"Privatization and Structural Economic Reform in Latin America, Russia and Eastern Europe"

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Introduction:

Privatization methods and various kinds of economic policies (liberalization, stabilization and adjustment ones), differ greatly between market type of systems and those other which are engaged in the transition from socialism to market.

In the former kind of societies, privatization and other policy categories relate to the existing substratum of an existing market type of economy. As a result, privatization has either a revenue enhancing purpose or is part of a wider scheme directed at the improvement of the efficacy of the system. In the latter societies, privatization and accompanying policies have for their fundamental objective the structural change of the economy and beyond.

Obviously, structural system rebuilding is much more intricate, complex, uncertain and long-termed than the mere increasing of the efficiency of a market system. This is true even for the specific case of underdeveloped economics. Although less developed economies do required institutional changes in order to promote acceptable rates of self-sustaining growth, the sequential policy paths necessary to reach that purpose are better known than the corresponding blueprint to effect the transition from socialism to market. Clearly, there is much more theoretical work and empirical evidence to back market development than to institute a successful transition project.

Reference to Latin American and Eastern European privatization cases are pointed out in order to illustrate the alluded differences.

The eighties and nineties were the decades that culminated in the success of the market as the organizing principle of economic life. The practical lessons taught by developed economies in the Third World were a powerful factor in bringing about that realization. However, it was the disastrous performance of the Soviet economy and its somewhat surprising debacle at the end of the decade that really drove the point home. Equally important but more difficult to grasp is the truth that a necessary condition for the operation of a market economy is the adoption of private property as the central pillar of that system. Political interests and ideological blinkers have made difficult for many governments the admission of that self-evident axiom.

In the case of Latin America, perhaps with the exception of the Chilean and perhaps the Mexican cases, privatization has largely come about as an unintended by-product, at a remove, resulting from the catastrophic effects of the slow growth and the area's external debt and the consequent attempts to deal with those problems. Privatization has been the linchpin of the Latin American reform programs aimed at radically improving the efficiency of the area's economies. Adjustment policies and austerity measures are the cohorts of a more basic effort directed at the institutional reorganization of the economic system of the Latin nations.

The obstacles to privatization in Latin America are largely of a politico-economic nature. Large public enterprises, often times monopolistic in nature, frequently constitute veritable redoubts defended by the vested interests of one or another political faction or, simply, by the governing party. They represent an important source of employment in the bloated public sector of economies characterized by high levels of unemployment and a mine of economic privileges for those in power. Understandably, it is both risky and destabilizing in the short-run to disturb the status quo.

Let us exemplify the Latin American quandary by referring to the most salient cases of privatization in the area. From 1991 to 1995 Brazil expected to sell state enterprises to the tune of $15 billion. Major companies were put on the block, so that their shares would be purchased by domestic and foreign investors. Through this measure the country expected to solve several problems. One was the establishment of mechanism for mopping excess liquidity in the economy. Another was the containment of its fiscal deficits. An additional objective was the distribution of assets to the population in cancellation of public debts. In this fashion, the Brazilian government intended to use privatization as a palliative for several macro and microeconomic problems.

One of the characteristics of the Brazilian privatization scheme was tying the purchase of shares to its foreign debt outstanding. Actually, most of the funds available for privatizing state enterprises originated in the country's $50 to $60 billion of the foreign debt owed to private concerns. However, Brazil is now cognizant of the controversy in foreign domination of the business sector, so it has limited such debt-equity swaps to ownership of at most 40% of any given privatized company.

Similar challenges are confronted by other attempts in Latin America to place privatization at the center stage of structural and systemic reforms. The Latin American countries whose privatization drives have been the most massive are Argentina and Mexico. President Menem placed this effort at center stage of his business and economic reforms, to the extent of naming the daughter of his conservative rival, Alvaro Alsogaray, to head the government's program.

Although certain successes have been achieved in the sale of the airline and telephone companies to consortia of foreign and local interest through bidding processes, the instability of the Argentinean economy has substantially hampered the progress of privatization. Just the opposite has been the case of Mexico, where the solidity of the economic reform process has imparted strength to a privatization scheme emphasizing the sale of public companies to Mexican capitalists, involving partial repatriation of their holdings in the United States. A pivotal element is President Salina's plan was the return of the banking system, nationalized in the early eighties, to private hands.

Per contra, degree and rapidity of privatization in Eastern Europe is directly related to the willingness and ability of those societies to effect the transition from centrally planned socialist economies to a bona fide market system. Clearly, the disequilibrating consequences of privatization in eastern European countries would be much larger than in Latin America. In the former instance, we are really facing the reinstitutionalization of a society's economic system with all its attendant difficulties. Unemployment, lower output and income, inflation, termination or reduction of subsidies to producers and consumers, higher prices for essential goods, cutbacks in social services, need to assume personal initiative and face heightened individual risks, each and all interacted in generating a milieu marked by uncertainty and unfamiliarity. Thus the attraction of gradualism in the transition period.

Poland's initial big bang approach never held much favor in Hungary or Czechoslovakia. Still and all, Poland as of the late nineties has only privatized about twenty large enterprises, with another twenty being readied for that purpose, of a possible total of approximately 7,500 large and medium sized. Czechoslovakia, after a prolonged debate, has only brought itself to pass a law allowing for the privatization of small enterprises. Even though, unexpected problems may loom in the horizon as the result of a law committing the government to return property confiscated after 1948 to its former owners. Hungary, which is the only eastern European country to show enthusiasm for foreign investment and so-called spontaneous privatization (that which is initiated <u>motu proprio</u> by the management of a given enterprise), has of recent restrained its original eagerness because of criticisms of under pricing and favoritism. Plans have been announced for the privatizing of another twenty firms in the near future. In the former East Germany 8,000 state enterprises have been privatized or liquidated amidst the seemingly unending problems of the newly created agency (<u>TREUHANDANSTALT</u>) whose objective was to stimulate that process. Other more general hindrances shared by all the countries in the region, arise from the fact that many enterprises are simply money losers, their plant and equipment being obsolete and their technology outmoded, their organization and management poor and uncompetitive, their payroll inflated and their productivity and quality control abysmally low. To boot, they cannot be properly valued due to the absence of a competitive market price system, which obligates authorities to engage in frankly artificial calculations in estimating the minimum asking price for productive assets.

Obviously, all of the above was originally compounded in the particular instance of the Soviet Union given the fact that the government had not declared its intention of adopting the measures to desocialize the economy. Initially, the central planning system and Gosplan remained in place. The CPSU, the KGB, the Nomenklatura and the military did not seem resigned to the passing away of the socialist society. In the end, even President Gorbachev refused to give his support to the Shatalin plan and the private property principle.

Under the circumstances, one would have been hard put not to conclude that the future of privatization in the Soviet Union looked mighty dim and bleak. Unless a radical change were to take place in the direction in which the country was moving (as was the case with the failure of the August coup), it would have been safe to conclude that privatization was to be constrained to the small distribution sector of the economy and personal services, along with some possible relaxation of regulations to facilitate cooperative production in agriculture.

Later events in the former Soviet Union indicate radical changes in the politico-economic panorama of the eleven (or perhaps even twelve) republics which occupy, with the exception of the Baltic states, the territory of that once unitary state, the USSR.

Although Presidents Yeltsin, and Putin of the Russian Republic have been the most explicit of the new heads of state of the twelve sovereign republics, it is not possible even in their case to clearly elucidate the content of their economic reform program and its immediate and longer term impact on privatization and the establishment of a truly competitive market economy system.

Yeltsin's repeated criticisms of former Soviet President Gorbachev's inaction and indecisiveness in deepening and accelerating the program of Perestroika, as well as his decision of implementing radical price liberalization policies on short notice (January, 1992), showed his commitment to a profound program of economic restructuring of the Russian Republic.

In keeping with the above and following the general tenor of the Shatalin and Yablinski reform plans, and the more specific lineaments of the Gaidar initiative, along with the right to hold private property in the means of production and the decision to decollectivize the economy, has inevitably led to a surge in privatizing activity in Russia. However, at this time there is still not sufficient information available as to the nature of the actual mechanisms that would be utilized in the process of perfecting the system, if at all in the first decade of the XXI Century.

Nonetheless, it is quite possible to anticipate a broad variety of approaches to that momentous issue throughout Eastern Europe and the former USSR. Clearly, the particular pattern to be followed in each country will depend on a number of crucial factors that will vary from one country to the next. Among them: socio-cultural and historical characteristics; availability of entrepreneurial talent; need for external resources (capital, technology); nature and extent of foreign economic relations; claims by former owners of socialized property assets; total volume and allocation of productive investment during the tenure of socialist regimes; operative organizational and administrative modes of enterprises in the countries in question; and the like.

Generally, one may distinguish between attempts at a rapid and/or total approach to privatization in contrast to a gradual and/or partial policy towards same. Another distinction deals with ownership patterns and the priority to be given to the claims of several social groups. Namely, former owners or their successors (if any); workers and managers of enterprises; the public at large (or some segment of it); foreign investors and, also, potential domestic entrepreneurs. Ownership modalities may also include, of course, mixed forms of representation of these categories.

Naturally, depending on the relative weight ascribed to different interests and the procedural methods adopted to conduct the privatization process, the results will vary accordingly. By way of exemplification, vouchers have been directly distributed in a proportional manner for all enterprises to the population at large, subject to certain justifying criteria or, per contra vouchers have stood for stock ownership in groupings of firms akin to holding enterprises. Again, the vouchers may or may have not been immediately tradeable in stock exchanges or among the various holding companies, cartels or trusts. The latter, in turn, were administered by their managers and privatized only later on or, by contrast, rapidly transferred in ownership to those very same state managers with or without the equity participation of the enterprises' workers. Moreover, it was also the case that productive assets were auctioned among domestic and/or foreign bidders, whose participation would then largely depended upon the initial conditions and restrictions defined at the outset of the process.

As already remarked, in Latin America privatization has taken place in response to altogether different forces and circumstances. The external debt crisis is both directly and indirectly largely responsible for the frame in which the process has occurred. The former set of stimuli (direct ones) is related to practices such as debt swaps and the inducement of foreign investment, often times involving publicly owned enterprises, for the purpose of alleviating the burden of servicing a large debt. The second set of stimuli (indirect), more important than the first as a determining element of the drive towards privatization in Latin America, has to do with the general low level of comparative efficiency of the Latin American economies, considerably aggravated by the huge increase in the volume of external indebtedness which took place among those nations after 1974 and which finally eventuated in the crisis of 1982. Privatization, along with the whole panoply of adjustment and austerity policies which have constituted the common denominator of institutional reform and policy making in Latin America and the Third World generally are, to a large extent, the unintended consequence of the so-called debt crisis. Perhaps we should join the Smithian and Hayekian chorus in praise of the invisible hand which has thus brought us such glad tidings by exclaiming: Felix Culpa.

All of the above distills some lessons for the last and perhaps most interesting privatization of all, that of Cuba. The country shares the characteristics of both Eastern Europe and Latin America, and is thus a hybrid. However, in character the Cuban privatization would not be akin to that taking place in Latin America, since the entire production matrix would be involved. Only in Nicaragua has the wholesale aspects of the process achieved a degree remotely comparable to that expected to happen in Cuba.

The Cuban situation at present represents a version of communism that only exists in one other country: North Korea. This means that practically none of the Island's economy is in private hands.

It is expected that owners of assets from the pre-Castro era will appeal to the government for redress, intending to recover the use of their wealth. This will complicate a rapid transition to a private-property-based market system. Clearly such petitions must be heard, for philosophical, moral, legal and practical reasons, but unless they are summarily decided, they may tie-up the forthcoming process of economic reform in Cuba sine die.

After the situation posed by the claims of previous owners is disposed of, the Cuban government will have to decide which state properties are going to be privatized. Even though the final goal might be a degree of privatization similar to that, which exists in Latin America at present, it is impossible to have ipso facto privatization.

The best strategy for asset valuation and privatization in Cuba would be on the basis of the present value of the gross output of the firms involved. In this way the state would maximize the return from privatization benefits per unit of its own administrative cost, given that it would probably make a very slight difference to privatize a large or a small concern. Also it would provide new owners with the incentive of a prospective larger market as the economy experiences renewal and expansion.

At that juncture a decision will have to be made regarding the participation of foreign capital in the privatization and developmental effort in Cuba. Again, overall standards prevailing in Latin America could be a guide. The goal would be not to make foreign investment in Cuba a disproportionate share of the total national wealth. Some flexibility is warranted here, allowing for great variations in the foreign participation by sector, industry, and firm as well as its collateral benefits in each specific case. Besides, the overall dismal state of the Country's economy and the urgency of its reconstruction must be taken in consideration.

The participation of the Cuban population in these schemes is a final point of contention, since the reform of the Cuban society allows the possibility of creating large numbers of native entrepreneurs. Two general approaches are in competition here: benefiting workers or favoring the population as a whole. If personal productivity is to be enhanced, a significant participation of employees (individual proprietors or cooperative members mainly in agriculture) in the ownership of capital stock in the companies would seem to hold an advantage, while not giving away that much in terms of a populist version of social justice, since the population as a whole is clearly part of and directly dependent on its work force. The trick then is how to finance this participation over the relevant time horizon, rather than just giving away capital shares. However, judging from the standpoint of rapid and sustained development, economic effectiveness and the long-term well being of the population, rapid privatization to insiders or mass privatization in favor of the population at large, should be avoided. The requirements of nation building and economic recovery necessitate concentrated, capable and committed ownership and management of enterprises. Privatization must be transparently, responsibly and skillfully negotiated with that key objective in mind.

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