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PRIVATIZATION THROUGH INSTITUTIONALIZATION, WHEN IT IS NECESSARY TO CREATE THE MARKET AND THE STATE

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Jeffrey Sachs started a recent paper saying that "the need to accelerate privatisation in Eastern Europe is the paramount economic policy facing the region" (1991: 1). The assumption behind this assertion is that privatisation is a sine qua non condition to a the set up of a market economy - the main objective of economic reforms in Eastern Europe. In fact, this is the objective, but I don't believe that privatisation have such a priority in order to achieve this task. Standard privatisation - the transference of business enterprises to private ownership - is the only way to create a purely capitalist economy, but fast privatization is not the only way to create a market-oriented mixed economy. And most likely is not the more economically efficient and politically feasible way.

For sure, to privatize is the more obvious way to create both a market and a capitalist economy. And to privatize small enterprises is the easiest and more sensible thing to be done. The same, however, is not true in relation to large corporations and even to medium size ones. According to Sachs, small-scale privatisation of shops and other small service units has proceeded very rapidly in Poland. Till the end of 1991 around "60,000 shops were either leased or sold to private sector... In industry, however, the is far less bright. Of the estimated 3,107 industrial (mining or manufacturing) enterprises

in the state sector, only about 100 to 150 have been privatized to date"(1992: 2-3). If this is so, the question is why? Is it because the bureaucrats oppose privatisation? Or are there deeper reasons for that? In the last case, is there any alternative to simple privatisation, given that the inefficiencies of statist ownership are well known?

In this note, that is being written just a day before the WIDER conference on "The Transformation of Centrally Planned Economies: Lessons for Developing Countries", I will try to give tentative answers to these questions, starting from three propositions:

First, in order to create a market economy in Eastern Europe, the main task is not just to create the market, but the market and the state.

Second, the market is made of competitive units, but not necessarily of private ones; there are other forms or ownership, beside private and state ownership, that are effective and efficient in assuring competitiveness among firms; particularly, institutional ownership should be carefully considered.

Third, the debate on gradualism or shock therapy is misplaced. Economic reforms in Eastern Europe, as well as in Latin America, should rather be efficient, should minimize transitional costs. And this can be done gradually or in shock terms, depending on the case.

To Create also a State

The first proposition is essential to any reasoning on Eastern Europe. It is usually thought that in the Eastern European statist

system the state was big and strong, while the market was small and weak if not non-existent. Actually - and paradoxically - in this economic and political system there was not either a market or a state in the sense that we know in the capitalist countries. The economy and the political system were so mixed, so intertwined, that not only the market was not defined, but also the state was not. We learned, since Hegel, that in a capitalist society there is a state and a civil society or a market. Both state and market are interdependent. One does not exist without the other. It is impossible to think in the state as we know in the capitalist societies without the market. But nevertheless, state and market are clearly separated from the other.

This simple fact is being forgotten by reformers when they deal with ex-communist countries. They are fully concerned in creating a a market in Eastern Europe. They know that the market is an institution and that this institution depends on the state to be created. But they assume that the state already exists. So, the only two tasks to perform is, on one side, to create the legal institutions that assure the well functioning of markets - the commercial or securities laws, the foreign investment laws, the stock exchanges, the central bank, etc. - and, on the other, to privatize, to create the business enterprises that will play the market game. Instead, I am suggesting that, indeed the state, as the market, does not exist, or rather it exists in a very imperfect and incomplete way. So, we should be as concerned with the creation and strengthening of the state as of the market. In order to establish or consolidate the state, as to establish and consolidate the market it is essential to separate the

business enterprises from the state, but it is not necessary to privatize them, if we use this word "privatize"in its strict meaning. It is also possible to transform them from state ownership to "institutional ownership". If this second alternative is politically more feasible. If it can be achieved in a faster way than standard privatization, if the political obstacles are smaller, if this is a "heterodox" privatization strategy that strength the state, that increases its legitimacy, instead of weakening it, it should be preferred.

The state is very weak in Eastern Europe. It is economically weak. It is politically weak. Probably weaker than the state in Latin America, where the crisis of the state - a fiscal crisis and a crisis of the intervention or development strategy - is the basic cause of the deep economic crisis. To try to privatize the business enterprises in a hurry originates such a strong opposition and may be so costly - look, for example, what is happening today in Argentina were state-owned enterprises are been sold for nothing - that it may make the state still weaker, and, as a result, to deepen an economic crisis that is already very big.

Privatization and Institutionalization

But, before explaining what I mean by that, lets go to the second proposition: standard privatization is not the only way to have a market. The statist economies failed for one basic reason: they lacked competition. To coordinate resource allocation exclusively or mainly through the state, as it was attempted, is

intrinsically inefficient. The market is a more efficient resource allocator than the state exactly because it is intrinsically competitive. A state is formed of independent economic agents or independent firms, but not necessarily, private ones. They can also be institutionally owned, ie., owned by non-state ("non-government") organizations, particularly by foundations. They are not private because they are not the private property of anybody individually, nor are profit-oriented. They are collectively held by their associates or by a board representing in some way society, and are "objective-oriented", rather than profit-oriented. Their objectives will be stated in theirs constitutions. An intermediary objective for the board of the foundation will be to run well its assets, the final objective may be to invest in other companies, or to promote social welfare, technological development, scientific research, promotion of the arts, etc.

