Privatization in a Transition Economy: Lessons Learnt from the Slovakian Experience*

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Privatization is one of the most complex, closely watched, and controversial processes in all post-communist countries. At the same time it is the most important condition of restructuring in a transition economy. The paper examines the course of privatization process in Slovakia, focusing on the years from 1991 to 1998. The methods and the privatization policies by individual governments, and their impact on the changes in overall ownership structure are presented. It shows that the main reasons for postponement of the restructuring of a transition economy are missing institutional framework and negative impact of politics on privatization decision process. Moreover, it suggests that besides appropriate time framework for privatization and institutional framework, country-specific factors play the most important role. Consequently, it provides recommendations for privatization policy in a transition economy.

I. Introduction

Privatization is one of the most complex, closely watched, and controversial processes that is changing the social system in all post-communist countries. Previous studies (e.g. Carlin et al., 1994) have argued that the primary rationale behind privatization is to create owners who have the power and incentives to monitor managers and ensure that they act in the firm's best interest. In other words, in the transformation process of the post-communist countries, the instrument of privatization serves to eradicate one of the most significant systemic characteristics of the communist system - the high prevalence of state ownership. Its particularity lies in the fact that the change of ownership is the most demanding, most dangerous and most sensitive process.

At the same time, privatization in a transition economy serves as an inevitable condition of restructuring. According to many economists, however, the sole transfer of asset ownership from the state to the private sector neither creates conditions for better corporate governance, nor leads to increased effectiveness which would demonstrate convincing advantages of private ownership.[1]

With regard to the non-existing market and the mass of property to be privatized, the opportunity to apply the experience of developed economies was rather limited. Privatization was to a

*This article is a report on the research undertaken by the author for his partial fulfillment of the graduate program of Economics and Business Management, Nagoya University. (*Editor*) great extent an experiment. A study of privatization in eight post-communist countries conducted by the World Bank concluded that the relationship between private ownership of the company and its restructuring was weak or zero; only a small change in the behavior had been noted between state and private companies; and significant behavioral change occurred only in those companies that were sold to a foreign investor (Nellis, 1999).

In these countries, as well as in other transition countries, assets fell into the hands of people who had neither the necessary experience, nor financial resources, and often not even the will to manage them efficiently. The result was manipulation (in standard and nonstandard methods), corruption, or "asset stripping" (i.e., unauthorized channeling of the equity of a managed company to another, private entity). Privatization, as a tool of transformation, became an instrument of struggle for the consolidation of power.

Reviewing the case of Slovakia, with regard to its privatization confirms the outcomes of this study. Slovakia first relied on voucher privatization, while the legal environment lacked appropriate regulation of capital markets, protection of minority shareholders, institutions, and enforcement of law. Privatization continued with opaque sales to Slovak managers who lacked the necessary funding and know-how to achieve privatization goals. Through their political connections they achieved the cancellation of the second wave of voucher privatization and replaced it with direct sales at symbolic prices, often manipulated in line with their interests. In the post-privatization phase, new owners maximized their income in different ways - from the resale of a company to the drafting of legislation. Restructuring was not perceived as the ultimate goal of privatization.

According to many critics, privatization has failed. The underestimation of the institutional framework demonstrated that capitalism required much more than just private ownership. It functions because of the widespread acceptance and enforcement of fundamental rules and safeguards that make the outcomes of exchange secure, transparent, and predictable. Where such rules, safeguards, and institutions are absent-fairness, equity, and firm performance suffer. With the institutions that would safeguard compliance with the above rules missing, none of the stakeholders associated with the privatized company (employees, management, creditors, shareholders) is able or motivated to ensure long-term prosperity of the assets. In such case, privatization may lead to stagnation and decapitalization, rather than improved financial performance and increased productivity.[2)]

However, this is not meant to discredit privatization. One must continually ask, what was and is the alternative to privatization? It is not clear that Slovakia would be better off today had it not undertaken the privatization program, although the ailing one. Nevertheless, the Slovakian case proves that transition economies that delay privatization usually find that enterprises continue to perform under soft budget constrains, threatening the whole of the reform process. At the same time rushed privatization without established fundamental market forces results in the same risk.

The purpose of this paper is to analyse the course of privatization process in Slovakia, with focus on the years from 1991 to 1998. The aim is to show that the main reasons for postponement of the restructuring as well as the prolonged ailments of the financial sector are missing institutional framework and negative impact of politics on privatization decision process. It demonstrates that in a transition economy political instability, frequent changes in political arena and consequently reform policies have negative impact on privatization process and thus on entire transition economy. Besides, it suggests that besides appropriate time and institutional frameworks to be implemented in a transition economy, country-specific factors play the most important role.

The structure of the paper is as following: Section 2 reviews the general goals of privatization in a transition economy and problems associated with achieving these goals. Section 3 describes in chronological order the policies pursued by individual governments while analyzing the most significant events, decisions and their consequences. Section 4 analyses privatization methods applied in Slovakia, and their impact on the changes in overall ownership structure. The last section summarizes the failures of privatization in Slovakia and offers recommendations for privatization policy in a transition economy.

