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Privatization, Asset Distribution and Equity in Transitional Economies

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ABSTRACT

The economies in transition are experiencing unique changes in the distribution of assets. The growth in the share of private ownership is occurring through the privatization of state-owned assets and through the birth of private firms. The changes in the property rights regime are exceptionally complicated in transitional economies. In the period of central planning the state not only possessed practically all assets, but also provided secure employment, low-priced housing and subsidies for industry. As the socialist system is replaced by private ownership and a much reduced role for the state, a completely new system of property rights must evolve, in addition to the changes in legal ownership.

When a country is experiencing this kind of institutional change, it is obvious that the resulting distribution of wealth might sharply deteriorate, and the whole transition process could lose its social acceptability. Income inequality and poverty have increased in all transitional economies during the past decade. A part of the growing income inequality has been induced by greater asset concentration, which has a special significance in transitional economies, in which the share of capital and entrepreneurial income is rising. The inequality problem has been particularly crucial in the early transition years, because privatization and the secondary markets of privatized assets have triggered a redistribution of assets at prices well below market value. The scope for concentrated asset distribution is evident.

In this paper we examine the changes in the distribution of assets during economic transition. We compare the initial conditions, privatization methods, the secondary markets of privatized assets and the birth of the enterprise sector in different transitional economies of Eastern Europe and East Asia. The main task is to analyse the way in which different policies and conditions affect the equity of asset distribution and the degree to which various countries have succeeded in avoiding the concentration of assets into the hands of a small privileged class and in encouraging the creation of an efficient and more egalitarian private sector. Finally, we outline several paths for the changes in ownership structure that have emerged in these countries.

1. INTRODUCTION: POVERTY, ASSET AND INCOME DISTRIBUTION IN TRANSITIONAL ECONOMIES

The problems involved in the economic and political transition in Central and Eastern Europe and Asia have already been widely discussed and recognized. Most of the research on economic problems has focused on the fall in income and output and the rise in inflation and unemployment. However, the effects of the decline in total wealth will become even worse, if the decline is spread unevenly. Therefore, the micro-level changes are at least as important for the well-being of society as are the changes in aggregate variables. This paper deals with critical issues of transition: privatization and the emergence of new enterprises. The emphasis is on the equality of the ownership reforms during transition.

Since the collapse of central planning, there has been a considerable surge in poverty in the former socialist countries. The share of the population whose income has fallen under the poverty line has been remarkable in all transitional economies, with the exception of only a few Central European countries. Even in these latter, some poverty increase has occurred. The significance of the growing poverty cannot be understated, especially in a situation in which notable political and economic changes are being accompanied by a vast expansion in the number of people reaching the limits of non-sustainable living standards. It should not be surprising that the public belief in the market economy system is at stake, since a large portion of the population must pay a high price in the form of sudden impoverishment for the advance in political freedom and the supply of goods.

There are several methods to determine the level of poverty. Poverty can be measured as a percentage of the average income in a country or as a share of the people living under a dollar-specified income level. The first approach tells us more about income distribution, although it disregards aggregate income level, whereas the second approach gives a more specific volume of absolute poverty, at least by Western standards, although it largely overlooks the relationship of poverty to the typical income level.

In Table 1.1, the share of poverty in some transitional economies is offered, first, in terms of the percentage of people earning less than 21-27 per cent of the country's average income (poverty relative to the country) and, then, in terms of the percentage of people earning less than $120 purchasing power parity (PPP) monthly income (poverty relative to the world). Although the figures for the poverty relative to the country are on average slightly higher, the trend of increasing poverty and the differences among various countries are visible in both cases. Both methods used in the table measure income poverty and ignore asset ownership.

Only the so-called 'Visegrad countries' (with the exception of Poland) have maintained a poverty level of under 10 per cent during the transition period. Of the 19 countries observed, 14 have seen more than one fifth of their populations falling below the poverty line. The jump in poverty has been even more significant in some republics of the former Soviet Union. The dollar-income of more than half of the Kyrgyz and Moldovan population has declined to below the poverty line during the transition, while the income of more than half of the Azeri population has collapsed to less than one quarter of the country's average income.