I am not inventing anything. Institutional ownership is already a very important type of ownership in the capitalist world. In contemporary capitalism we have private property, state property and institutional property. Institutional property does not control only hospitals, schools, museums, research institutions. It owns also real state and stocks of business enterprises. Not only foundations, that may be very rich, but also pension funds, are examples of institutional ownership.

Institutional ownership is consistent with the market as it is private ownership. Both lead to the control of business enterprises independently of the state. The essential condition for the market to work is the independence of the economic agents, ie, the possibility

they go bankrupt. The state, by definition, does not go bankrupt. Thus, state-owned enterprises are not supposed to go bankrupt. A foundation or a pension fund can go bankrupt as well as an individual. The firms owned by foundations or by individuals can go as well bankrupt. Thus they are consistent with the market and with competition. Beside this, they are consistent with the objective of creating the state and the market, separating the economic activity - that is supposed to take place in the market - from the political activity, that is performed by the government and the political parties in the realm of the state.

Proposal

Given these propositions and assumptions, I can go now to privatization in Eastern Europe. My point is that privatization will be more consistent with a stronger - and much leaner - state, if it is perform d principally, although not exclusively, through "institutionalization" - by the transference of the ownership of large business enterprises from the state to public institutions.

Privatization is moving slowly in Eastern Europe, and will continue to move this way, not only for technical reasons, but particularly because people is afraid of creating privileges, because everybody is concerned with the distributional effects of privatization. Everybody knows that privatization is only possible selling cheap. Everybody knows that some will win some will lose in the privatisation process. Unfairness or unevenness is part of the game. After all, entrepreneurs are supposed to be recompensed. But

unevenness has its limits. Moral limits. Political limits. And economic limits. Unevenness may be not the consequence of entrepreunership, it may well be the outcome of privilege., of being smart or opportunist. If privatization is too unfair, it will be politically damaging, and will seriously weaken the government that runs the state.

The transference of state property to institutional property will be much more easily accepted, because property will remain public. It will not benefit individual X or family Y but everybody - in the case of foundations - or the associates - in the case of associations of pension funds.

My proposal is that privatization be achieved in Eastern Europe essentially be the creation of foundations, that would immediately receive 40 percent of the stock of the business enterprises, that would be all joint-stock companies. 40 percent would be distributed to investment funds, commercial banks, pension funds, workers and managers, according to Sachs proposal (1992: 31-34). Each group would receive 10 percent. The remaining 20 percent would be sold by the Treasury to local or foreign investors.

Each large business enterprise or a group of large enterprises would have its respective foundation, that would have as its only asset 40 percent of the stocks of the company. Its only function would be to participate in the general assemblies of the company, electing its directory, and following its performance. It would have no permanent staff, nor offices.The dividends it would receive would be reinvested in the same enterprise, in another enterprise or the foundation could define a social or cultural objective where it would

apply the dividends. This last alternative would have the advantage of putting additional pressures on the board to have their stocks valuable and profitable.

The problem with a foundation is who runs it? Or, in benefit of whom is it managed?.The objective is to make it managed in the benefit of all, but this may well not happen.

A foundation is controlled by a board. If this board is fully self-appointed, it may well start protecting the interests of its participants. If it is appointed by someone else, this someone else may be the beneficiary. But, if the board is board is formed of indicated and self-elected members. If the indicated members are representative of three or four groups. If they are not entitled to remunerations except a very limited compensation for their time. If the elected members are supposed to represent society as a whole, we will have a system of balancing powers inside the board that will probably avoid diversions from the objectives of the foundation. A law regulating the creation of the foundations that would be entitled to receive stocks from the companies should be carefully designed, assuring that no individual group will have the possibility of controlling the formation in its own interest.

Let us suppose that the typical board of these foundations will have 11 members: two representatives of central government, two representatives of local government, two representatives of workers and managers, and five elected representatives of society. The elected representatives will be elected by the other members of the board, among representative citizens. In this way we will have the

balancing powers that will not permit the board to act in its self interest.

This foundation will participate of a second board of directors: the board of directors of the corporation, that probably will be formed mostly by the same members. In this second board, again, no remuneration will be permitted, except a jeton.

Conclusion

In the conclusions of the report on February conference on "Transformation form a System of Central Planning to a Market Economy" (WIDER, 1992), it is asserted that "it is clear from the experience of these and many other countries that structural adjustment is not an overnight process", and that reforms should be divided "into those that can or must be done rapidly (e.g. stabilization and price liberalization) from those which must proceed slowly (e.g. privatization)" (WIDER, 1992: 18-19). Indeed, privatization cannot be achieved overnight. But, as all economic reforms, it may slow or fast. It can be efficient, ie., not involving too much transition costs, or inefficient. It may politically oriented or it may be not. The essential thing today in Eastern Europe is not to privatize, but to consolidate a market and a state, separating one from the other.

Privatization through institutionalization may be a good strategy in this direction. It will also present problems. It will not be easy to create the foundations, i.e., to form the boards of the foundations and the boards of the corporations, to which the

managers will respond. The boards, in capitalist economies, theoretically represent stockholders, in a foundation, not. But notice that the difference is not big. Corporations will be judged by their market performance. They will fail or will be successful, depending on their capacity to adjust to market conditions, to be economically efficient and market-oriented. The foundation boards and the corporation boards will have the responsibility to choose the right managers, to decide on major policies proposed by management, and to follow their performance. There is a good chance that the boards will work. And in this way privatization, understood in this broad sense as encompassing institutionalization, will proceed faster and more smoothly than otherwise.

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