Ⅱ. Privatization Dilemmas - Theoretical Review

Privatization in transition economies is aimed to achieve multiple goals. First, it seeks a change of ownership as an inevitable condition for adapting companies to market mechanisms. Second, it seeks to protect against a reversion of the reform process. Third, it must provide a signal to gain credibility for the new economic policy (Beblavy and Marcincin, 2000, p.294). Specific problems related to achieving these privatization goals can be summarized in the following basic points:

- Speed of privatization. Excellent survey is done by Havrylyshyn and McGettigan (1999). They identify two schools of thought. The first school of thought stresses the importance of the competitive environment and market structure over ownership (Nellis, 1999, Sachs et al., 2000). For transition economies, the creation of a competitive environment would occur through the hardening of enterprise budget constraints rather than a rush into privatization (Dewatripont and Roland, 1992). This was thought to occur, according to Frydman et al. (1999), as a result of pressures from macroeconomic stabilization on firms to restructure or go out of business. The second school of thought stresses the need for a fast privatization[3] (Aghion, 1993; van Wijnbergen, 1992). Although, some works note the need to eventually follow up with the development of supporting institutions. Both these views underscore the importance of the hardness of the firms' budget constraints, as well as the likely importance of establishing a multitude of market institutions.

▶ Privatization methods.[4] Mass privatization enables fast privatization. However, creating diffused ownership without defining protection for minority owners does not lead to fast restructuring. Restitution is the least problematic issue from the point of view of change in ownership. Lengthy litigations that hamper the manipulation of property is a problem. Public auctions are applicable only to sales of smaller companies or specific assets. Public tenders and direct sales require a costly assessment of asset market value and significantly slow down privatization. However, they result in concentrated ownership that will more likely lead to better company management. Sales to foreign investors appear to be the best form of privatization.

▶ Privatization restructuring. According to many economists, the sole transfer of asset ownership from the state to the private sector neither creates conditions for better corporate governance, nor leads to increased effectiveness which would demonstrate convincing advantages of private ownership.[5] As for an impact on economic performance, recent surveys (based on micro data) come up with mixed assessments. These range from finding of no systematically significant effect of privatization on performance (Bevan and Estrin, 2000), to concluding that privatization tends to improve performance (Shirley and Walsh, 2000, and Djankov and Murrell, 2002).[6]

▶ Impact on unemployment growth. Privatization should result in restructuring that addresses excessive labor. Even so, the development of privatized companies should inevitably create new jobs. A government goal to keep unemployment low can therefore substantially slow down privatization.

▶ Privatization sequence. Privatization of natural monopolies is more complicated than the privatization of companies in competitive industries. This factor can therefore delay privatization and risk the need to maintain distorted prices that may significantly impact all other prices in the country.[7] For example, privatization of banks is a complex and sensitive issue. Maintaining state ownership there could result in soft budgetary restrictions for non-performing companies (Dittus and Prowse, 1995).

▶ Transparency. The voucher method is generally considered the most transparent method of privatization. Non-transparent and uncontrollable privatization results in for state disadvantageous sales, often further hampering restructuring (Beblavy and Marcincin, 2000; Marcincin et al., 1997b).

▶ Political benefit. Privatization is a political process, where the transfers of immense assets are followed by shifts in political power. Political parties have a unique opportunity to use the privatized property for obtaining the support of the business community.

▶ Public involvement. The involvement of the public in the privatization process can help to ensure the irreversibility of the reforms. There could be fears of transferring a majority of property to foreign investors. These fears are based more on political arguments than economic arguments. The government can win support for a privatization policy by involving people that have a personal interest in the reform and the new order.

▶ The use of privatization revenues. A precondition for privatization is the use of government revenues for the compensation of inevitable reform-related costs. For example, government revenues will likely be required for retraining the unemployed or for developing the missing infrastructure.

▶ Inadequate national funds. The lack of national funds can be handled in two ways - offering assets to foreign investors, and free transfer of property (voucher privatization).

All in all, the transition experience provides multiple case studies of reform, exhibiting great successes and spectacular failures. Scholars of policy reform have much to learn from the study of the former socialist economies. The distinctive history of the transition economies, which still affects present structures, provides the great variation in independent variables so important in the generation of incisive lessons.

Ⅲ. Impact of Politics on Privatization Development in Slovakia

Until January 1993, privatization in Slovakia was almost identical to privatization in the Czech Republic. Since the speed of privatization was an important goal of the federal government, the voucher method was used. After split of Czechoslovakia in 1993, the privatization process in Slovakia began to deviate from the federal pattern. Privatization was significantly influenced by frequent changes in the government and the ministers of privatization. During the decade since November 1989, there have been seven governments with differing approaches to privatization. This resulted in minimal privatization revenues for the government, delays in restructuring, and mingled political and economic power.

In December 1989, the first Slovakian government replaced the last communist government and prepared the first free parliamentary elections. In the elections, a broad movement "Public against Violence" obtained the majority of votes and Vladimir Meciar took office in June, 1990 (his cabinet was recalled in April 1991). In 1991, the National Propriety Fund (NPF)[8] was established, and the government initiated small-scale privatization and began to prepare the first phase of large-scale privatization that were both based on federal legislation.

The third government was headed by Jan Carnogursky during the period from April 1991 to June 1992. The Ministry of Privatization was established in August, 1990. The government hoped to win the support of the public with the voucher privatization, which started in May 1992 after the registration of the citizens and the investment funds in late 1991 and early 1992.

Meanwhile, the parliamentary elections in June 1992 saw the victory of The Movement for a Democratic Slovakia (HZDS) formed by Vladimir Meciar, and his government took office again. The Government launched the second phase of large-scale privatization, emphasizing the standard methods. The privatization process then almost came to a halt. The revival of privatization came during the period of February to March 1994, when the NPF approved 44 privatization projects under the threat that the government would be recalled, which actually happened in March 1994.[9]

The next - the fifth government of Jozef Moravcik was to prepare for early parliamentary elections. The government planned the privatization of 174 companies with a total book value of SKK 176 billion, out of which SKK 80 billion were to be privatized through vouchers. Also, additional assets held by the NPF in the amount of SKK 20 billion (these were not sold in the first phase of the voucher privatization) were offered. The government started to issue new voucher books and some 3.4 million people (92% of the eligible citizens) had their books registered at the end of November, 1994. Thirteen approved privatization projects of the previous government were cancelled.

A winner of early elections became again HZDS and the government of V. Meciar assumed office in December 1994. The first change in privatization delegated the NPF Presidium with the right to issue privatization decisions initiated by the Privatization Ministry or the NPF Executive Committee. On November 4, 1994, the new Parliament passed Act intended to revoke 50 privatization projects approved by the previous government. The Act was repelled in May 1995 by the Constitutional Court, nevertheless, in late November 1995, NPF continued with the privatization process of 27 companies (Trend, Dec.13, 1995).

In its policy, the government emphasis was supposed to be put on competitive forms of property sales to domestic investors101 and payments for the purchased property was to be spread over a period of ten to fifteen years. The first payments usually were for 20% of the agreed sales price.[11] The NPF stopped providing information on privatization projects and selection criteria. In general, up to 50% of the sales price could be waived, as compensation for the acquirer's investments, and concurrently be subject to favorable taxation terms.[12] The voucher method was replaced by the bond method and the NPF was empowered to issue privatization decisions based on a recommendation of its Executive Committee instead of a recommendation of the Ministry, as used to be the case. In June 1996, Meciar stated that privatization came to a halt in December 1995 due to tension amongst coalition partners.

Another proof of government's non-transparent policy was the unclear Act on Strategic Companies, dated July, 1995. This Act suspended privatization of selected companies with total assets value of SKK 150 billion (about 40% of the size of privatized assets in Slovakia; Marcincin, 1997). The list of strategic companies included state enterprises operating in gas, power, post, telecommunications, heavy engineering industries, pharmaceutical production, transportation, agriculture, forest and water management. According to the Act, these entities were to be privatized based on special legislation.

In 1998, Slovakia narrowly avoided an economic and financial crisis, which resulted in early elections. In October 1998, the new government of Mikulas Dzurinda announced a new policy, emphasizing its intention to privatize banks, conduct a court review of privatization decisions, pursue privatization by applying tender methods, redeem at least those bonds held by senior citizens aged sixty and above, foster bond trading in capital markets, ensure that the ownership rights of the State are exercised, and create conditions attracting foreign investors into the privatization process.

The greatest progress was achieved in bank restructuring, though the cabinet also focused on the privatization of other state-run corporations. The first government signaled its openness to FDI by rescinding the previous governments' law on strategic privatization, which prohibited privatization of numerous state-owned enterprises. The new law allowed 49% foreign ownership and management control of the natural gas company, the electric power producer, electricity distributors, an oil pipeline, and Slovak telecommunications. All of these privatizations, except for electricity production, have been completed.[13] As a result of investment liberalization efforts and improved business environment, Slovakia has attracted significantly high foreign investment. During 2000-2001 it received close to US$ 2 billions per year on average, compared to US$ 231 million in 1997.

Ⅳ. The Methods Applied in Slovakia

Privatization was initiated in the early 1990s while Slovakia was still a part of the former Czechoslovakia. The privatization program rested on three pillars - restitution of assets to their original owners, small-scale privatization (predominantly shops and restaurants) and large-scale privatization - and utilized a combination of standard and non-standard methods. After the break-up of Czechoslovakia, large-scale privatization evolved in different directions in the two successor countries. Slovakia abandoned voucher privatization in favor of noncompetitive direct sales.

1. *Restitution*

The purpose of the restitution, a non-standard method, was to make up for the wrong-doings of the previous regime with regard to the unlawful and/or immoral nationalization and confiscation of private property. The property was to be returned in kind, or by providing financial compensation (in cases when the original property no longer existed). The actual value of property returned to the original owners or their heirs in the process of restitution is very difficult to estimate because of the complexity and decentralized nature of the whole process (Olsson, 1999).[14] Nevertheless, there were around 17,000 restitution claims lodged within the stipulated deadline, April, 30, 1991. There were 5170 claims for cash compensation registered and by 30 June, 1999, 809 claims had been discharged with the amount of compensation paid amounting to SKK 227 million.