Table 1.1: Increase in poverty and GDP decline during transition

	Poverty relative to the country[1] *(%)* 21-27% of avg. income			*Poverty relative to the world*[2] *(%)* income < $120 PPP			*GDP change*[3] 1995 as % of 1989
	1989-90	**1993-94**	**in-crease**	**1987-88**	**1993-94**	**in-crease**	
Azerbaidjan	11.1	65.2	**54.1**	..	..	..	34
Belarus	..	..	..	1	23	**22**	54
Bulgaria	2.0	32.7	**30.7**	2	33	**31**	73
Czech Rep.	0.2	1.4	**1.2**	0	<1	**0-1**	87
Estonia	1.0	27.0	**26.0**	1	40	**39**	66
Hungary	1.1	4.0	**2.9**	<1	3	**2-3**	85
Kazakhstan	..	..	..	5	50	**45**	46
Kyrgyzstan	..	..	..	12	84	**72**	42
Latvia	1.3	33.5	**32.2**	1	25	**24**	54
Lithuania	1.5	39.1	**37.6**	1	46	**45**	41
Moldova	2.4	40.6	**38.2**	4	65	**61**	40
Poland	5.8	10.9	**5.1**	6	19	**13**	99
Romania	7.0	25.3	**18.3**	6	39	**33**	84
Russia	..	..	..	2	45	**43**	54
Slovakia	0.1	5.1	**5.0**	0	<1	**0-1**	86
Slovenia	4.5	6.1	**1.6**	0	<1	**0-1**	93
Turkmenistan	..	..	..	12	57	**45**	63
Ukraine	..	..	..	2	41	**39**	40
Uzbekistan	..	..	..	24	47	**23**	83

Sources: [1] UNICEF (1995). Poverty lines: 21 per cent of average income for the Czech Republic and Slovenia; 24 per cent of average income for Estonia, Hungary, Latvia, Lithuania, Poland and Slovakia; 27 per cent of average income for Azerbaidjan, Moldova and Romania. [2] Milanovic (1996). [3] Calculated from EBRD (1996).

Table 1.1 also shows the changes in GDP that are measured as the ratio of 1995 real GDP to 1989 real GDP. Even the most rapidly recovering country, Poland, had a GDP slightly beneath the 1989 level in 1995, while five FSU Republics have experienced a more than 50 per cent decline in the real GDP over the past six years. Increasing poverty seems to be related to a bigger decline in GDP during the transition, although even some countries with a relatively modest drop in production, like Estonia and Romania, have experienced a radical climb in poverty. A surprising feature of Table 1.1 is that the increase in the poverty 'relative to the country' seems to correlate with a GDP decline at least as much as does the increase in poverty relative to the world. This means that rising poverty seems to be caused not only by a decline in aggregate income, but also by falling income equality.

Calculations by UNICEF (1995, page 11) for three transitional economies support the view that the poverty increase cannot be explained by a fall in total income alone. After the initial shock, widening income distribution has been a stronger determinant of poverty than has the decline of income per capita in both Poland and Bulgaria. Milanovic (1996, pages 117-19) has discovered a similar relationship between poverty rise and income inequality. According to Milanovic's regression model, a one point increase in the Gini coefficient of the distribution of income has led to an increase in poverty headcount of 1.06.

The climb in income inequality has been one of the negative consequences of the transition. Before the transition, the Gini coefficients of the distribution of income per capita were around 20-25 in the European socialist countries and around 25-30 in the Central Asian economies. The first range was comparable to the value of the highly egalitarian OECD countries, like the Scandinavian countries, and the second to the average of the OECD countries. Since the transition, the average income Gini coefficient for transitional economies has risen to over 30, which is similar to the figures observed in the least egalitarian Western European countries, such as United Kingdom and Italy. Some countries, like Russia or Armenia, with Gini coefficients of 48 and 51.5, respectively[1], have reached levels of income inequality comparable with the corresponding levels in the very inegalitarian Latin American countries.[2]

Figure 1 shows the increase in income inequality in transitional countries which are classified into four different groups according to the share of poverty in 1993-94. In all transitional economies, with the exception of Slovakia, the Gini coefficient rose in the beginning of the 1990s, and poverty has been more pronounced in countries exhibiting a greater rise in income inequality. Relative to the situation in recent years, poverty was at quite an equal level in the various

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[1] Figures from Milanovic (1996, pages 57-58), except for the Armenian Gini coefficient, which is from Bakhshian and Wyzan (1995).

[2] The Gini coefficients for Italy and UK in the early 1990s were 29.2 and 33.7, respectively (Atkinson 1995). Some observations from Latin American countries during the same period are: Argentina 47.6, Bolivia 52.5, Brazil 60.6, Mexico 53.5 (Deininger and Squire 1996).

countries during the socialist period, and the income Gini coefficient was between 19 and 28 in all countries observed (with the exception of China, where the reforms were undertaken ten years earlier). Transition has boosted inequality both within and among the different countries.

A group of four countries – Hungary, