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Modelling the Privatization Process in Transition Economies

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ABSTRACT *Alternative economic paradigms give rise to alternative models of transition, which give rise to alternative privatization processes for transition economies. This is because each transition model is associated with a unique privatization process compatible with the predetermined assumptions and value judgements of the paradigm in question. As a result, five alternative models of transition that give rise to five alternative privatization processes are considered: the shock therapy model of transition; the neoclassical gradualist model of transition; the Post Keynesian model of transition; the pluralistic market socialist model of transition; and the Chinese model of transition. The privatization method adopted is directly linked with the value judgements associated by the economic paradigm in question. Comparisons of privatization processes that ignored the value judgements of economic paradigms were meaningless.*

1. Introduction

Building knowledge in economics is not a straightforward matter of applying an agreed logic to an agreed set of facts; consequently, ideology takes on great importance. Value judgements are what we use when there is no clear demonstrated conclusion. Value judgements are of particular importance for economics, because the subject matter keeps changing and also because theorizing requires abstraction. This results in competition between alternative economic paradigms derived from scientific observation and procedure. Empirical testing cannot provide a final resolution, since empirical tests themselves are theoretically based (Lee, 1990, p. 263). Theoretical analysis in a social theory like economics "inevitably has a casual story to tell" (Dobb, 1973, p. 30). Different types of "casual story" may have very different implications for what it is possible to do and to achieve by way of policy and social action; thus it is relevant, indeed crucial, for establishing what alternatives are viable within a given politico-economic-ideological framework. The "battle of ideas" in the transition case focused on which paradigm was most realistic, feasible, desirable and appropriate for the process in question. Awareness of such a background facilitates the interpretation of the less clear sources of disagreement between economists and of the overall complexities involved in transition economies.

Hence, different economic paradigms give rise to alternative models of transition.

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Table 1. Alternative models of transition

Primary elements	Models of transition: Shock therapy	Neoclassical gradualism	Post Keynesian	Pluralistic market socialism	Chinese market socialism
Economic analysis	Neoclassical	Neoclassical	Post Keynesian	Marxism	Marxism Maoism
What is a good society?	Competitive capitalism	Competitive capitalism	Social democratic capitalism	Market socialism	Market socialism with Chinese characteristics
Speed	Shock therapy	Gradualism	Gradualism Self-interest	Gradualism Self-interest	Gradualism Self-interest
Ideology	Self-interest	Self-interest	Common good	Common good Participation	Common good Participation through the party
Methods of privatization	Restitution, liquidation, auctions and free distribution of vouchers	Liquidation, auctions	Restitution, liquidation, free distribution of vouchers, financial intermediaries, labour-managed firms	Labour-managed firms, leasing of land and capital	TVEs, private enterprises in special economic zones, leasing of land.

The aim of this paper is to consider the privatization of state enterprises in transition economies as a result of alternative models of transition, based on different methods of economic analysis, different views of what is a good society, different speeds of implementing the transition policies and different value-systems i.e. ideology. Thus, the alternative models of transition are distinguished on the basis of economic analysis, what is a good society, speed and ideology. As a result, five alternative models of transition are considered: the shock therapy model of transition; the neoclassical gradualist model of transition; the Post Keynesian model of transition; the pluralistic market socialist model of transition; and the Chinese model of transition. The alternative models of transition are presented in Table 1.

2. The Role of Privatization in the Transition Process

Most economists identified the privatization of state enterprises as the most pressing issue to be solved in transition economies. Private property is the foundation of market economies: without private ownership the market cannot exist, and vice versa. However, the establishment of private property did not exclude the development of other forms of property. Whether a majority or minority of property should be privately owned depended on what was deemed to be a good society (see Table 1).

Nevertheless, establishing effective private ownership was an essential prerequisite for the creation of a market economy. This faith in private property is based on the incentives that it produces which always guarantee the efficient use of resources and eliminate shortages. The privatization of state property had additional objectives, such as providing revenue to the government, stimulating the restructuring process and enticing foreign investors to became active participants. There was no historical experience of privatization starting from a centrally administered economy without private property and a capitalist class. The lack of any historical parallels gave rise to a new set of problems, such as to whom to sell, how and what to sell, and whether considerations of equity and fairness should be taken into account. The answers to these questions were linked to the following alternative ways in which privatization could take place:

(1) *Restitution.* There was a legal requirement for property to be returned to the rightful owners, where former owners existed and could prove their past ownership before the state expropriated their property, or for the provision of compensation. The success of the restitution process depended on the existence of the past owners, of the appropriate documentation and political judgement about which acts of expropriation to redress.

(2) *Sale of state property.* Kornai (1990, p. 83) and Chubais & Vishnevskaya (1997, p. 74) argued strongly that the transformation of state property into private property could only take place by auctioning state enterprises and selling them to the highest bidder. In this way, all individuals would have the opportunity to become owners at real market prices. Foreigners would also have the ability to participate so long as some guidelines were imposed to protect the nation's interests, which, of course, depended on what was considered to be a good society. This national policy, however, should not be based on isolationism or xenophobia. An obstacle to be overcome was that the financial assets of the people were not adequate to purchase state enterprises. This problem could be solved by the state providing loans to finance purchasing of state enterprises.

(3) *Financial intermediaries.* This involved the transfer of ownership of enterprises to financial intermediaries whose ownership structure may consist of pension funds, worker and/or management funds, citizen funds, or private financial institutions such as banks and government agencies. The advantage of this method was that it was fast and could be viewed as equitable. However, a loss of government revenue was involved. There was also a shortage of experienced financial managers operating in a market environment who could administer these financial intermediaries efficiently.

(4) *Distribution of vouchers.* Under this scheme, every adult member of the society was supplied with vouchers that could be used to buy shares in the enterprise in which they worked or at a share auction, to subscribe to investment funds, or sold for cash. This was privatization through free distribution of shares to the whole population because all citizens had contributed to the development of state enterprises through their taxes. This type of scheme was adopted in Russia, Czechoslovakia, Lithuania, Mongolia, Poland, Romania and Latvia. Free distribution could be justified on the basis of equity, since those who were otherwise able to purchase property were likely to have accumulated wealth either illegitimately or by abusing their power under the previous regime. The advantages of this method were speed, relative transparency and the creation of an instant capital market, less political opposition from insiders and popular support for the reform process. In addition, it helped develop a shareholding culture. The scheme was also difficult for a future government to reverse. A counter-argument was that

property acquired for nothing might not be treated seriously. However, the market process would be able to solve this problem, since those who were not intending to use their shares productively would sell them to those who would. The free distribution of shares would be an unattractive solution, however, if the goal of privatization was to increase government revenue.

(5) *Spontaneous privatization.* The collapse of the centrally administered system conveyed power to the enterprise management and provided managers with the ability to appropriate state enterprises for their own benefit. In other words, those who managed state enterprises took possession of the enterprise's assets and transformed them into a joint-stock company, thereby effectively becoming owners of the enterprise. This was an easy way out of tackling the complexities involved with privatization and could also be implemented very fast. However, it violated the principles of equity, since managers became owners by, in effect, confiscating the enterprise. In addition, there was a high probability that efficiency might not increase when people who formerly managed these enterprises poorly now owned them. Spontaneous privatization was motivated by managerial self-interest and there was an inclination for managers to lower the value of the assets, consequently being able to secure the enterprise at a very low price. It was a selective privatization process without pluralism, consultation or debate, an auto-appropriation process by the few well-informed individuals in a position of power.

(6) *Labour-managed firms.* Another alternative was to transfer the ownership of the enterprises from the state to the workforce, creating labour-managed firms. This had the advantage of very low administration costs and it could be implemented extremely rapidly. In addition, labour-managed firms had a useful role to play since they would be able to fill the gaps left by the private and state sectors. Unsuccessful state enterprises might become labour-managed firms.

(7) *Management and employee buy-out (MEBO).* Enterprise insiders are a composite group, where workers and managers purchase the enterprise. However, MEBOs do not distinguish between managerial ownership and labour ownership. The reason for this provided by Frydman *et al.* (1999, p. 1170) was because enterprises owned by managers or employees "are statistically impossible to differentiate from each other in terms of their post-privatization performance which makes it quite natural to look at them together".

(8) *Leasing.* For some state assets, where privatization was not desirable or not possible due to the high risks involved, privatization could take the form of leasing state property to individuals. As long as the lease or rent was market-determined, this would result in the productive exploitation of resources, as well as the creation of the preconditions for transforming these assets into private property.

(9) *Asset privatization through liquidation.* For unsuccessful enterprises that could not be restructured, and shares of companies that could not be sold, the government could initiate liquidation proceedings and sell the physical assets owned by the state enterprise. This process would facilitate the reallocation of resources to the most productive activities.

The dominant method of privatization depends on value judgements with regard to equity and speed. The shock therapy model was in favour of the immediate privatization of state enterprises through restitution, liquidation, auctions and free distribution of vouchers. Conversely, neoclassical gradualists were in favour of a slower pace of privatization though liquidation and auctions. Post Keynesian economists were in favour of a gradual privatization process, which would involve restitution, liquidation, the free distribution of vouchers and the transferring of ownership to financial intermediaries that were state controlled. Labour-managed firms were also favoured. Pluralistic market socialists favoured transferring ownership to the workers and, thus, encouraging the development of labour-managed firms to enhance participation and retain a large percentage of state-owned enterprises together with leasing land and capital equipment and the privatization of small enterprises. The Chinese socialists suggested the retention of state enterprises and encouraged the development of co-operatives in the form of township and village enterprises (TVEs) and private enterprises in special economic zones together with the leasing of land (see Table 1).

In the following an analysis is made of alternative privatization methods as a result of alternative models of transition.

3. The Shock Therapy Approach to the Privatization Process

The industrial structure under the command system was inefficient, since state enterprises were inefficient and prone to financial crisis. This was because of internal rent-seeking and the imposition of non-economic goals by governments upon state enterprises, which were used as instruments to serve personal goals. Thus, privatization aimed to reduce political interference in the economy. The undesirable functioning of state enterprises was due not only to soft budget constraints, but also to the principal–agent problem. Marketization without privatization was not considered a viable alternative. The experience of Russia, Eastern Europe and China revealed that marketization without privatization destabilized the economy, increased inflation and the likelihood of corruption and did not heighten efficiency (Woo, 1997, p. 320). There was a need for a radical change in the property structure by reducing, restructuring, modernizing and privatizing state enterprises. Consequently, "until privatization has been accomplished, the economic crisis is likely to persist" (Aslund, 1992, p. 87).

The dominant form of ownership had to be private. Private ownership of enterprises constituted the ultimate form of decentralized property rights because individuals owned their equity, which was freely transferable. Without private property, effective market relations could not have existed. "When there are no capitalists there is nobody to represent the interests of capital" (Sachs, 1993, p. 29). When there was a dominance of state ownership, it was impossible to maintain financial discipline under a soft budget constraint. In this context, private ownership of unprofitable firms was still desirable (Aslund, 1995, p. 267). However, a market economy did not prohibit other forms of property, as long as they survived the market test.

In addition, privatization was a means of increasing popular support for the whole reform programme. Political support for the reform programme reduced the power of opponents, altering the balance of political power. For example, in Russia the populist character of the voucher system of privatization preserved the whole privatization programme (Shleifer & Boycko, 1993, p. 51). Political support for privatization resulted in a positive externality in facilitating reforms in other areas. In addition, immediate privatization could have produced the goods that consumers wanted. Privatization of state enterprises was a means of reducing the budget deficit, even in the case of a non-sale of state enterprises such as the transfer of state enterprises to pension funds, in this way reducing the budget obligations for social security payments.

While asset privatization through liquidation was a desirable means to reallocate recourses, not all firms had to be liquidated, provided there was appropriate restructuring as a result of privatization, the development of new enterprises and the opening of the economy to international competition. The proposal to prepare state enterprises for privatization through corporatization under the direction of the government, a popular "transition measure" in mature capitalist economies, was not acceptable to shock therapy supporters. It was considered to be undesirable and an unnecessarily time-consuming process that would have resulted in an extremely slow privatization process. The government had to focus on establishing a framework for privatization and not be actively involved in the restructuring of state enterprises. The government did not have the knowledge or the ability to restructure enterprises. That was the responsibility of the private owners. Enterprises had to be privatized first and then restructured under private ownership. The private owners possessed a great deal more information and incentive to restructure the enterprise in an efficient manner. Moreover, the proposition of developing necessary measures to ensure that "perfect owners" acquired the enterprise was senseless. The market alone could have selected the perfect owners, by using the objective yardstick of efficiency; therefore, there would have been no need to use any discretion. "Only a sufficiently pluralistic market can generate sound owners" (Aslund, 1992, p. 75).

Labour-managed firms were out of the question (Chubais & Vishnevskaya, 1997, p. 69). This was based on the traditional efficiency objections to labour-managed firms. It was even less proper to transfer ownership to the management, which constituted an even smaller percentage of the workforce in the enterprise. It appeared that spontaneous privatization was faster and less time-consuming. However, the problems associated with spontaneous privatization were not only economic but also political. The appropriation of state enterprises by managers, through spontaneous privatization, resulted in social unrest, which questioned the political legitimacy of the government. Hence, there was a need to develop a suitable legal framework, especially "conflict of interest" laws to prohibit spontaneous privatization and discourage labour-managed firms. In addition, the transitional measure of transforming state enterprises into state-holding companies was undesirable, as this was likely to become a permanent mechanism and state enterprises would, thus, not have been privatized. In the end, shock therapy supporters conceded that giving a share of ownership to workers and managers was an important strategic move. Management and employee buy-outs were not based on ideology or justice, but rather on the need to facilitate rapid privatization. In this way, both workers and managers were transformed into supporters of privatization (Aslund, 1995, p. 20).

In this context, shock therapy supporters argued that the development of new firms as a means of stimulating growth should not be underestimated. Since the efficiency gains of privatized firms would take some time to materialize, any improvement in economic conditions in the short run would have come from the establishment of new firms. Actually, the birth of a private ownership market economy would be the result of two mechanisms: "bottom-up privatization", whereby new private firms are formed; and "top-down" privatization, in which state enterprises are privatized (Sachs, 1992, p. 44). The main effect of introducing market relations was the origination of new firms, which could be used as a measure of success. The increase of competition due to new firms had a major influence in depoliticizing state firms. However, economic welfare could be maximized only if state enterprises were privatized. The development of new private firms was not a substitute for restructuring and/or privatizing state enterprises. This was because the private sector did not develop in a vacuum: the restructuring and reduction of the state sector were crucial for the genesis of the private sector.

Privatization and financial restructuring manifested the greatest intellectual and political complexities of the entire transition programme. This was due to privatization being driven by many conflicting objectives. Firstly, there were issues of fairness, compensation, restitution, enterprise efficiency, budgetary revenues and employment concerns. Secondly, it was based on previously unknown methods such as vouchers, management acquisitions and worker buy-outs, which were characterized by administrative complexity as there were thousands of small, medium and large enterprises that operated within a legal vacuum, incomplete markets, and were fraught with the possibility of corruption.

I believe that the concerns and reservations that shock therapy economists had about the privatization process were unfounded. The aim of the shock therapy process was to develop an economy based on market relations without the presence of discretionary power. In such an environment, it did not matter who the initial private owners were because ultimately the only firms that could have survived were those employing efficient management practices. Therefore, whether the privatization process gave ownership of state enterprises to the workers or management, or to members of the society, they would only have been able to retain their ownership rights if they had used their property productively by satisfying market demand at minimum cost. If they had used their ownership for non-market purposes it would have increased the costs of production. In the long run, in a competitive environment, this would have resulted in a substantial fall in consumer demand for the goods produced by the enterprise, endangering the viability of this enterprise. For example, if labour-managed firms increased wages instead of repaying their loans, it would result in bankruptcy or take-over and the removal of their ownership rights and possibly their employment. Labour-managed firms would survive in a free market environment if, and only if, they satisfied market demand at minimum cost, as private firms did. These firms would lose the characteristics that made them labour-managed.

Nee (1996, p. 913) argued that, due to market competition, collective ownership in China had led to behaviour by the collective owners similar to that of the owners of private firms. Hence, in a competitive market, which was the ultimate goal of shock therapy supporters, only efficient owners and efficient behaviour would be able to survive, independently of how the initial distribution of ownership took place. Yavlinsky & Braguinsky (1994, p. 105) stated: "the *laissez-faire* argument maintained that it does not matter who the initial owners are. It is sufficient to create free trade in new assets claims, and the most efficient owners will eventually take over". The establishment of competitive market conditions ensures that managers serve the interests of the enterprise. In addition, the development of small and medium-sized enterprises, and the spread of entrepreneurial motives, helped force enterprises to behave in an appropriate manner.

Aslund (1995, p. 247) justified "irregular privatization" in terms of avoiding the obstruction of privatization by interest groups. In a free market process, as long as "irregular privatization" did not institute discretionary power, it was desirable. Consequently, the development of a free market process would have derived an efficient ownership structure, making the method of privatization unimportant as long as the privatization process was rapid. Ownership of property by the Mafia was not desirable because they did not respect the rules of a competitive market.

4. The Neo-classical Gradualist Approach to the Privatization Process

A competitive market capitalist system required a dominance of private property because "there cannot be capitalism without capitalists" (Gustafson, 1999, p. 26) and "common property is nobody's property" (Carrington, 1992, p. 23). However, the efficiency virtues associated with privatization—the main instrument of overcoming the recession and stimulating growth and employment—were "a simplified misconception of the real relationship" (Kornai, 1994, p. 50) and policies were aimed at artificially accelerating the privatization process. Both privatization and liberalization were simply instruments of economic policy, not targets, and privatization of state enterprises was very painful. This was because politicians would not have given up their control of state enterprises easily. Meanwhile, "state-owned enterprises have become dependent on the paternalist helping hand of the state and the constant availability of a bail-out, just as many weaker-willed individuals become addicted to the relief of smoking, alcohol or drugs" (Kornai, 1995, p. 148).

Based on the gradualist approach, growth would have resulted from the development of new enterprises in the short term. In the long run, growth would have resulted from the privatization of state enterprises and the enforcement of hard budget constraints. In contrast, the shock therapy supporters argued that growth in the short run would have been the result of privatization. The shock therapy economists were "stuck on the theme that one is to create the new economy by privatising the old" (Leijonhuvfud, 1993, p. 124). Immediate privatization resulted in a reduction in output, increased unemployment and a reduction in aggregate demand. Considerations of growth were not given due attention; there was a negative relationship between the speed of privatization and economic performance (Kornai, 1996, p. 37; Murrell, 1992b, p. 80). By implementing a gradualist approach to privatization, it was the responsibility of the government to ensure that an appropriate balance was achieved between short-term anti-recession goals and long-term growth goals. Consequently, the immediate privatization of state enterprises was not necessary, since theoretical and empirical evidence indicated that rapid privatization was utopian and misplaced in the transition process. The gradual process of transition required not only a slow process of privatization, but also, more importantly, its postponement. The neoclassical gradualist economists favoured "deferred privatization", and even though Kornai (1992, p. 174) claimed that he was a "believer in the process of privatization proceeding as fast as possible", he did not think it could have been "accelerated by some artful trick".

Consequently, by approaching the privatization issue from this point of view, the question was not how to privatize state enterprises but rather how to develop the appropriate conditions to stimulate the development of new enterprises. A suitable legal environment and an appropriate institutional structure were essential. The privatization process consumed most of the already scarce resources, thereby hindering the growth of new enterprises. There was an inverse relationship between the amount of privatization and the rate of growth of new enterprises (Murrell, 1992a, p. 46). In addition, the experience of developing countries showed that growth had taken place through the development of new enterprises, not by adapting the existing ones (Krueger, 1992, p. 221). Thus, it was argued that, instead of speculating on the speed and the type of privatization, reformers should have concentrated on the development of new enterprises, restricting the development of monopolies and developing an appropriate institutional framework. This would have resulted in a set of conditions where the speed and the type of privatization process would not have been significant.

The interests of society would not be served by immediate privatization, since the tax agency would not be efficient in collecting tax revenue. Neo-classical gradualists were in favour of firstly restructuring and corporatizing state enterprises, and privatizing these organizations later. The experience of the transition economies revealed that terminating soft budget constraints and liberalizing prices, foreign trade and commercial activity encouraged enterprise restructuring independently of ownership. Thus, the "ownership structure and the modus operandi cannot be changed overnight by legislative 'gunpowder' " (McKinnon, 1992, p. 35). In actual fact, privatization of any variety was a political issue, which might result in the re-nationalization and deferment of privatization. Consequently, in a democratic society, neither the sequencing nor the speed of privatization could be planned, since it determined "who will eventually get to the sunny or the shady side of this evolving capitalist paradise" (Jarai, 1993, p. 78).

Kornai (1990, p. 83) argued that the transformation of state property into private property could only have taken place by auctioning state enterprises and selling them to the highest bidder. Privatization could help to increase state revenue through the proceeds of selling enterprises. The Hungarian government was in agreement with Kornai that privatization had to result in "real owners" or "strong owners" rather than artificial recipients of state assets. Privatization revenues had to fund the budget deficit and reduce public debt. This was considered a major advantage of the sales strategy over the free distribution of shares.

Kornai (1992, p. 157) did not show any enthusiasm for compensating the original owners of enterprises. In Hungary, original owners were eligible for compensation vouchers. Owing to the auctioning of state enterprises, all individuals would have had the opportunity to become owners at real market prices. The frequent argument against privatization by sale was that the accumulated public savings were too small to buy the state enterprises. Experience revealed that this was not the real bottleneck in the privatization process (Kornai, 1997, p. 159). The deferment of privatization allowed the development of a domestic entrepreneurial class with proven managerial expertise to accumulate sufficient capital to buy state-owned industrial assets.

Foreigners would also have the ability to participate, so long as some guidelines were imposed to protect the nation's interests. The national policy, however, should not be based on isolationism or xenophobia. The government would have to regulate the participation of foreigners. Through the privatization process, most property should remain "in national hands, because they are indispensable to sovereignty"; in other words, "capitalism should strike root primarily in domestic soil" (Kornai, 1992, p. 174) so as to foster the development of domestic entrepreneurs. In Hungary, foreigners dominated the purchase of state assets. In 1991, 85% of the 40.1 billion forint of privatization revenue came from foreign investors (Samonis & Hunyadi, 1993, p. 38; Jarai, 1993, p. 80).

The neoclassical gradualist economists did not favour the privatization of state enterprises through the free distribution of vouchers or through financial intermediaries. Kornai considered it curious "to turn all citizens into shareholders overnight by a free distribution of shares" (Kornai, 1992, p. 172). With shares distributed so widely, the monitoring problem was not solved. In Hungary, officials contemptuously dismissed free distribution schemes as dangerous experiments, incapable of producing "real owners". There was no justification for the distribution of free gifts beyond the discount price of share purchases by employees and the distribution of property to pension funds and non-profit organizations.

In conclusion, the neoclassical gradualist economists did not favour immediate privatization. The democratically elected government had initially to gain control of state enterprises and make managers accountable prior to privatization. Ironically, large state enterprises had to be renationalized before they could be privatized, and even then the gradual neoclassical approach would not have been gradual. Instead of a gradual process of privatization, enterprises were put up for auction. Hence, the gradualist privatization process was more a "deferred big bang privatization" process. The only difference between the gradualists and the shock therapy supporters was the proposed timing of privatization, not its speed.

5. The Post Keynesian Approach to the Privatization Process

According to the Post Keynesians, large-scale privatization was not essential to overcome shortages as the neoclassical transition models stipulated. It appears that the soft budget constraint explained inflation rather than shortages (Ellman, 1994, p. 11). However, selling state enterprises to the highest bidder, as recommended by neoclassical gradualist economists, violated equity principles. The amount of savings available in the transition economies was not enough to finance a large privatization drive. The only people who could have purchased firms were those who had benefited under the previous regime through black-market and illegal activities. The typical answer from mainstream economists—"the firm is worth whatever someone is willing to pay for it" or "let the market decide"—was problematic where there was not yet a market and where, in fact, the explicit motive for the sales was to create a market. There were political as well as equity reasons against auctioning firms because there would have been a lack of support from the majority of the people, the true owners of state assets.

Vickers & Yarrow (1991, pp. 113–118) argued that empirical evidence demonstrated that private property had efficiency advantages in competitive conditions, but was not superior when there was market power. Meanwhile, when state-owned firms were subjected to competition similar to private firms, their performance was superior. It was not ownership that determined efficiency but environmental factors. Thus, the development of competitive conditions and a regulatory framework should have been the goal, not ownership. The case for privatization in the transition economies became even less clear when the underdeveloped markets for capital, corporate control and managerial labour were considered. The absence of a capital market where take-overs could be initiated, the lack of corporate control in the form of institutional norms and the substantial imperfections in the managerial labour market could only have promoted managerial failure. Under these conditions, enterprise managers did not behave in an "optimal" way, as prescribed by the neoclassical model. This actually facilitated "spontaneous privatization"—the transformation of state enterprises into joint-stock companies—whereby the managers became the new owners.

The Post Keynesians concluded that no form of ownership was perfect. Private firms suffered market failures, a divergence between private and social benefits and costs. Public enterprises experienced government failures, a divergence between political and social benefits and costs. Therefore, private ownership with competitive and regulatory markets, while eliminating government failure, still gave rise to market failure. The more desirable ownership structure depended on the magnitude of the imperfections. Consequently, there were no firm guidelines with respect to appropriate ownership structure. The experience of mature market economies demonstrated the variety of ownership structures in these economies and the changing character of ownership structure over time. As such, the framework of political and social institutions, traditions and history, and the state of economic growth of the particular country, had to be included in the analysis of the development of property relations. There was thus no single ideal strategy with respect to privatization. It had to be done on a case-by-case basis, depending on the type of asset, the internal organizational structure, the level of technology and the need for capital.

The implementation of the shock therapy model of privatization resulted in a "cruel deception" in which many individuals colluded, a few profited, and the public at large was the great loser (Oberschall, 1996, p. 1039). Privatization, in an environment of hyperinflation and instability, could only breed corruption. Instead of the development of an efficient private ownership structure, managers responded to the high level of uncertainty by breaking their firms into numerous joint-stock and limited liability companies along divisional, factory, departmental and workshop lines. This gave rise to a new form of ownership, which Stark (1996, p. 1014) named "recombinant property": "recombinant property is a particular kind of portfolio management. It is an attempt to have a resource that can be justified or assessed by more than one standard". In this way, managers and banks controlled and reaped the benefits of the most profitable parts of the enterprise, while the unprofitable, loss-making and inefficient parts became the responsibility of the state. Recombinant property did not increase efficiency because, firstly, it did not reduce monopoly power, since the same management effectively still controlled the numerous break-ups. In addition, there was a loss of economies of scale. Rather than genuine restructuring, there was a transfer of the responsibility to state.

The initial distribution of private property was paramount for the Post Keynesians, in contrast to the neoclassical approach, shock therapy or gradualism, since the initial distribution of property would have determined those members of society who would start from an advantageous position. In an environment in which market power was permanent, due to the nature of technology and industrialization, the "free" market process would not have been able to alleviate any of the arising inequalities. Rather, these inequalities would increase in magnitude. In relation to whether restructuring should precede privatization, the answer was clear for the Post Keynesians. They believed it was the responsibility of the government to use discretionary measures to ensure the viability of enterprises before and after privatization. The government should assist and equip enterprises with the essential internal structures necessary to survive the competitive market process.

In summary, for the Post Keynesians, there could be a transition to a market economy without a substantial change in property ownership. This was because ownership, as such, was less important than competition, the incentive structure and the nature of regulatory policies. There would be no gain to society if state enterprises were replaced by private monopolies. Thus, restructuring and the establishment of the regulatory framework needed to precede privatization. However, "some critical minimum of property rights reform may have to be undertaken quickly, for democracy without a solid market economy is unthinkable" (Van Brabant, 1991, p. 35). Post Keynesian methods of privatization would incorporate restitution of state property to the rightful owners and liquidation of enterprises that could not have been revived. In addition, efficiency and equity would guide the process and this would only be possible through the distribution of free shares to the people. The government would need to retain a percentage of shares as a source of revenue, with the balance going to the workers, to pension funds, in order to finance retirement benefits, and the rest to the population.

Such an exercise would attract political support from the people. The transfer of state property to financial intermediaries was another alternative to outright privatization. The advantages were that it was less time-consuming and people with specialized skills would have been in charge. In addition, free shares to the workers would provide them with a financial incentive to restructure their operation into a more efficient one based on their "inside" knowledge. Labour-managed firms were viewed favourably by Post Keynesians. Post Keynesians believed worker motivation would increase to make enterprises efficient and profitable, at the same time mobilizing support for the transition process. Labour-managed firms required government financial assistance and an appropriate institutional structure so that they would not be disadvantaged. Labour-managed firms could become a transitional mechanism, allowing people gradually to adjust their behaviour in a participatory environment. It was up to the reformers to exploit and develop further the existing co-operative property structure.

6. The Pluralistic Market Socialist Approach to the Privatization Process

In conditions of general uncertainty, it was impossible to carry out privatization without weakening economic links and undermining managerial confidence and efficiency. This resulted in destabilizing production, destroying productive forces, increasing unemployment and generally deepening the crisis. Privatization simply resulted in enriching the managers, without any benefit to the workers or to production. The collapse of central administration passed power from the central authority to the managers, who appropriated—"stole"—the enterprise's assets through spontaneous privatization, transforming themselves into a new bourgeoisie. In Russia, due to the sluggish institutional structure, the former Russian nomenclatura, often in collaboration with Mafia-like groups, allegedly composed of former KGB officers, was more successful than its central European counterparts in turning public property into private wealth. Eyal *et al.* (1997, p. 62) characterized post-Stalinist central Europe as "capitalism without capitalists", while the emerging Russian structure was "capitalists without capitalism".

The myth behind the development of the widespread ownership of private property through the free distribution of vouchers—"people's privatization"—had not materialized, nor had the dream of "people's capitalism". For the transition towards capitalism to succeed, it was essential to gain the support of the managers. Support was gained by allowing management to keep its privileged position and, at the same time, to increase substantially its fortune despite the "free distribution of shares". Control still rested with management, who disregarded the owners of vouchers. They considered vouchers to be inconvenient, as they did not help raise capital but required a dividend payment. In many cases in Russia, managers encouraged workers to buy more shares in the enterprise so as to strengthen their own control, which resulted in the concentration of large amounts of capital in the hands of the few. Finally, the bureaucracy "got what it wanted: a title to property and the right for the first time to be defined as a 'class' in its own right" (Ticktin, 1998, p. 90). In such an environment "it is not the state which is privatising the soviet enterprise, but the soviet enterprise which is privatising the state" (Clarke, 1992, p. 5).

At the end, "not only despite, but because of marketization" (Parish & Michelson, 1996, p. 1045) through the free distribution of vouchers, a dominant class of private owners emerged. Market socialists were not at all surprised by the outcome. The voucher privatization of state enterprises in transition economies was reminiscent of Roemer's coupon economy. Roemer (1996, p. 386) & Bardhan (1993, p. 149) demonstrated that, if vouchers representing shares in the nation's firms were equally distributed to all citizens and held as traditional private property, with the right to sell, such vouchers would have rapidly become concentrated in the hands of a few. It was individually optimal for the weak and disadvantaged to sell the vouchers. Under Roemer's (1994a, p. 73) version of market socialism, the poor and the middle class would have been only able to exchange, not liquidate, their vouchers and, therefore, would have remained the dominant voucher-holders.

For the market socialists, the initial distribution of ownership was a major concern, because it determined the distribution of power and influenced equity and efficiency. Because markets did not approximate perfect competition and were dominated by domestic and international monopolies, the initial distribution of power increased inequalities. In addition, privatization, through the distribution of free vouchers, did not change the competitive environment. Thus, monopoly power was not reduced and success in business was linked inextricably to the personal relations enjoyed. As a result, the entry of new firms was obstructed and innovation stifled.

The transition economies lacked private capitalists with the necessary financial capital to purchase enterprises, making foreign ownership the only alternative. It was not by coincidence that foreign capital came to the rescue of transition economies. This was an act of purposeful action by the mature market economies, ensuring that foreign ownership was the only permissible medium of privatization. A process like shock therapy implicitly had the goal of initiating the destruction of any institutional barrier inhibiting the penetration, influence and power of foreign capital. The market socialists argued that the International Monetary Fund and the World Bank were responsible for creating the depression in transition economies through the collapse of domestic markets and COMECON, the development of the hard budget constraint, and the provision of foreign aid conditional on satisfying specific "shock therapy" targets. In such an environment, the only interested buyers come from abroad at a price "for next to nothing" (Gowan, 1995, p. 45). There was "a brutal struggle to steal everything they could get their hands on" (Holmstrom & Smith, 2000, p. 7). Equally important was the pressure exerted on governments from transition economies to sell state assets and public utilities to multinational companies (the only possible buyers) to reduce fiscal deficits, lower inflation and discipline the labour market by inducing high unemployment. Effectively, multinationals practised "cherry-picking" in the name of global integration and national disintegration (Radice, 1993, p. 10). Packages of incentives and legal regulations were often negotiated on a case-by-case basis, making the process appear arbitrary and even corrupt.

The market socialists argued that state ownership *per se* did not guarantee efficiency. If the structure of state ownership conflicted with the changing economic realities, state ownership would be a negative rather than a positive element in economic development. State property was no longer seen as sufficient or even necessary for socialism. Within the market socialist economic system, and based on state property, a variety of property forms could have existed. Thus, all forms of property—individual, co-operative and state—were important and were consistent with socialism.

This argument did not dismiss the role of state property in the socialist economy. State-owned enterprises would be large enterprises characterized by monopoly power. State ownership would ensure that the behaviour of large enterprises was in line with the social good. State enterprises would be both instructed and motivated to maximize the long-term rate of profit and thereby also efficiency. Managers of state-owned firms would be induced to pursue profits, not only by making their salaries and bonuses subject to achieved profits but also by threatening job security. Decision-making in state firms would be based not on the conventional hierarchical structure of firms, but rather on a democratic process in which all workers participated.

Market socialists argued that labour-managed firms were consistent with socialist principles. Enterprises in market socialism would normally have taken the form of workers' labour-managed firms, with capital supplied externally. Under this structure, ownership and control would be exercised by all members of the co-operative, in the form of group property. All members of the co-operative would be equal, with no distinction between employers and employees and no exploitation of labour. While a hierarchy is necessary for the co-ordination of production processes even in labour-managed firms, authoritarian hierarchies were not a natural result. There was a positive relationship between participation in decision-making and productivity, as well as between profit sharing and productivity. In firms that allowed the workers to make the decisions, the workers could draw from their shop-floor experience to make the correct decisions and responded rapidly. Where work yielded utility, and since labour-managed firms eliminated the exploitation of labour by capital, labour-managed firms could perform better than hierarchical firms (Estrin & Le Grand, 1990, p. 16). In a democratically self-managed enterprise, workers, as a group, had a strong interest in assuring good job performance by monitoring the labour process of individual workers. Empirically, the claim that hierarchical firms necessarily outperform labour-managed firms has yet to be proven (Satz, 1996, p. 80).

The new perception of property relations under market socialism went further than the co-operative form. Private property should be legalized, thereby recognizing that it had a role in a socialist system. Market socialists encouraged privately-owned firms; however, they would be restricted to small-scale enterprises, with large-scale privately-owned capitalist firms being abolished. "Capitalist firms that are sufficiently small do not pose a serious threat to the well-being of others" (Winter, 1990, p. 157). Capital should be socialized and rented to firms. Private property was considered complementary to state and group ownership. Individuals should be permitted to operate their own enterprise subject to certain regulations administered by local government. The regulations covered areas such as the level of activity permitted and the obligation to pay tax on profits and a "capital use tax", since the means of the production were owned by society. It should also be possible for a private entrepreneur to employ a few people. While this would make him/her an exploiter, he/she would have had to work within, as well as manage, the enterprise. This would be subject to conditions such as the number of people employed, or the value of capital assets, which would have varied across sectors. Private property was considered the most effective structure for the development of labour-intensive activities, especially in the service sector, and this was one of the major weaknesses of centrally administered socialism. Perhaps the most important reason for legalizing individual property was the need to liquidate the black market and associated activities. By bringing the shadow economy into the open, its activities could be taxed and regulated.

Once privately-owned enterprises reach a predetermined size and gain regional market power, the sole ownership rights of the private owners should be abolished, appropriate compensation paid and the firms transformed into labour-managed firms. This is analogous to the capitalist entrepreneur, who sells out to the corporation when he/she is prepared to expand the business beyond its small size. But there is one important difference: a capitalist entrepreneur sells out voluntarily to the other self-interested firm wanting to purchase the investment. Under market socialism it would be compulsory, with compensation determined by the state. Did the proper compensation for the original entrepreneur result in illegitimate enrichment? Not as long as the socialist market and the price mechanism were functioning correctly. From a societal point of view, there would have been no unearned income arising simply from the capitalization of small ownership of capital and land.

Once labour-managed firms reach a predetermined size and gain economy-wide monopoly power, the labour-managed firms' rights should be relinquished, after appropriate compensation, and their assets transferred to state ownership through legislation. Market socialists view the property structure of the enterprise as directly linked with monopoly power and the principal–agent problem. While small private ownership of the enterprise would not have given rise to power, as the firm grows its power increases, requiring a change in ownership. As the power of the firm increases with its size, ownership would also have been altered from private, to co-operative, to state. In this way, no individual or group of people would gain substantial power in the economy. They would be unable to accumulate substantial wealth and incapable of influencing economic policy by virtue of their economic control of significant sectors of the means of production. In this market environment, state-owned firms must compete with one another and with co-operative and private enterprises. Thus, it would be wrong to conclude from the experience of firms in a command economy that state-owned firms would have behaved in a similar manner under a market socialist economy (Roemer, 1994b, p. 296, 1991, p. 565).

7. The Chinese Approach to the Privatization Process

In central and eastern Europe and the former Soviet Union (CEEFSU) privatization emerged as a radical strategy to counteract the problems that haunted centrally administered economies, such as bureaucracy, lack of enthusiasm and initiative, and inefficiency. Meanwhile, the Chinese reformers argued, and disaggregated data actually showed, that ownership was entirely irrelevant to the day-to-day operations of the enterprise. The Chinese experience of transition demonstrated that state ownership had remained a critical actor in the transition process. China rejected the privatization approach followed by CEEFSU. While the Russians rapidly and criminally privatized state enterprises right at the start of the reform process, the Chinese have, so far, maintained state ownership, management and planning for the bulk of the industrial economy.

China's experience of industrial reform suggested that economists tended to overstate the importance of early privatization programmes during the transition process. China's success demonstrated the continued economic relevance of social ownership: markets do not require private ownership to function. It was argued that privatization of the state sector is always necessary but immediate privatization is not. Privatization would be more feasible and smoother after a large non-state sector emerged. Much of China's gains have been due to "pseudo-privatization" of rural land and of rural industry to "owners" who were not always private, such as township and village enterprises, and did not enjoy all the attributes of ownership; however, they have faced incentives similar to private owners. Overall, China has pursued a pragmatic approach with regard to ownership, not an ideological one.

The Chinese reformers chose to deal first with their biggest economic problem, agriculture, partly because it was the easiest political route to take. It was much easier to assign autonomy to the individual plots that farmers were working on. Furthermore, Chinese agriculture was easier to reform than Russian agriculture because of the big difference in labour intensity (Woo, 1994, p. 282). China started with agricultural reform by breaking up the large collective farms into smaller, more efficient, units and introducing the household responsibility system under which peasant households were the basic units of farm production. The village collective, on the other hand, takes charge of managing land contracts, maintaining irrigation systems and providing peasants with equitable access to farm inputs, technology, information, credit and the services of farm machinery, product processing, marketing, primary education and health care. This new form of village collective organization overcomes the main drawbacks of the commune system, while preserving the principal merits of economic organization characterized by public ownership of the means of production. Initially, household contracts for the use of the land lasted for 15 years, then were extended to 30 years, and now have, for all practical purposes, been made indefinite. Hence, it virtually amounts to individual ownership. Up to now, Chinese reformers have not contemplated the formal privatization of land.