2. *Small-Scale Privatization*

The subject of small privatization was only movable and immovable objects without the rights and liabilities being transferred, while the transferee of the privatized assets could only be national subjects. The intent of the process of small privatization was also to demonopolize trading and catering units, with the objective of significantly raising the quality of service in areas serving the consumer.

The sole institute, through which assets were sold in small privatization, was public auction. For the legal framework, so called model of the "Dutch auctions" was utilized.[15] The small-scale privatization began in February 1991 and ended in March 1994, and a total of 9,667 business entities with a net book value of SKK 12.3 billion were auctioned off at almost SKK 14 billion (Table 1).

3. *Large-Scale Privatization*

Large-scale privatization included all state enterprises and other state organizations (such as budgetary and contributory), ownership interest in businesses of legal persons, approved by the Government as early as 1991. It was divided into two waves or phases, with accompanying division of enterprises into two groups. In the process of large privatization standard methods, a non-standard method and a combination of a standard and non-standard method have been used.

(1) *The First Phase of Large-Scale Privatization*

The first wave of privatization was characterized primarily by the application

Table 1 Privatization by Methods and Waves

	Firstwave			Secondwave			Total		
	Num.	Property		Num.	Property		Num.	Property	
		mil.SK	%		mil.SK	%		mil.SK	%
Companies for privatiz.	678	169,097		610	136,804		1,288	305,901	
Privatized companies	1,010	169,097	10	1,366	136,804	92	2,376	305,901	96
1 Property sale	330	12,428	7	813	52,226		1,143	64,654	21
11 Direct sale				645	45,072	33	645	45,072	
12 Public tender				155	7,140	5	155	7,140	
13 Public auction				13	14	0	13	14	
2 Free transfers	116	2,086	1	303	2,822	2	419	4,908	2
3 Restitution	7	19	0	16	22	0	23	41	0
4 Joint stock companies	557	154,564		234	81,734		791	236,298	
41 Own equity		154,564							
411 Basic equity		134,705			70,933			205,638	
4111Standard meth.		3,419	2		36,041			39,460	13
41111 Direct sale					34,801	25		34,801	
41112 Public tender					1,240	1		1,240	
4112 Voucher privatiz.		79,752	47		0	0		79,752	26
4113 Free transfer					2,414	2		2,414	1
4114 Restitution IF		3,797	2		2,161	2		5,958	2
4115 In admin. of NPF		47,737	28		30,317	22		78,054	26
412 Reserve and other funds		19,859	12					19,859	6

Note: Num. is a number of enterprises.
Source: Beblavy and Marcincin (2000), Ministry of Privatization (1999).

of the non-standard method. The privatization wave was defined as a time interval during which, owners of investment vouchers were able to either directly, or through investment privatization funds (IPFs), apply their right to buy shares.

The first phase of large-scale privatization in the period of 1991-1993 saw the (partial) denationalization of property of 678 state-owned companies worth SKK 169 billion, mainly in the area of industry and services. Some 1,500 projects were submitted for privatization. Of the total privatized value, 48% was privatized through vouchers, 28% remained with the NPF, 12% constituted the reserve fund and other funds, and only 7% was sold directly (Table 1).[16]

Voucher Privatization

The first wave of large-scale privatization was characterized mainly by the non-standard method[17] of voucher privatization. Standard methods were used to a lesser extent. The voucher privatization was expected to solve the problems of scarcity of capital in relation to the volume of property offered in privatization, to ensure a speedy privatization with an emphasis of compensating citizens through handing out shares free of charge, to enable acceleration of the rise of the capital market, and to increase the knowledge of the population about securities and institutions of the capital market.

Since the method had never been successfully tested, it was actually an experiment. Its weak aspects included high measure of fragmentation of the property, too diffused ownership,[18] with the ensuing nameless ownership and abuse by investment privatization funds.

The basic dea of the voucher privatization was the transformation of a substantial portion of state-owned enterprises into joint stock companies and a gratuitous handing over of their shares to the population in return for no money, but rather for so-called investment vouchers. In other words, the voucher privatization was basically a free distribution of property using a simple procedure where the voucher prices - initially equal for all shares - progressively approach equilibrium prices due to the changing ratio between supply and demand. Each interaction reduced the total demand and the total supply of shares. The volume on the supply side was given by the number of shares of companies to be privatized, while the number of unused vouchers determined the volume on the demand side. Five interactions were sufficient to achieve equilibrium.

Although the registrations of citizens were in progress from November, 1 1991, the first wave itself began on May, 14 1992 and was completed by the end of 1992. Based on the approved privatization projects, the shares of 503 joint stock companies with a total book value of SKK 86.9 billion (ca. US$ 2.6 billion) were offered for the first phase of voucher privatization (943 join stock companies worth KCS 206.424 billion in the Czech Republic). In the individual rounds of this phase, the Fund sold shares worth SKK 79.8 billion of the above mentioned offer (Table 1). SKK 7.1 billion worth of unsold shares were progressively sold by the Fund using standard methods. There were 2.579 million Slovak citizens (5,943 million Czechs) participating in the voucher method of privatization (Beblavy and Marcincin, 2000).

Investment Privatization Funds

The participants of voucher privatization placed their investment points independently into joint stock companies or 429 IPFs,[19] respectively, of which 169 were Slovak entities. While small investors acquired majority stakes in 244 Slovak companies, IPFs acquired majority in 173 companies (Table 3). In comparison with the IPFs, all other stakeholders in companies privatized through vouchers were negligible (Beblavy and Marcincin, 2000). The nominal value of the shares acquired by all IPFs was around SKK 55 billion, i.e., 70% of the property privatized by voucher privatization. The seven largest IPFs owned 61% of companies privatized through vouchers in Slovakia (Table 2). This represented a significant economic power within the distribution of ownership rights among scores of small shareholders. Accordingly, there was a relatively high risk of abuse on the part of investment funds, which could be set up with the aim of speculation or fraud.[20]

The number of IPF grew in 1994 to 311 due to the planned second phase of the voucher privatization that was never completed. In 1996, the IPF number fell to 36. The IPFs escaped the supervision of the Ministry of Finance through a re-registration as joint stock companies. Their shares often were not publicly traded.

The IPFs were themselves under control of some power groups. Such groups were either created around well-established financial institutions (particularly big state-owned banks and insurance companies) or they represented privately owned financial groups, which started accumulating their capital only in the voucher privatization process. The IPFs were in the position of a strong shareholder and at the same time, a supervisor that was without supervision himself. Their shareholders, like small shareholders of the companies, did not have any chance to control and influence the management of the IPF. In an unregulated environment, banks also did not have the proper incentives and capabilities to play a monitoring role, thus the IPF managers were free to abuse their positions to enrich themselves at the expense of the shareholders.

Important constraints on the incentives of the IPFs were the limits on the size of ownership stakes.[21] The purpose of these limits was to mitigate the potential harm brought by speculative trading and to prevent abuse of minority shareholders. At the same time, however, the ownership limits put a ceiling of sorts on the willingness of funds to invest in active monitoring of their portfolio firms.

(2) *Second Phase of Large-Scale Privatization*

The second wave of large privatization started in September 1993 and was intended to finish in 1996. Several essential changes were characteristic of the second wave, including a lack of transparency, abolition of the voucher method, and the frequent conclusion of privatization deals benefiting close supporters of the leading political party.[22] At the beginning of the phase, in the year 1993, the privatization process slowed down (2% of the total assets designated for privatization was privatized). The slowdown was due to lack of assertiveness of the Government in decision making about the methods to be used. Later, however, it was restarted again, and decision making responsibilities about direct sales were transferred to the NPF (at the same time, the ruling coalition nominated solely their representatives to the bodies of the fund).

During this stage, property was handed out for very low, even symbolic prices for the benefit of narrow groups closely tied to the ruling coalition or directly coalition colleagues. The ruling coalition was thus acquiring greater economic power. In order to extend it still, the ruling coalition abolished the second wave of voucher privatization in 1995 and replaced it with the so-called bond method (see later). This gave it

Table 2 Seven Largest Groups of Funds by Republic and Federation.

Slovakia		Czech Republic		Federation			
IPF	No. of Shares	IPF	No. of Shares	IPF	No. of Shares	No. of Shares	% Points
SSK	6,008	CSP	20,210	SCP	21,376	950	15.6
SIB	5,541	IB	13,157	HCC	15,225	639	10.5
VUB	5,375	HCC	12,003	IB	13,594	714	11.9
SLP	3,995	KB	11,358	VUB	11,985	501	8.2
HCC	3,222	CP	7,623	KB	11,932	466	7.6
DI	2,249	VUB	6,611	SIB	10,987	333	5.5
CSP	1,166	SIB	5,446	SSK	7,708	169	2.8
7 IPFs	27,556	7 IPFs	76,408	7 IPFs	92,807	3,782	62.1
All IPFs	44,943	All IPFs	131,037	All IPFs	175,980	6,135	100.0

Note: The groups of funds defined by founder. Number of shares quantified in thousands and specifies the number of shares gained by the fund in voucher privatization. Number of points quantified in millions. The point percentages are calculated relative to points gained by all funds. The last line quantifies the total for all funds in voucher privatization.
Source: Beblavy and Marcincin (2000, p.318).

even easier access to the property, excluding the possibility for other potential investors, including foreign ones, to participate. Just as foreign investors, the employees of privatized enterprises too, could only be involved in the process in a limited scope.

In total, until 1999 58% of the total assets amounting to SKK 137 billion were privatized through direct sales and only 5% were privatized through public tenders. Noncompetitive direct sales to a predetermined buyer (often at a very low price) was by far the most frequently used method, accounting for 83% of the property that was privatized in this wave, compared to only 9% using other standard and more transparent and competitive methods (Brzica, Fidrmucova and Olsson, 2001). Overall, the privatization process became extremely politicized and corrupt.

Bond Privatization[23)]

In June 1995 the Meciar Administration initiated the bond method of privatization, which replaced the second phase of voucher privatization. While the Premier said his government made the switch to be more equitable in creating a class of domestic entrepreneurs, critics said it was designed to help businesses owing the NPF, most of which they claimed were cronies of the ruling coalition, to pay back their debts towards the agency.

The essence of the actual procedure was that persons registered in voucher privatization received a bond with nominal value of SKK 10,000[24)] maturing on December 31, 2000, and an interest rate equal to the discount rate of the National Bank of Slovakia. There were two major ways in which bonds could be used: to help purchase a home or flat; or to pay off installment debts incurred in a direct purchase of a company from the NPF. But as distinct from the voucher system, what the bond scheme lacked was an automatic conversion of the bonds into shares of a large number of privatized enterprises through a system of auctions open to all on equal terms. Allowing bonds to be used to pay NPF debts exposed the scheme's hidden intent. Only firms that the NPF chose were sold. And insiders who bought their shares through direct sales from the NPF (putting down little of the usually low asking price) could then buy the bonds at a discount from ordinary Slovaks and use their face value to cut down even further their privatization debts.

As bond demand was minimal, their price plummeted. Therefore, in March 1996, the government set "an average bond price" at above 75% of the nominal value plus cumulative earnings. Bonds constituted a potential problem both for NPF and the state budget. On one hand, NPF promised to pay SKK 33.3 billion plus yields. On the other hand, it sold assets at minimal prices, with payment schedules spread over ten up to fifteen years. Even in such cases, instead of cash, it received its bonds back.

By December 31, 1998, a scant one-third of the bonds were redeemed, whereby 68% of them were used for discharging due amounts of NPF's debtors and 24% were paid to citizens above 70 years of age. Only 5% were redeemed for shares of privatized companies. The commitment of the new government after 1998 election to repay all NPF bonds was finally fulfilled in the course of 2001.

Example of Privatization Abuse

On August 23, 1995, NPF sold 39% of the Slovnaft, the country' sole oil refinery, to the joint-stock company Slovintegra that was owned by Slovnaft's management-led group. The book value of the stake was SKK 6.4 billion (about US$ 206 million at the time), the actual total sales price was SKK 1 billion with the first installment SKK 100 million (1.6% of the book value) and the remaining interest-free payments of SKK 900 million were spread over a period of ten years. The agreed price per share amounted to SKK 156 while the market share price exceeded SKK 800. Based on the market price of a share, the stake was worth SKK 5.1 billion and the State lost several billions of Slovak crowns. Slovintegra privatized additional 15% of Slovnaft shares at a sales price of SKK 385 million in July 31, 1997.

In June, 1997, the NPF approved without notice the sale of an additional 15% stake in Slovnaft for SKK 384.61 million (US$ 11.5 million) to Slovintegra. Slovintegra, owned by Slovnaft officials and staff, paid SKK 155 (US$ 4.69) per share, compared to US$ 24 per share on the open market. After the sale, Slovintegra became the majority owner of Slovnaft, raising its stake from 39 to 54% (P67value, April 14, 1997).

Table 3 Investor Ownership Stakes.

Investor	50 %	30 %	20 %	10 %
Vouchers total	468	489	499	503
Holders of investment booklets	244	381	438	494
Investment funds	173	305	365	406
Group of 3 funds	55	255	339	401
Group of 4 funds	110	276	349	402
Group of 5 funds	145	290	351	402
Direct investors total				
Foreign	3	6	8	10
Domestic	11	14	22	31
FNM	10	30	56	77

Notes: Data of 1992. Table indicates, in how many enterprises does the given type of investor hold more than x percent. Groups of funds indicate shares of n largest funds by size in every enterprise.
Source: Beblavy and Marcincin (2000).

V. Conclusion

Privatization of state companies in a transition economy is considered as a primary prerequisite of restructuring. The associated incomes for the state budget are important during the transition period but not the most import aspect. In general, the restructuring of companies is not possible without a market economy, which again is not possible without private ownership. However, private ownership alone is not a sufficient guarantee for restructuring. If not accompanied by a good framework for corporate governance and law enforcement, results can delay restructuring, and subsequent later, higher costs of reforms, as it happened in Slovakia.

The restructuring of Slovak companies was determined by the method of privatization and by the strong mingling of political and economic powers. Due to the absence of a market and the mass of privatized assets, the application of experiences of developed countries was rather limited. Privatization was to a great extent an experiment. Slovakia's approach to privatization proved to be not very lucky. Voucher privatization was not supported with subsequent appropriate regulation of capital markets, protection of minority shareholders, institutions, and enforcement of law. Subsequent favoring of opaque sales to local managers lacked the necessary funds and know-how.

Restructuring was not perceived as the actual intended objective of Slovak privatization until 1998. At the same time, the lack of emphasis on privatization revenues failed to accumulate funds to alleviate social impacts of the reform process. Privatization was political because it represented a unique opportunity to acquire both property and political influence. As a result a number of negative outcomes emerged:

- Control remained in the hands of politicians and managers with incentives for a fast maximization of wealth as a result of the expected short-term position.
- Privatization of assets by large shareholders without the protection of minority shareholders resulted in an expropriation of profits and assets.
- Privatization by diffused shareholders (voucher method) without the possibility to exercise the right of control or sale of shares left the old managers without supervision and motivated them to transfer assets to other companies. The goal of mass privatization schemes was to achieve fair treatment of all citizens and protection against property being sold to foreign investors at low prices. However, only a small number of people benefited from this privatization, and the majority of the population remained frustrated, holding worthless shares.
- Privatization favored old managers (insiders). When managers became sole owners, they usually lacked the capital

and the willingness to share control with external investors. They would frequently bribe a bank or/and government officials in order to obtain new funds or receive protection of their monopoly position.[25]

- Particularly important was privatization by IPFs. In the beginning, policymakers fully recognized that individual citizens would have neither the capability nor the incentive to provide any meaningful governance, so they accepted the necessity of capital aggregation in the hands of financial intermediaries. In particular, bank-sponsored IPFs were believed to be the effective agents of restructuring and thus central to imposing hard budget constraints. In reality, they remained under political control and lacked experience in commercial banking and restructuring.[26]
- In addition, the IPFs were also poorly positioned to establish a basis for the active equity market envisioned by the privatization planners.271 As a result, the IPFs, in an unregulated environment, devalued the vouchers and also the shares of a majority of the participants in voucher privatization. Moreover, they undermined the Slovakian trust in collective investment.
- Prevailing shares of the state in the banking sector resulted in soft budget practices and consequently accumulated bad loan problems. The unwillingness of the government to privatize state banks to strategic investors (with know-how and capital) further aggravated the problem and postponed the enterprise restructuring.

All in all, the privatization process facilitated a transfer of ownership but often failed to stimulate enterprise restructuring or deliver effective corporate governance. This was largely due to gaps in the legal framework and the ineffective enforcement of contracts. Revising the Slovakian experience with privatization, several lessons can be drawn.

First of all, the political situation must address how to create a broad framework for corporate governance, which could help to cope with a lack of funding in soft budgetary conditions for selected companies, the non-performing loans in banks, the mutual debt of companies, and the loss-making companies. However, establishment of a legal framework is not the end of the story. Development of appropriate practices is often more important, although it is more difficult and takes time. Moreover, each country should develop a corporate governance framework adjusted to its legal and regulatory systems, financial market system, business customs, employment practices, etc. Ownership structure is the ultimate basis for corporate governance.

Last but not least, continued institutional reform is crucial for sustainable high growth. The development of institutions that can take the initiative to provide external monitoring of management is a key for well-functioning corporate governance, hence restructuring. Here, an important question comes to the foreground: what are the options available? Given the inefficient state, small and illiquid capital market, powerless minority shareholders and workers, banks seem to be the only alternative available. Despite their lack of experience and knowledge, the specific situation at the beginning of transition suggests that they may play a crucial role. Yet we should stress again that a stable political and economic environment, rule of law, safe property rights, effective enforcement of contracts and low corruption are necessary (though not sufficient) conditions for sustained growth and prosperity in the long run.

Notes

1) See for example, Bonin et al. (1998); Hawkins and Turner (1999); Jakoby et al. (1999); Marcincin et al. (1997b).

2) See Nellis (1999) for further discussion.

3) Fast privatization is synonymous with the success and irreversibility of the reforms. According to Collin and Rodrik (1991), potential foreign investors considered political instability, uncertainty related to economic policies and lack of legal protection of private property as the most important restrictions to investment in Eastern Europe and the former Soviet Union. A fast privatization was to convince them that the countries are capable to guarantee enhancement in all three areas.

4) M.E.S.A (1999) provides an excellent description of methods in general and methods applied in Slovakia.

5) See e.g., Bonin et al. (1998), Hawkins and Turner (1999), Jakoby et al. (1999), Marcincin et al. (1997b).

6) The diversity of findings is generated by analytical problems related to the rapidly changing transition economies, very limited data available and/or short time periods observations. See also Pohl, Anderson, Claessens, and Djankov (1997), Claessens and Djankov (1999), and Frydman, Hessel, and Rapaczynski (2000).

7) At the same time poor quality of services and products might result.

8) The NPF was established with the purpose to assist the privatization of national property and clearly separate the administration of companies targeted for privatization and the privatization revenues from the government. The NPF assumed ownership of state property and, based on the individual privatization decisions, transferred this property to private persons. The use of the NPF-held property is decided upon by the Parliament. However, the NPF was politicized with many sales absolutely disadvantageous for the State.

