounting to 5.5 percent of GDP in 1988, rising to 9.2 percent of GDP in 1989. In Yugoslavia, cumulative losses of the enterprise sector rose from 5.7 percent of GSP[5] in 1988 to between 8 and 9 percent of GSP in 1989. In both cases the changes reported in the short run reflect longer run trends. It is thus now widely acknowledged that the SOE sectors as presently structured are performing inadequately; that reforms more fundamental in nature than those undertaken in the past must be implemented; and -- in the majority of socialist countries -- that the state sector should be downscaled and a substantial portion of activity turned over to private hands, or at least opened to private involvement.

III. Past Reforms

What makes the present poor performance particularly disquieting is that most socialist countries have a lengthy history of enterprise reform. Starting as early as the mid-1950s in the Soviet Union (though only becoming significant in 1965), and echoed and reinforced in many other member countries of the CMEA (Hungary, Poland, the German Democratic Republic, Czechoslovakia and Bulgaria) and Yugoslavia and eventually China through the 1960s and 70s, socialist planners sought to increase operational efficiency in their SOEs. They tried generally to achieve this goal by substituting market or market-like mechanisms for the command mechanisms of plan fulfillment and central physical allocation of inputs and outputs.

Though the intensity and breadth of the proposed reforms varied from place to place, the invariant essence of the revision was to decentralize some decision-making to the level of the firm. The idea was to turn SOEs from pure production goals to efficiency objectives, and make them sensitive to prices, costs and consumer demand. It was also argued that increased enterprise autonomy would lead to increased technological innovation. Note that public ownership was not called into question by these reforms (except, in a sense, in Yugoslavia). The notion was to graft on to a still basically socialist body some selected efficiency and productivity enhancing aspects of the market.

These attempts have not worked. In some cases the reforms were but marginal manipulations; they were insufficient to attack the problem. In several cases reforms, modest to begin with, were never implemented, or only partially enacted, due to the resistance of vested political-bureaucratic interests and

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[5]. GSP refers to Gross Social Product, which is calculated in a slightly different manner from Gross Domestic Product.

habits. Workers and particularly managers (who often were not really managers, but rather production engineers, taking orders and filling quotas) frequently preferred the administered security of government control to the uncertainty and risks of the market. Particularly in the Eastern European cases, the technical difficulty of constructing a simple and coherent reform package, combined with frequent and politically-inspired shifts in the nature and rate of implementation of the package, confused enterprise management and encouraged passivity. Why try to implement a new set of signals when the likelihood was great that the set would shortly change?

Even in the case of the longest-standing, most concerted and "market-oriented" reform effort, that of the "New Economic Mechanism" of Hungary, the assessment of internal and external observers is that there has not been "a qualitative change in the way the Hungarian economy operates..."[6] Responsibility for certain production matters was decentralized to the level of the firm, but many other major decisions (i.e., investments) still required state approval. Firms that performed poorly were bailed-out. Managers paid some heed to market conditions, but much more attention to their bureaucratic guides and funders.

The conclusions from Hungary are applicable elsewhere: the past experimentation with ways to incorporate some efficiency-promoting mechanisms of the market without changing the essential features of socialism has not produced satisfactory results.[7] (With regard to the SOE sector the "essential features of socialism" can be said to include: public or social ownership; considerable and often absolute barriers to enterprise exit, with loss-makers usually being maintained through a combination of a "soft budget constraint" and widespread cross-subsidization; employment maintenance being given a higher priority than cost-containment; and continued government control of major enterprise pricing and investment decisions.) In large part, it is dissatisfaction with the continuing losses and the meager results of past partial reforms, and in particular dissatisfaction with the stagnating or declining standards of living that have resulted, that has provoked a search for more drastic, more far-reaching change.

To assess what is now taking place, the following section reviews the present reform packages being implemented or devised in seven socialist countries: Algeria, China, Hungary, Laos, Mozambique, Poland and Yugoslavia. The seven were chosen because: (i) being active members of the World Bank group, information is available on their activities and plans; and (ii) in all, more far-reaching reforms than previously carried out are underway or being considered.

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[6]. Brus and Laski, op. cit., p. 66.

[7]. "The experience of socialist countries that introduced partial reforms (Czechoslovakia, Poland, Hungary, Yugoslavia and the USSR in the 1980s) has not been impressive at the micro (enterprise) level and it has led to varying degrees of macroeconomic instability." Jan Svejnar, "A Framework for the Economic Transformation of Czechoslovakia," mimeo, University of Pittsburgh, January, 1990, p. 5, parentheses in the original.

IV. Present Reforms

The Range of Reforms

Available techniques for public enterprise reform fall under three main headings: further attempts to improve performance while retaining public ownership, privatization and liquidation. All are being considered or implemented in the seven countries under review (though not all three sets of techniques are being applied in each of the seven).

As is shown below, in every country in the study there are considerable obstacles to massive and rapid privatization. Thus, for the medium term at least, public ownership is likely to continue to play a large role (greater than many desire or now anticipate) in these economies. A critical question, therefore, is: what can be done to effect necessary improvements in the performance of the enterprises that will -- in some cases temporarily, in others indefinitely -- remain in the hands of the state? A variety of measures can be taken. Restructuring of a financial, technical or organizational nature may lead to an increase in productive and X-efficiency. Clarifying goals and streamlining the relationship between the government and those who manage the firm -- by increasing the autonomy and accountability of managers, clearly defining how the government will exercise ownership, and imposing the financial discipline of a "hard budget constraint" -- might improve efficiency and reduce rent-seeking. Finally, improving the environment external to the firm by creating a market or market surrogate -- by means of legal and regulatory changes and the introduction of a competitive environment -- may improve allocative efficiency.

Due to a strong desire to break with the political and economic patterns of the past, and because of the poor past performance record of previous partial enterprise reforms short of ownership change, most (not all) reforming socialist countries want to move quickly to ownership patterns similar to those found in OECD countries. All seven countries reviewed are thus tolerating or encouraging new private entrants into industrial and commercial activities; five of the seven have privatized or plan to privatize certain of their SOEs. From an economic standpoint, the prime goal is to place assets -- either newly created or formerly state-owned -- in the control of self-interested owners who will use them efficiently.

There is a wide range of possible outcomes to the privatization process. When privatized, firms can end up in the hands of private individuals or corporate owners, domestic or foreign, as either wholly or partially privately-owned firms. (Joint ventures, increasingly common in socialist economies, can result in private-private or private-public partnerships.) The new owners can be private or public persons, private or public institutions, or employees and managers of the previous SOEs. The firms, or shares in them, can be either sold or given away.

The last reform option, liquidation, is a measure governments the world over have been loath to take; and reforming socialist governments are not

proving exceptional in this regard. Even when liquidation becomes unavoidable -- as it has in some countries in the study -- a number of decisions have to be taken: at what precise point can one judge enterprise performance to be so bad as to justify definitive closure (as opposed to spending more money on a restructuring exercise)? what will substitute in the medium term for governmentally guaranteed employment? and how will the remaining capital assets be disposed?

Of the seven countries considered, two -- Algeria and China -- plan (at time of writing) to retain complete public ownership of their SOE sectors. The remaining countries, with the possible exception of Poland, will retain the majority of SOEs in public hands, for the medium term at least. Six are considering or enacting some liquidation, and five of the countries are presently pursuing or actively contemplating various forms and degrees of expanded private ownership of formerly state-owned property. In most of the countries, the measures under consideration will be implemented simultaneously.

Algeria

The Algerian public enterprise sector presently consists of approximately 350 national and 2500 provincial and communal enterprises. The important provincial and communal SOE sector is currently undergoing a (World Bank-supported) consolidation as a first step towards performance improvement. More extensive and advanced reforms are underway in the national SOE sector, aimed at putting the public and the private sector on an equal legal/regulatory footing when engaged in the same field of activity, and subjecting SOEs to the stipulations of the national commercial code (from which they were previously exempt).

The budgetary burden of the national SOE sector has been recognized as a problem since the early 1980s. In 1982-83, initial reform efforts decentralized, both functionally and geographically, a few of the largest and most concentrated SOEs, such as the hydrocarbon giant, SONATRACH. The second phase of reform concentrated on sorting out the arrears (cross-debts) situation between parent companies and subsidiaries. Enterprise restructuring was rather unsuccessful in the past; but changes in the system of enterprise taxation will, it is claimed, enhance the effectiveness of future rehabilitation efforts.

The main thrust of current reform is clarifying the government's relation to the national SOEs, and distancing the public companies' management from intervening sectoral ministries. The vehicles for the most recent stage of reform are eight Fonds de participation (Participation or Shareholding Funds). These publicly owned and operated Funds are intended to act as holding companies, each of which will hold shares in a diversified portfolio of SOEs. Their mandate is to buy or sell shares, to invest or disinvest their holdings, with a view to maximizing their profits. Trading of shares is permitted among the Funds and between SOEs themselves, as the first steps in the development of a capital market. (Private ownership of the existing SOE portfolio is not envisaged at this stage. However, in early 1990 the National Assembly authorized new joint

ventures between state enterprises and private capital, foreign or domestic.[8]) Each of the Funds will receive an initial allocation of a substantial minority of shares in a particular industrial subsector, but no one Fund will own more than 40 percent of the shares of any one firm. Thus, ownership of every enterprise will be spread among at least three Funds. The Funds will monitor enterprise performance and enforce profitability standards. The objectives of the Funds are to stimulate competitive market forces, decrease political and administrative interference in the day-to-day running of the firms, provide enterprise management with profit-maximization signals and the autonomy to accomplish these goals, and in general increase enterprise operational efficiency.

The Algerian Participation Funds came into official existence in mid-1989. The initial transformation steps involved the formation of an agency which recommended how each enterprise could be placed on a more firm financial footing,[9] and assigned enterprise assets a value in terms of the number of shares that would be issued for each firm. The enterprises were then turned over to the Funds.

Fund managers are now in place, but the Funds are presently understaffed relative to their task (about 30 enterprises per existing staff member), and operating procedures have yet to be determined. The Funds are expected to have the power to appoint enterprise Boards of Directors, but it is unclear how they will set, monitor and enforce enterprise performance standards. Similarly, the parameters of managerial autonomy have yet to be specified. Managers apparently will be able to hire and fire employees. Pricing has been somewhat liberalized, but margins remain controlled, in view of the monopoly structure of the economy. Access to foreign exchange remains severely constrained. Some progress has, however, been made in tightening up domestic credit allocation; this is a step on the road to the imposition of a hard budget constraint. But no liquidations of national SOEs have yet occurred, despite their now being subject to the commercial code which allows for closures.

China

State owned enterprises presently account for the majority of the Chinese industrial sector. They are owned by the central, provincial and local governments. In the past, all decisions on output, investment and choice of technology were made by government agencies, not firm managers. However, in the

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8. SOEs are not excluded from the provisions of this legislation, but it appears mainly to be aimed at newly established firms, or those which are presently privately owned.

9. Debts were split up into several categories: those owed to Treasury were converted into quasi-equity, those to investment banks were mainly written off, those to commercial banks have been rescheduled. Firms were also categorized into those having positive and negative net worth and cash flow. Enterprises scoring negatively on both of these financial criteria have not been turned over to the Participation Funds.

last decade Chinese enterprises have undergone a series of reforms, all intended to increase autonomy at the level of the firm. The most comprehensive reform has been the "production responsibility system," now adopted by 90 percent of SOEs. Under this scheme, increases in managerial discretion regarding production planning, use of retained profits, pricing,[10] (for "above quota" production) and financial payments to government have been granted. This system is designed to establish and enforce performance targets and encourage sound long-term planning. However, as turns out to be the norm in China, these reforms have been quite cautiously implemented. Observers claim that the production responsibility system is unevenly applied, that there is excessive scope for government to impose mid-term revisions in targets, and thus management's decision-making capacity is limited.

Over and above the production responsibility system, the Chinese are conducting a set of enterprise experiments with different types of autonomy-increasing management modes. These are taking place in several specially designated "pilot cities" and "special economic zones." In these, enterprise managers have been allowed more freedom to vary output pricing, and to manipulate incentives to increase employee productivity by, for example, issuing bonds to employees, and allocating bonuses. In some few cities, enterprise workforces have the power to elect managers for fixed terms. In theory, many[11] Chinese enterprise managers now have the right to hire and fire staff in order to maximize their financial objectives; in fact, because of the close relationship maintained between enterprise management and local or provincial government authorities, few if any managers exercise this right. Again in theory, there exist sanctions for persistently loss-making enterprises; in practice loss-making firms are usually bailed out.

Further measures to intensify the reforms, explicitly aimed at increasing the efficiency levels of the resources used in enterprises, are under active consideration. Suggestions include separating the ownership from the management functions of government, spreading ownership among multiple public sector "owners," and enhancing competition among existing enterprises. (The latter is presently officially allowed, but not enthusiastically endorsed.) Specifically, one idea is to use the newly created asset management bureaus, and

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[10]. Pricing flexibility varies among sectors, with light industry having significantly greater flexibility than heavy industry and producers of other "core" products. The system is described as "negotiated pricing" rather than strict price control.

[11]. In China, given the experimental and regionally varying approach to enterprise reform, and the combination of national, provincial and local government ownership, there are few instances in which one is justified in using the terms "all" or "none." In terms of hiring and firing, some firms are allowed to fire contract workers (with 3-5 year contracts) and are permitted to refuse renewal of the contract. These contract workers constitute, however, a small percentage of SOE employees. Non-contract workers may not be fired, although they can be shifted from position to position.

banks, pension funds, and insurance companies as public sector equivalents of institutional investors. This, presumably, would distance enterprise supervision from the administrative process, by placing enterprise guidance in the hands of persons interested more in a return on the assets than in bureaucratic politics or the non-commercial objectives of the firms. A similar idea is to disperse ownership "shares" in SOEs among the provinces. The concept here is that provincial governments far from the firm's location will be interested mainly in the return generated by their shares, and less likely to trade-off poor financial performance for non-commercial objectives. In addition, the idea has been advanced to convert at least some SOEs to joint stock companies to facilitate implementation of the dispersed ownership plan. To the extent these institutional revisions can provide profit-maximization signals to the firm (through Board membership perhaps, but this is not yet clear) they could constitute an advance.

The mechanisms for implementing and supervising these reforms are many and varied and still mainly in preparation. The National Administrative Bureau for State-Owned Property (NABSOP) was created in 1988 under the central government Ministry of Finance. Similar agencies exist at the provincial level. It is unclear whether these bodies will act more as holding companies or as legislative/supervisory agencies.

It is understood that reforms will generally <u>not</u> alter the publicly owned character of the enterprises; they aim more at minimizing and channeling government involvement in enterprise affairs, not eliminating it. Privatization is not presently under consideration. However, some experimentation with limited deviations from full public ownership has occured on a pilot basis; for instance, by the issuing of shares to workers and managers in a selected few firms, and the issuing of minority percentages of shares in a group of enterprises to the public in one particular region. Many restrictions have been lifted on private ownership of small businesses. China has permitted small new entrants to be entirely private and this sector now accounts for a growing percentage of industrial activity. The cities of Shanghai and Shenyang even boast embryonic stock exchanges. Also, numerous joint ventures (with a resultant inflow of foreign capital) exist in China.

As can be seen, the Chinese approach to enterprise reform is multi-faceted and experimental. A range of innovation -- short of privatization -- is tolerated and encouraged. Reforms are periodically reviewed to determine those deserving more widespread implementation. Much remains to be specified. Performance standards -- clear signals from the principal to the agent -- to improve efficiency have not been strictly devised, nor have sanctions for poor performance (replacement of managers, bankruptcy and liquidation procedures) been imposed. On the whole, despite a growing acknowledgement of the need for change, and a series of institutional revisions in the right direction, most enterprise managers do not yet have sufficient autonomy with which to achieve improved performance. Finally, there exist no enterprise or commercial laws as are common in most other economies, thus necessitating considerable effort for their development.

Hungary

Hungary has long been in the vanguard of socialist economic reform. Its New Economic Mechanism (NEM) was launched in 1968, with the primary goal of increasing economic efficiency. The NEM included a number of reforms of state-owned enterprises, and re-introduced both cooperative and private ownership. In addition, it abolished plan fulfillment and input/output allocation. The post-1968 period has been characterized by indirect bureaucratic control of enterprises, through financial instruments and regulatory devices. As noted above, the partial decentralization of decision-making to enterprise management did not, prior to 1990, extend to investment decisions, nor were poor performers allowed to exit. Moreover, controls became more restrictive, with a resurgence of political interference, after 1972.

In 1985, further efforts were made to decentralize enterprise management. This phase of reform introduced enterprise self-management in the majority -- about 75 percent -- of the approximately 1700 medium and large SOEs.[12] As elsewhere, the introduction of this management form did not arrest the performance slide; and indeed probably contributed to its worsening.[13] By 1988, Hungarian enterprises were exhibiting even more severely depressed investment funding, perceptible declines in efficiency levels, squeezed profits, and credit shortages. This led to yet another round of reform initiatives.

A variety of measures are presently being prepared to improve the performance of enterprises that will remain in the public portfolio. Most of the measures were started by the previous one-party regime; but they have been

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[12]. In terms of asset value, about half the Hungarian SOE sector is managed by enterprise councils, and half -- representing mainly monopolies and public utilities -- is "administratively managed" directly by ministries. In the roughly 1275 firms managed by enterprise councils, those with over 500 employees have one form of management; those with less than 500 employees a slightly different form. In all self-governed firms, the managing director is elected directly by the workforce, employees and managers, on a "one man, one vote" basis. For details see Lajos Borkos, "Privatization in Hungary," paper presented to the IMF Institute Seminar on Centrally-Planned Economies in Transition, Washington, D.C.: July, 1990, p. 7.

[13]. Manuel Hinds argues forcefully that workers' management of socially owned assets inevitably leads to the workers maximizing their income at the expense of the long-run health of the firm. See his "Issues in the Introduction of Market Forces in Eastern European Socialist Economies," World Bank, EMENA Region, Internal Discussion Paper, Report No. IDP-0057, April 1990. This viewpoint is contested by Milan Vodopivec (among others) who argues that "it is the notorious softness of the budget constraint of firms, caused by state paternalism..." more than the workers' management system that accounts for poor performance. ("Over-Full Employment in Reforming Socialist Economies: A Goal or a Consequence?" World Bank, Reforming Socialist Economies Unit, mimeo, Washington, January, 1990, p. 2.) The fact of poor performance is not in doubt.

accepted and intensified by the multi-party government chosen by the electorate in April of 1990. These measures include strengthened bankruptcy laws, and reductions or elimination of production and investment subsidies, both serving to harden the budget constraint. Auditing and accounting procedures based on the Western model are being installed in key enterprises, and a number of companies in the critical sectors of mining, metallurgy and construction are being restructured. The new government states that restructuring is not a euphemism for bail-outs; persistently loss-making firms will, it insists, be allowed to exit in a normal commercial manner. To back its claim, regulations have been changed to allow creditors to begin liquidation procedures against insolvent SOEs. A number of liquidation procedures are slated for coming months.

In the search for more effective measures to improve enterprise performance, a more permissive attitude regarding private involvement in SOEs emerged. The Company Law of 1988 and the June 1989 Law of Transformation allowed enterprise management and workers to initiate the privatization process. The main, unanticipated and generally negative result was a number of "spontaneous privatizations," whereby managers more or less confiscated enterprise assets and either became the new owners, or involved foreign investors and became highly paid managers in now partially privatized firms.[14]

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[14]. Spontaneous privatization poses four major problems in Hungary (and in Yugoslavia, Poland and elsewhere as well). Financially, the former managers become owners without paying a "fair price" -- though the determination of a "fair price" for enterprise assets is one of the most difficult technical issues in the transition from a socialist to a market economy. Economically, it is hard to see why turning the firm over to the people who ran it poorly in the past makes allocative sense -- though as owners rather than agents they might be operating under a dramatically different incentive system. Politically, the new owners will be either former "nomenklatura," whose shift from party elite to asset owners most people in socialist countries would regard as intolerably unjust; or groups of workers (or some combination thereof). Turning enterprises over to workers might be acceptable were it not for the equity problem; i.e., worker ownership might be fine for those employed in profitable or potentially profitable firms, but not for those in persistent loss-making operations or those currently unemployed (and what about professionals, civil servants, farmers, etc?). Organizationally, denying ownership to the former managerial group eliminates those with the experience and know-how to run the firms. In sum, in Hungary, Yugoslavia and Poland the choice for new purchasers appears to be mainly (not exclusively) between foreign investor/managers or former "nomenklatura." The issues of the rights of workers, and what to do with the former managers, will be a continuing preoccupation for most of these governments. Note that to date, very little quantitative information is available regarding the number of spontaneous privatizations in Hungary (or elsewhere), or the assets involved, or on the foreign or domestic private partners frequently alleged to be in on the deals. For a thorough discussion of these issues see F. Dhanji and B. Milanovic, "Privatization in East and Central Europe: Objectives, Constraints and Models of Divestiture," paper presented to the World Bank Conference on "Privatization and Ownership Changes in East and Central

Recent Hungarian legislation and institutional action has focused on preventing this outcome by providing transparent regulations for the sales process. A March 1990 creation is the State Property Agency (SPA), which will establish competitive bidding procedures, act as a "factor owner;" i.e., as the representative of capital, and generally guide and supervise privatizations. The legislation has not fully clarified the question of ownership and governance, including supervision of the necessary restructuring process, of those firms that will remain as SOEs. Nor, judging from parliamentary outcries over the first privatization actions taken in June of 1990, does the legislation reflect a consensus as to the scope, the pace and the details of divestiture. Parliamentarians bitterly objected to what they perceived as the low price of the share offerings of the first firms going public. Another problem is that the existing legislation implies that the SPA could undertake the supervisory/restructuring role, but SPA management has announced a desire to concentrate the agency's scarce human and financial resources on the privatization issue.

Hungary has greatly liberalized regulations regarding foreign investment. Foreigners can purchase equity in existing or former SOEs. Approval is automatic for investment proposals that will result in a minority position for the foreigner. Official permission is required for majority or full ownership; applications must be accepted or rejected within three months of filing.[15] Profits can be repatriated; foreigners can own real-estate. In June of 1990 the Hungarian stock exchange formally reopened, with 50 firms listed -- but only two of them are newly floated companies. The state travel agency, Ibusz, went public with shares being traded on both the Vienna and Budapest exchanges. Well over half of the issue went to non-Hungarians (but the company remains 2/3 state-controlled).

Europe," Washington, D.C.: June 13-14, 1990. Borkos (op. cit.) presents information on how spontaneous privatization was accomplished in the case of the SOE Apisz, a chain of stationery retail stores. The story is long and complex; the point is that by use of loopholes in the law and the involvement of foreign investors, the previous managers of the firm extracted cash for themselves, ended up as owners of a new company with the assets of the old, and left the state with some long term fixed interest rate bonds that are generally conceded to be poor compensation for the assets privatized.

[15]. Three Western financial institutions have already created investment funds in Hungary; five more are in an advanced state of preparation. Reportedly, the prefered strategy of the funds is to obtain a share in a Hungarian company, public or private, that already has an active partner/investor from a western country. A thorough discussion of the legal and administrative framework for foreign investment, and recommendations concerning needed improvements, is found in Joel Bergsman, "Foreign Direct Investment Policy in Hungary," Foreign Investment Advisory Service, International Finance Corporation, Washington, D.C., 1990.

Legislation empowers government to privatize the state-administered but not the worker managed enterprises. However, the SPA has the authority to "reclassify" -- i.e., nationalize -- worker managed enterprises when the ultimate objective is privatization. It does not appear that any "reclassification" has yet been carried out. How the SPA will temporarily manage the assets coming under its control and carry out the privatization transactions remains to be specified. Options for privatizations remain open, from full or partial sales through joint ventures[16] to leasing arrangements. The reported prime candidates for divestiture include the steel and metallurgical sectors, mining operations, the state airlines and a bus making plant.

Following the 1990 elections, the new government has reiterated its intention to reduce the SOE sector from 90 percent of the economy to 30 percent within three to five years. It is nonetheless probable that privatization will unfold less rapidly than originally anticipated. The intricacy of constructing transparent and beneficial transactions is becoming more evident, as is the scarcity of investors interested in and capable of playing an active management role. (Capital is available.) The result is a slowing of the process. In these circumstances it is likely that Hungarian officials dealing with the SOE sector will be pushed to shift their concern to: (i) examining ways to privatize more rapidly, perhaps through transfer of ownership rather than sale;[17] and (ii) continuing the search for mechanisms to increase the efficiency of enterprises remaining, temporarily or indefinitely, in the hands of the state.

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[16]. Hungary reportedly leads the socialist bloc in the number of joint ventures negotiated with Western partners. In March 1990, an unsubstantiated report noted over 1,000 joint ventures registered in Hungary, compared to 950 in Yugoslavia and 700 in Poland. Regardless of the precise numbers, it is clear that the capital inflows generated by the Hungarian joint ventures have been modest.

[17]. Transfer is the method generally recommended by Hinds (op. cit.) and specifically for Czechoslovakia by Svejnar (op. cit.) The one historical instance in which a large-scale transfer was made to the public at large took place in the Canadian Province of British Columbia in 1979. See Guy Heywood, "Giving It Away: Case Study of the British Columbia Resources Investment Corporation," paper presented at the World Bank Conference on "Privatization in Developed Countries: Lessons for LDCs," Washington, D.C.: June 11, 1990, which reviews how the scheme came about and was implemented, and the post-transfer workings of the company. Poor investment decisions by the private managers, operating in a highly politicized environment, have resulted in a significant decline in the value of the portfolio, and a loss of most of the value of the shares. However, the subsequent poor management of the company does not prove that the "give away" mechanism is inherently flawed, or would inevitably produce the same negative results. Some sort of privatization through transfer "vouchers" will probably be used in Czechoslovakia, Poland and Romania.

Laos

Prior to recent reforms, all medium and large enterprises in Laos operated under state, provincial or municipal "tutelle" (supervisory authority). Industrial state enterprises numbered about 260 and comprised the majority of the 500 SOEs in the country. About a third of these industrial firms, generally the larger enterprises, were supervised by the central government, while the rest (comparatively smaller units) were controlled by local authorities. A number of small artisanal and service firms existed in the private sector. The SOE sector has undergone a variety of reforms in the last five years, directed first toward increasing enterprise autonomy, and more recently toward creating a level playing field for the public and private sectors, and privatizing selected enterprises.

Until 1987, SOEs were enmeshed in a thicket of bureaucratic controls, despite a series of reforms, from 1982 onward, ostensibly aimed at increasing autonomy. In 1988, Decree No. 19 greatly expanded operational and financial autonomy of SOEs, giving the enterprise Director increased jurisdiction over operational planning and budgeting, procurement, personnel and financial management. However, the autonomy of the Director remains constrained by a workers' control system.

The Decree makes a distinction between ownership, which rests with society as a whole, and usufruct -- use of the assets -- granted to the employees and management of the enterprises. The Decree ended arbitrary transfers of enterprise surpluses to government, and eliminated direct budget support to SOEs. Directors were made accountable for firm performance, although important decisions still must be cleared with representatives of the workers. Directors are nominated by the tutelle authorities; and then confirmed by the Assembly of Workers. They may be fired by the tutelle after three consecutive loss-making years. Henceforth, the state's role is supposedly limited to overall enterprise review and policy guidance. The criteria for the granting of increased autonomy of this nature is financial solvency and a decent performance record or capability. As of the end of 1988, 400 SOEs had been granted such autonomy.

Enterprises pay to the tutelle turnover and profit tax. Managerial accountability is reinforced by allowing the enterprises to dispose of after-tax profit. In addition, funds for emergencies (unspecified), expansion -- i.e., capital investments -- and employee bonuses are required to be maintained by the enterprise. As in Eastern Europe, devolving to the employees near-complete authority to dispose of after-tax profits has tended to increase salaries and bonuses at the expense of retained earnings. While short run performance is not now suffering, long-run profitability is at risk.

Enterprise autonomy presumably carries an obligation to repay the state for all past investment capital. However, the rules governing ownership of assets and credit arrangements have changed frequently and continue to be opaque. This vagueness affects the sale of equipment, depreciation, asset valuation and the untangling of arrears and cross-debts. Enterprise accounting systems are acknowledged to be in deplorable condition. Mechanisms to assure financial accountability -- including guidelines on incentives to labor, profit

distribution, enterprise taxation and investment funding -- are areas requiring improvement for those enterprises remaining in the public domain.

Privatization emerged discretely and in a limited fashion only during the course of 1989. Power, water, road construction and some transport enterprises are exempt from the process; privatization is to apply only to industrial and commercial concerns. The process is officially labelled "disengagement" and has a variety of forms: the contracting out, or leasing, for a fee or share of the profits, of the management of the enterprise; allowing private investment in public firms; partial or full sales; closures and liquidations of a very few firms; and subcontracts of certain activities to foreign firms. A 1989 decree clarified the rights of foreign investors to enter the Laotian market.

Disengagement is being implemented primarily in the capital province of Vientiane, where approximately thirty-five enterprises were "privatized" within a year; several further full sales are, reportedly, in process. Central ministries have also begun to privatize enterprises under their tutelle. In contrast to enterprises selected for autonomous status, many of the firms chosen for privatization are those with poor performance records.[18] The process of privatization has so far proceeded in a rather ad hoc fashion, and it has been constrained by limited institutional capacity. Nonetheless, in the Laotian context, where the state has played an active role in small-scale and retail operations, privatization possesses considerable potential.

Mozambique

The industrial sector in Mozambique is estimated to employ approximately 100,000 persons in the formal sector and another 50,000 in the imformal sector. Those employed in the formal sector work in one of approximately 600 registered firms; half of these are classified as state-owned or "intervened" enterprises.[19] Prior to 1984, the Mozambique government had attempted to use a central planning approach based on the East German model. Dramatic changes in economic management in general and enterprise reform in particular were spurred by severe economic decline from the mid-1980s onwards.

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[18]. About one third of these privatizations are actually management contracts or leases; one third are joint ventures with foreign partners (often Thai), and one third are full divestitures. Two closures were also reported.

[19]. A number of enterprises were abandoned by their former Portuguese owners after independence. Their management was assumed by the state but their formal ownership remained undetermined. These enterprises are presently considered "intervened" rather than fully government owned. Irrespective of legal status, all firms on the national register are under the supervision of one of eleven central ministries.

The Economic Rehabilitation Program of 1987 introduced liberalized pricing, increased enterprise autonomy and accountability, dismantled a centralized control and distribution system, and simplified access to foreign exchange allocation. Since then, financial discipline has been re-introduced. Increased managerial autonomy for public enterprises -- albeit limited by the lack of qualified managers -- has included setting prices and wages, hiring and firing employees, and initiating changes in production scale and product. All of these measures (with the exception of firing, which is frequently avoided) are reportedly being exercised, although there is considerable variation among enterprises.

Enterprise restructuring is considered a high priority. On the financial side, this involves untangling past inter-enterprise cross-debts and arrears, revaluing enterprise assets and developing new and meaningful balance sheets. The government's primary goal is to clean up what it now admits is a financial and budgetary mess. Observers stress that the future of the enterprise reform program is contingent upon the systemization and rationalization of various aspects of corporate law. From bankruptcy practices to asset valuation statutes, the legal framework is presently a haphazard conglomeration reflecting the conflicting objectives of previous regimes. Restructuring is being orchestrated by the Enterprise Restructuring Technial Unit in the Ministry of Finance, which reviews rehabilitation and restructuring plans submitted by the enterprises. Finally, competition is being encouraged through a new investment law giving incentives for industrial investment from both foreign and domestic sources.

Privatization, including foreign ownership, has been hesitantly introduced since 1986. In the period 1986-88, 25 sales and 20 partial sales have reportedly been transacted. Privatization has so far been approached on a case-by-case basis, involving primarily small and medium-sized commercial and industrial firms with good financial track records. Foreign partners have been encouraged to come in with existing enterprises on a joint venture basis. Up to 75 percent of an SOE can be sold to a foreigner and 100 percent to a domestic purchaser. New entrants, now encouraged, can be 100 percent foreign-owned. The government is presently attempting to systematically review all "intervened" enterprises to determine whether to sell them (in some cases back to their previous owners) or officially nationalize them as a necessary legal step prior to restructuring and/or divestiture. An action plan to determine the legal ownership status of the "intervened" enterprises is to be completed by December 1990. Several liquidations are planned, but none have yet taken place.

Poland

The first significant and enduring SOE reforms in Poland were enacted in the early 1980s, in good part due to the power and activity of the labor movement.[20] The 1982 Law on State Enterprises attempted to decentralize

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[20]. The present government is an outgrowth of that reform movement; and most people in Poland well remember and thoroughly deplore the relatively recent period of central planning and direct state control of enterprises.

decision-making and increase enterprise autonomy through the now familiar method of instituting workers' council management in the bulk of the SOE sector. The results were poor. During the subsequent period micro performance worsened; macro instability ensued.

Enterprise reform is the key element in the economic shock treatment presently being administered to the Polish economy by the government that came to power in 1989. SOEs number more than 8000 (not counting subsidiaries and some enterprises at the local level) and comprise at least 70 percent of total economic activity. Ongoing enterprise reform encompasses the spectrum of efficiency improving measures: privatization for some enterprises (estimates range between 100-1000 for the first two years), liquidation for others, and, for those firms remaining public, ownership clarification and restructuring -- financial, technical and organizational. Financial discipline has already been imposed, consisting of an end to direct and indirect subsidies, what amounts to a freeze on wages, near-complete liberalization of prices, and massive liberalization of imports behind a very low general tariff wall. This is a "hard budget constraint" with a vengeance. Stabilization has been achieved, but at great cost to the SOE sector. There has been at least a 30 percent drop in industrial production, and an upsurge in unemployment, from less than 10,000 at the end of 1989 to over 640,000 as of mid-July, 1990.[21]

All SOEs are affected by the changed macro situation. Particularly hard-hit are the firms exporting to the CMEA countries, as prices for their inputs have risen exponentially while their selling prices are generally fixed. Many enterprise managers are for the first time ever having to deal with the concepts of marketing, cost containment and quality control. Many are finding that purchasers are not picking up past orders, since they can now import cheaper, and generally higher quality, alternative inputs. This is a rational move, since most firms are for the first time facing demand barriers in the internal market. Cutting costs will allow them to cut product prices, and perhaps survive. The unemployment figures show that some firms are cutting costs by shedding labor; other firms are simply shutting down production lines as the recession and macroeconomic changes affect demand. Estimates are that unemployment will continue to mount. Bankruptcies are now tolerated; an unspecified but apparently rapidly growing number have taken place or are in process.