The most significant change in the structure of the Chinese economy has been the rise in the industrial output produced by the collective sector, the township and village enterprises (TVEs). This sector consists largely of enterprises under the administrative control and ownership of local governments at the township and village levels. TVEs operate under close supervision from the township or village industrial departments, which contribute start-up funds, appoint managers and are intimately involved in major strategic decisions. The growth of TVEs benefited from the success of China's agricultural reforms, which greatly expanded the supply of rural savings, freed millions of workers to seek non-farm employment and boosted rural demand for consumer goods. The non-state sector in China, dominated by TVEs, has been the main engine of industrial growth in the reform period. TVEs were able to satisfy numerous niches in the developing market economy. China's experience demonstrates that the fastest economic improvements in industry can result from creating an environment where new industries can emerge and that privatization proved to be an unimportant part of the explanation for the accelerated growth.

The crucial point is that the TVEs represent localized collective ownership, compared with the centralized state ownership embodied by the state-owned enterprises. This difference renders TVEs and state-owned enterprises fundamentally different in nature. Even though both are publicly owned in the legal sense and are subject to government regulations, there is a lot of autonomy associated with TVEs. In addition, TVEs have closer relations with the community where they are located than do their state-owned counterparts. TVEs have been characterized by better governance, greater autonomy, clear-cut incentives, fewer regulations and social obligations, greater competition and hard budget constraints. Employment is not guaranteed; TVEs do go bankrupt and workers do lose their jobs. In short, TVEs operate in a highly competitive environment and managers, local workers and local officials appear to behave as shareholders with consistent objectives.

There is widespread disagreement regarding the effective property structure of the TVEs. This is because TVEs have vaguely defined ownership structures (Weitzman & Xu, 1994, p. 121). On the one hand, there is the argument that TVEs are some kind of "quasi-private" disguised private enterprises. Private firms have registered as collectives to overcome political discrimination: "wearing a red cap". On the other hand, there is the argument that a typical TVE is not a private firm, but a genuine collective firm. Independently of the ownership structure of TVEs, Smith (1993, p. 90) and Woo (1997, p. 322) argued that almost certainly these collectively owned industries will undergo a metamorphosis from collective enterprises to capitalist enterprises, or be privatized outright.

Nevertheless, actual privatization is taking place in China through spontaneous privatization and "state asset stripping" by local cadres who are often transformed into entrepreneurs. This was the means by which hard-line opponents of reform were given some stake in the new system in order for reform to progress smoothly. Meanwhile, the government is quite successful in privatizing small and less important businesses, effectively permitting the growth of a sizeable private and semi-private capitalist economy outside the state sector. If present trends continue, Weil (1996, p. 36) and Smith (1993, p. 86) argue that the "collective sector" will gradually merge with the private capitalist sector. It does not thereby follow that a large state sector would be a permanent part of China's market economy.

In 1995, China began a reform in privatizing and restructuring the state-owned enterprises under the slogan "grasping the large and letting go the small" (Cao *et al.*, 1999, pp. 104, 105; Lau, 1999, p. 58). It was announced that 1000 of the largest state-owned enterprises were to remain under state control and that the 13 000 large and medium-sized state-owned enterprises, as well as most of the 350 000 smaller companies, were to be denationalized. The sale of state enterprises occurs by auctioning or corporate transformation, where most shares are sold to private individuals, or a share-based co-operative system (SBC), where shares are sold mostly to employees. The all-familiar picture has emerged in China, where firms were either bought by foreigners or the share distribution favoured managers who have acquired shares from workers who often immediately resell their share allocation. The SBC, with its supposedly "co-operative" features, was obviously a useful formula to disguise *de facto* privatization.

The privatization process has been initiated by local governments and tolerated, sometimes even encouraged, by the central government. It has become in the local government's interest to privatize or restructure state enterprises due to the hard budget constraints of local governments and the increased competition from the non-state sector that has made it increasingly costly to maintain these inefficient enterprises. It has also been a strategic move, as in all elements of the reform process, to assign the responsibility of privatization to the local governments. Local governments can pursue the reform at a speed suitable to local conditions. The central government does not force local governments to reform all at once or all at one speed. Thus, if the local government found that workers were not being absorbed as fast as predicted, it could slow down the pace of privatization or lay-offs. This, in part, accounts for the unevenness of privatization across localities.

8. Conclusion

Alternative economic paradigms give rise to alternative models of transition, which give rise to alternative privatization processes for transition economies. This is because the economic paradigm determines the assumptions and value judgements with regard to economic behaviour, how the economy functions and what is desirable, acceptable and feasible. Consequently, each transition model is associated with a unique privatization process compatible with the predetermined assumptions and value judgements of the paradigm in question.

The shock therapy privatization process required the immediate transition of the economic system to a compatible market environment. As such, effective ownership structure could only be the result of a free market process independent of the privatization method and the initial distribution of property. The neoclassical gradualist approach to privatization, consistent with the goal of achieving a competitive market system gradually, effectively postponed the privatization of state enterprises until the necessary institutional structure was in place and restructuring was complete. After these prerequisites were satisfied the neoclassical gradualists auctioned state enterprises. The Post Keynesians used a variety of privatization methods consistent with their goal of achieving a social democratic capitalist system: restitution, distribution of free shares to people and workers, the transfer of state property to financial intermediates or to workers. The pluralistic market socialists recommended the maintenance of state ownership of large enterprises, establishing labour-managed firms for medium enterprises and privatizing small enterprises. The privatization process was consistent with establishing a pluralistic market socialist system. The Chinese reformers, having the goal of maintaining the authoritarian rule of the communist party, maintained state enterprises, encouraged the development of new enterprises in the form of TVE and introduced the leasing of land.

It is obvious that the method of privatization is directly linked with the value judgements associated with the economic system, which was desirable, acceptable and feasible, by the economic paradigm in question. Comparisons of privatization processes, which ignore the value judgements of economic paradigms, are meaningless.

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