9) The projects were often cases of privatization abuse. E.g., on February 8, 1994, *Matica slovenská*, a.s. signed a contract on the privatization of *Neografia*, a.s., valued at SKK 600 million for a symbolic SKK 1, against the promise to support HZDS (SME, April 19, 1996, p.5). Another example is the company *Manager*, a.s., which was founded on March 11, 1994 by the managers of *Východoslovenské železiarne*, a.s. (VSZ; Eastern Slovak Steel Works). It was the day of the no confidence

vote to the government of Vladimir Meciar. Three days after its foundation, it obtained approval for the privatization of 9.53% of VSZ's shares at SKK 200 per share, even though the market value at that time was three times higher (Trend, Oct. 11, 1995).

10) The NPF Presidium Chairman Stefan Gavornik underscored that NPF's goal was to create a strong community of domestic businessmen. The only thing that mattered was "whom to will Slovakia belong" regardless of the sales price (Hospodárske noviny, October 24,1995, p.4).

11) In the period from January through November 1995, NPF received SKK 6.7 billion out of the total agreed sales prices amount of SKK 35.2 billion representing some 20% (Hospodárske noviny, February 11, 1996; Trend, November 15, 1995).

12) According to the Tax Act amendment dated March 1996 acquirers were exempt from paying tax on the income incurred by them as a result of the waived payment for the acquired property.

13) The state must still retain ownership of railroad rights of way, postal services, water supplies (but not suppliers) and forestry companies.

14) The OECD estimated that 70,000 persons were eligible in the former Czechoslovakia for compensation, focusing on relatively small assets. Furthermore, some 10% of all state property (around US$ 10.7 billion) was to be returned under the Large Restitution Act, the second part of the program that in general aimed at the transfer of larger assets.

15) With the participation of minimum five competing bidders, the auctioneer is gradually decreasing the initial auction price, always by 10% at a time, but not more than 50% of the initial auction price, or, in repeated auctions, not more than by 80% of the initial auction price (for more detail see M.E.S.A, 1999; p.27).

16) Here it is necessary to be aware of the fact that the market value of the assets differed from the book value. Therefore, it could be assumed that the share of direct sales was probably more significant than 7%.

17) Under non-standard methods there are non-existent market institutions, the price structure is distorted, the function of money is restricted, the legal prerequisites are inadequate, etc. These methods are specifically "tailored" to particular conditions of a given state.

18) Studies have analyzed the influence of voucher privatization on the price of company shares soon after their placement on the market. The studies actually established that unlike in voucher scheme, a concentration of ownership improved the capital costs and performance of the companies (e.g., Lastovicka et al., 1995; Claessens and Djankov, 1999; Marcincin, 1997; and Marcincin and van Wijnbergen, 1997a).

19) According to data of the Center for Voucher Privatization, the IPFs acquired 72% of all vouchers. Out of that IPFs registered in the Czech Republic obtained 73% and IPF registered in Slovakia 27%.

20) This can be illustrated by the case of First Slovak Investment Privatization Company (PSIPS). This fund attracted 190,000 investment voucher holders, primarily from among the ranks of pensioners by promising them to buy out shares which the investment vouchers holders would acquire on the basis of investing of the whole voucher book, within one year for a sum of SKK 20 000. Already this promise, which was not feasible when massively applied, (at the same time

the highest among all funds) should have alerted the Ministry of Finance to be more cautious in supervising the activity of this fund and its managers. It was only on the basis of an audit control made on July 11-15, 1994, that the MF SR issued a decision to suspend PSIPS from handling property and place it in receivership. The controls revealed that the founder of IPF unlawfully billed a reward of more than SKK 125 million for the management of assets, and there was a faulty reward accounted for the management of the fund in the year 1993.

21) IPFs were only allowed to own a maximum of 20% of any single enterprise. This was in 1995 reduced to 10%.

22) For a detailed description of the second wave, see Olsson (1999).

23) Sources: Hospodárske noviny (1996), April 18; Pravda (1996), June 3, June 6; Profit (1996), June 1; SME (1995), June 27, SME (1996), January 9; Trend (1995), August 16, Trend (1996), May 15, June 5.

24) That resulted in a shrinkage of the book value of the property earmarked by the previous government of Jozef Moravcik for the second phase of voucher privatization from SKK 100 billion to SKK 33.3 billion.

25) Transfer pricing and sale of assets were two ways a manager - owner would exchange private information for profit. Usually a state owned loss-making company was left with a high volume of unsettled bank debt and debt to input suppliers. Its products were then sold below market price through highly profitable trading companies. These products were sold to the original customers of the state owned company.

26) With regard to capabilities, it was never clear that even the biggest banks had any necessary knowledge and capabilities for facilitating effective restructuring, even if proper incentives were in place. Bank representatives, just like managers in the enterprises in which they were investing, had spent their careers as bureaucrats in command economies and thus did not have any experience with the financial and operational management of a firm in a market economy.

27) In order to have any positive effects on corporate governance, equity markets must be large and liquid, that is, investors must be able to move in and out of investments relatively easily while incurring relatively low transaction costs. But Slovakia did not develop such an equity market. There were a few simple reasons, particularly the too small number of equities available to trade on these markets, lack of good financial and operational information, missing or poor industry and managerial expertise.

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