Even if the government were to succeed in selling (successfully) 100 enterprises a year -- a rate that would far exceed the sales record of most privatization programs eslewhere in the world -- some seven years would pass

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[21]. At the time of writing, a group of eight medium sized firms are being liquidated, and a number of persistently loss making coal mines are to follow. Other sub-sectors that will reportedly suffer closures will be fuel, power, iron, steel, construction materials, transport equipment and food processing.

before 10 percent of the sector was divested[22] . This realization has led many to suggest the use of more rapid privatization measures, such as employee ownership schemes, or a "give away" transfer of shares to the public at large. These options are still being debated, but the current official emphasis is on the sale of shares (for reasons discussed below).

For the enterprises remaining -- temporarily or indefinitely -- in the hands of the state, a past problem has been the inability of the owner, the state, to set and monitor performance standards. The government has attacked this problem by instituting minimum financial performance standards. It now requires that enterprises break even and that they pay a "dividend" on the amount of government furnished capital in the firm. Due to accounting complexities, it is extremely difficult to estimate an equivalence between the required dividend and some percentage of return on total assets,[23] but if enterprises assets are periodicly revalued to keep up with inflation, the dividend would be significant. In the event that the enterprise persistently fails to meet its financial obligations to the state, the parent ministry creates a Recovery Commission (receivers) that intervenes in the firm, suppresses the workers' council, and effects a workout. The possible outcomes of the intervention are closure, putting the firm up for sale, or restructuring and retention in the public sector. One suggested outcome for firms that will be retained is that they be managed by a public sector holding company (which does not yet exist). The government "does not exclude" the possibility that restructured enterprises could be returned to workers' council management. As of May 1990, 450 firms were unable to pay this dividend.

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[22] Note that the problem is limited to the larger entities officially classified as SOEs. Smaller shops and retails outlets can be rapidly divested, and some 6,000 of the micro-enterprises have reportedly already been divested in the first half of 1990.

[23]. The enterprise dividend on after tax profits is a forced return on equity. It is calculated as an annual payment of 32 percent on the amount of enterprise capital attributed to the "founding organ" (a ministry or a province) as of December, 1983. In the <u>average</u> enterprise, after December 1989 and April 1990 asset revaluations (and the elimination of a ceiling linked to profits) this amount is said to be equal to about 40 percent of total capital; and the dividend to approximate a return of between 8-10% on total assets. The dividend is paid monthly; thus, its non-payment alerts government monitors to problems in the firm. It is not an ideal signal. Managers and workers' councils might well choose to sacrifice long term interests or even de-capitalize the firm in order to achieve the dividend payment. (Since a consequence of government intervention is the suppression of the workers' council form of management and the conversion of the enterprise to a joint stock company, one can assume that workers' councils will make special efforts to pay the dividend.) There is evidence to suggest that this has already begun to happen in some enterprises. Moreover, treating non-payment of dividend as a mechanism to "trigger" government intervention is pointless if government does not have the administrative capacity to respond, which may be the case in Poland at present.

Government is creating an Industrial Restructuring Agency in the Ministry of Industry to orchestrate and implement the technical assistance/rehabilitation of companies. The Agency will determine which enterprises are worth rescue efforts, of what kind, and what should be done with enterprises after restructuring (e.g., privatization or return to SOE status). A new Polish Development Bank will also play a role in appraising and financing enterprise workouts.

Parliament passed a law on the privatization of SOEs in July of 1990. This creates a Ministry for Ownership Change, to supervise and execute the sales process. Enterprise decision-makers -- i.e., the managers and workers' councils -- will voluntarily put the firm up for sale, or the enterprise can be designated as a candidate for sale by the Ministry. The Ministry intends to start the sales process with firms exhibiting a good financial position, high sales volume, good export earnings and high export to sales ratios. Ministry officials state that they wish the initial sales to be clearly transparent and beneficial to the country, the new owner, and the involved workers. This means that good performers will be the first privatized, probably drawn from that group already exporting to hard currency markets. More than 30 test case enterprises have tentatively been identified by officials, and more than 50 other firms have put themselves up for consideration. The government's goal is to privatize over the next two years a number of the larger firms, the turnover of which represents 10% of 1989 total sales of the sector.

If the workers' council of an enterprise selected by the Ministry should contest the decision to privatize, the dispute would be arbitrated by an independent committee appointed by Parliament. Its decision would be final. Ministry officials admit that in the first instance only enterprises voluntarily seeking private involvement will be put on the bloc, but the involuntary process might soon become important as the process deepens. The method of sale will be auction of shares by the State Treasury to domestic and foreign investors. Workers in affected enterprises will have the right to purchase up to 20 percent of the issued stock in the company, at a 50 percent discount on the established price. (If workers wish to purhase shares at the regular price after taking up all available lower-priced stock, they are free to do so.) It appears that "privatization vouchers" will be given to the population at large; these can be redeemed for shares in privatized firms. The details of this partial give away process remain to be specified. (How the shares are to be valued is not yet known).

Poland has embarked on a massive and risky reform. Its overall goal with regard to its SOE sector is to "develop an ownership structure akin to that of industrially developed nations." Despite much talk, only a few privatizations, at least one of them of a "spontaneous" nature,[24] have taken

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[24]. In May of 1990 the Polish Universal import-export company offered to the public 9.8 million shares at $2.00 (US) a share. No preferences were announced for workers in the firm, and the existing government shareholders stated they would not take up the issue. Demand is apparently very weak. See

place. In Poland, much is expected of privatization, partly because no costly consequences of the process are yet apparent, and partly because of the widespread perception that the previous system was not simply flawed but catastrophic. Most Poles are agreed that the need is not to reform public ownership, but rather to eliminate it.

Yugoslavia

Following World War II, Yugoslavia adopted central planning. The organizational innovation for which the country is well-known, workers' self-management, had its beginnings in the 1950s, with the bulk of the reforms coming in the mid-1960s. Yugoslav workers' self-management is a system aimed at retaining decision-making at the enterprise level, whereby employees actively run the approximately 2000 major enterprises in which they work. They choose and then work closely with and supervise a management team. Workers possess some of the property rights of ownership in that they have custody and usufruct of the assets they manage. As of 1990, they can even, in special circumstances, alienate assets through sale. However, workers do not have unlimited rights with regard to dissolution or change of form of the enterprise. Thus, workers are not owners in the strict, Western legal sense of the term.

The transfer in the 1960s of management decisions from government agencies to the level of the firm did indeed increase the autonomy of the worker-managers; and it also meant that the relation between enterprises was handled by financial mechanisms that were supposed to function in a market-like nature. The resulting hybrid has been termed a "labor-managed market economy". Early results of these reforms were viewed by Yugoslavs as quite positive. In the late 1960s, enterprise performance improved, both absolutely and relative to performance in Yugoslavia's then centrally-planned neighbors. However, in the last 10-15 years performance has deteriorated, to the extent that cumulative losses of the SOE sector in the 1980s totalled $20 billion U.S. As the difficulties have mounted, there has been an increasing effort to find ways of stemming the losses. Up until the end of 1989 the reforms proposed were very much in the "partial" tradition; and indeed there has still not been a frontal attack on what many external observers would regard as the root causes of enterprise problems: the concept of "social property" and the workers' management system.

In the context of an active stabilization/adjustment program, a number of enterprise reform efforts have been launched in the first half of 1990. First, workers' councils are scheduled to be transformed into "social boards." The social boards will be comprised of representatives of the state, creditors[25]

K. Stupnicki, "Poles Keen on Privatisation but Prefer Hard Currency to Investing in Shares," Privatisation International, No.21, June 1990, p. 6.

[25]. Most Yugoslav banks were previously owned by the very enterprises to which they lent; they were not a financial intermediary but rather a conduit of funds for their owner. The banking system is presently under reform, with World Bank assistance. As the reform takes effect, a number of

and employees, and will be vested with the power to fire managers and take other decisions typically made at the Board of Director level in a capitalist firm. In theory, these social boards will more strictly exercise the property rights of owners; and at least and for the first time the creditors and representatives of the ultimate furnishers of the capital employed in the enterprises take part in the guidance proceedings. (However, it must be admitted that experience elsewhere with composite public sector supervisory boards has not been all that encouraging.)

Second, enterprise restructuring agencies -- at the republican and provincial level -- were created in early 1990. The composition and powers of these are still not fully defined, but it is clear that they are expected to intervene in illiquid and poorly performing enterprises, replace poor managers, and recommend and handle other necessary restructuring, as appropriate. The problem is that under the existing Enterprise Law, the restructuring or sale of an enterprise still has to be initiated or at least approved by the firm's workers' council. Thus, the restructuring agencies can, at the moment, only intervene when action is approved by the council.

At the end of 1989 a Law on Social Capital was passed, opening the door to the sale, partial or full, of worker managed enterprises. The Law also introduced safeguards[26] to prevent the abuse of the sale process; stipulated that the proceeds of sales would go to newly created Development Funds (investment agencies established at the republic and province level); and stated that henceforth all parties involved in an enterprise would have a say in management proportional to their capital share. The Law is a first, cautious but progressive step in the transformation of a system in which the lack of clearly defined property rights has posed serious obstacles to efficient enterprise functioning. Since the revenues from sales will go to state-owned Development Funds, one has at last a tacit admission that the state -- and not the workers -- is the residual claimant on the assets employed in enterprises.

It is widely recognized in Yugoslavia that the reforms launched to date are partial and need deepening. A proposed amendment to the Law on Social Capital is being considered which would create minimum financial performance criteria for enterprises. Should an enterprise fail to meet these criteria,[27]

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enterprises are presently complaining that banks are starting to reject their applications for continuing injections of working capital. But it is not at all clear that cross-subsidization and bank funding to losers has ended in all regions.

[26]. To prevent "spontaneous privatization," the Law on Social Capital allows any actor in the sales process, including the government, to call at any time for an independent valuation of the assets.

[27]. The proposed criteria are as follows: an enterprise must avoid losses (break even), earn a stipulated return on capital, and maintain a minimal liquidity level. The definintion of liquidity and illiquidity have, however, not yet been specified.

government -- in the form of the republican or provincial restructuring agency -- would henceforth have the right and obligation to step in, suppress the workers' council form of management, and effect a workout.[28] The workout would in turn lead to closure, sale or restructuring. The situation is urgent. A full one-third of all enterprises are reportedly illiquid at time of writing, but there have been no closures to date. Government officials state that bankruptcy is in process in several persistently offending enterprises, and that liquidation will be widely enacted, where necessary and appropriate, in the immediate future.

A complicating factor is the federal nature of the Yugoslav state. Development Funds and restructuring agencies are being established in each republic and autonomous province, at considerable administrative cost. Revenues from sales will go to the republic or province in which the enterprise is registered for business; this may cause problems when the plant being divested is physically located in a second region. Changes to the Constitution -- necessary for the complete liberalization of property rights -- require approval of the constituent bodies of the state; while federal legal officials are currently proposing constitutional changes that would clearly specify property rights in the capitalist sense, it is not clear as to whether the amendments will be passed, or if so, how long it will take for passage to be effected. The present situation allows the republics and provinces that are most active to seize the reform and privatization initiative; this could widen the readily apparent regional differences in the country.

V. Conclusions

The seven socialist countries reviewed in this paper have long tried to improve SOE performance by restructuring; i.e., by the introduction of partial reforms short of ownership change. This is not unusual; governments the world over have prefered restructuring to privatization (much less closure). In the early 1980s, governments in mixed economies generally came to the conclusion -- sometimes enthusiastically, sometimes reluctantly -- that sale or liquidation of at least some of their SOEs was necessary and desireable. In socialist countries up until very recently, the sales option simply was not considered. This still appears to be the case in Algeria and China. Elsewhere policy has changed. The other five socialist countries reviewed are pursuing privatization; and liquidations have been effected or are in process in at least five of the seven. In all seven countries, major efforts are underway or envisaged to improve performance in enterprises that will remain public. The means chosen to effect reform (other than sales) vary widely.

Why does the type of reform vary so greatly among these countries? One explanation is the complexity and multiplicty of these governments'

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[28]. An undecided issue is whether enterprises "intervened" and restructured, but not privatized, would be permanently changed to joint stock companies, or whether one possible outcome of the process would be a return to the workers' council form of management.

objectives. Simply put: goals vary. The stated objectives of enterprise reform and privatization programs in socialist economies are always multiple: they are a mixture of economic gains -- decreasing the fiscal burden, increasing state revenues, increasing allocative, productive and X-efficiencies produced by the enterprises -- and socio-political gains: introducing popular capitalism, creating a property-owning middle class, or increasing economic equity. This multiplicity of goals leads to varying combinations of priorities in differing countries, at varying times, in fluid socio-political circumstances.

If goals could be listed in priority form, then specific means could be proposed to achieve the objective. For example, if the fiscal burden were designated as the most pressing problem, the imposition of a hard budget constraint -- including the elimination of all subsidies, and strict bankruptcy enforcement -- would be a relatively simple and effective measure (administratively if not politically). Similarly, massive privatization through sales to private persons would most likely increase state revenue, were that stipulated as the number one goal. A commitment to enhance allocative efficiency would emphasize reforms external to the firm (deregulation, introduction of competition, easing trade barriers), while a stress on improvements in productive efficiency at the level of the firm would focus on managerial autonomy (the right to fire, set prices, etc.) accountability (performance indicators) and incentives to workers. The evident problem is that these governments, as all governments, are hard-pressed to maintain a coalition of supporting forces, and they thus find it exceedingly difficult to contain themselves to single objectives, or to state and maintain clear priorities. They prefer to support a multitude of means to obtain a number of ends. That being the case, one can expect the wide variation in reform programs to continue.

There is a powerful logic supporting privatization in socialist economies. The most telling fact is that the numerous reforms short of ownership change have not produced sufficient or enduring benefits. Eastern and central Europeans, for example, state that they have for twenty years experimented with schemes to make public enterprises efficient, and they have not been able to make them work; now they wish to adopt private ownership, a system they regard as having proven its positive performance.[29] A second compelling reason for privatization is that the state sector is so massively dominant in these economies that to rely on new private entrants to redress the balance would imply a wait of many years. All these economies are searching feverishly for rapid ways to create markets (or market-like mechanisms), enhance competitive forces, generate entrepreneurs and investors; and most of the countries examined have concluded that these can only be brought into being quickly through an active program of SOE privatization. A third and related reason, particularly appealing for the rapid reformers such as Poland, is that only privatization of larger SOEs offers the prospect of bringing in, in the short run, the new money and dynamic management necessary to rejuvenate and maintain, and perhaps even add to,

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[29]. See again Brus and Laski, From Marx to the Market, Chapters 6 and 8 on the reforms attempted and the rejection of further partial efforts; see also Janos Kornai, The Road to a Free Economy (New York: W. W. Norton and Co., 1990), for a sustained argument in favor of this position.

employment levels. In other words, privatization is necessary to produce a sufficiently large "supply response" to policy reform. This response is crucial, to create jobs and to demonstrate to the population that the painful transition process produces benefits.

But even if privatization programs were perfectly to produce the financial, efficiency and employment gains expected of them, the cases examined above, as all other privatization experiences, indicate that privatization will take time: time to conceive, to implement, and to produce the positive response. Even in hard-charging Poland the transition process will take longer than envisaged. Indeed, this finding is the key conclusion of many of the most recent reviews of privatization the world over.[30] Thus, one is back to the vexing question of how to enhance productivity in enterprises that will continue to be state-owned?

Most reforming socialist governments have found the legal/legislative struggle with property rights clarification to be so demanding, and their hopes for rapid privatization so great (and their expectations of SOE performance improvement so slight) that there has been a relative neglect of the issue. The Chinese case becomes particularly interesting in this regard. Having so far rejected privatization, that government is looking hard at all other options. The array of experimentation undertaken by China merits particular attention and monitoring; and the general question of performance improvement in remaining SOEs deserves further attention.

In addition, all the countries examined recognize the deficiencies of their previously used enterprise management methods. The reform process appears to be progressively iterative in that second stage actions frequently deal forcefully with problems revealed in the first phase (for example, countermeasures are being devised to combat negative effects of "spontaneous privatization"). Approaches to enterprise reform have changed rapidly, almost overnight in some instances such as Laos and Mozambique. However, there is a risk that countries could get stuck in a rut of marginally compensating for the mistakes of the previous round of reforms without developing a clear vision of the desired end state.[31]

Obstacles and problems regarding enterprise reform are evident, most economically expressed as a series of questions: Particularly for those

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[30]. "There is an unfailing tendency to underestimate the time required to execute each privatization transaction..." states Roger Leeds in "Privatization in Developing Countries: Some Lessons Learned," paper delivered at International Privatization Conference, Saskatoon, Saskatchewan, May, 1990, p. 9. Leeds notes this is true for industrialized as well as developing countries.

[31]. This may be a downside risk of the Chinese approach. One rationale for more far-reaching reform in China is that past increases in managerial accountability without defining property rights have, reportedly, contributed to increased corruption and de-capitalization of enterprises.

undertaking dramatic reform, how much economic pain can basically populist governments inflict; how much sacrifice will populations endure without protest? Will a local private sector supply response come forth with sufficient force and at a sufficient pace to put presently idle or under-utilized resources to productive work? From where does the local private sector obtain needed capital? Will foreign private investors come in sufficient number, and with sufficient resources, to make privatization a success? Conversely, will foreign investors be welcome? How long will it take to produce the legal/institutional/regulatory framework that will shift the role of the state from an allocator of resources to a regulator and analyst of economic activity? Finally, from where will the resources come to diagnose and rehabilitate -- prior to sale or to productive operation -- the thousands of SOEs that will need financial restructuring, replacement or upgrading of obsolete technology, environmental safeguards, new management, etc.?

Despite the number and intensity of apparent problems, the fact remains that major and generally progressive changes have taken place regarding enterprise policy and functioning in this group of socialist countries. In each of the seven countries, the World Bank has been assisting the described reform programs both analytically and financially. Enterprise reform and privatization feature prominently in the Laos structural adjustment credit of 1989. These elements receive concerted attention in the structural adjustment loans presently underway or well-advanced in Yugoslavia, Hungary and Poland; and the same components are addressed in industrial and financial sector loans and projects, already signed in Poland and in preparation in the other two countries. In most of these operations and in Poland in particular, special attention has been paid to the construction and operation of a "social safety net;" i.e., measures to ease the social costs of adjustment and transition. Sectoral adjustment operations, projects, and analytical work in Mozambique, Algeria and China also deal directly with SOE reform. In sum, a surprising amount has already been accomplished; and enterprise reform efforts will multiply in the near future.

A Summary of Recent Enterprise Reform in Seven Socialist Countries

	Algeria	China	Hungary	Laos	Mozambique	Poland	Yugoslavia
1. RETAIN PUBLIC OWNERSHIP Restructure	Proposed emphasis of future reforms - Selected enterpises underway	No known SOE sector-wide reform	Sectoral restructuring in metallurgy, coal mining & construction. No central SOE restructuring agency	No known SOE sector-wide reform	Substantial progress on financial side Enterprise Restructuring Technical Unit	Industrial Restructuring Agency	Republican & Provincial Restructuring Agencies
Improve Government/PE Relations	Creation of Fonds de Participation	Production Responsibility System - increase of managerial autonomy	Hardening budget constraints creating auditing/ accounting standards	Operational and financial autonomy, but limited by worker control	Increased autonomy/ accountability	Proposed transfer of 2000 SOEs to local government; Imposition of financial discipline through dividend payments	New "Social Boards"
Improve Environment	Proposed competition through inter-fund trading	Beginning to discuss legal framework; talk of inter-regional competition	Opening economy to foreign ownership and trade	Reduction of financial subsidies	Competition encouraged through investment incentives (domestic & foreign)	Attempts to attract foreign investment; Enacting demonopolization	
2. LIQUIDATION	None to date - permitted under commercial code	None to date	Liquidation proceed-ings slated for a number of SOEs	Some	None to date -- some being planned	Some (10) to date-will be substantial	None to date -- becoming possible
3. PRIVATIZATION	None to date	None to date -- many joint ventures	Company Law, Transformation law permitting privatizations State Property Agency to orchestrate. Some privatization to date, many joint ventures	Varied forms being implemented 35 enterprises to date	Some sales and joint ventures	Ministry of Ownership Change created Plans for substantial sales, joint ventures and employee purchase Goal = 1000 enterprises in two years, none to date	Law on Social Capital opens doors to sales Restructuring Agency to negotiate and validate sales
4. APPROXIMATE NUMBER OF FIRMS	350	1,000,000	2,000	500	300	7,000	2,000

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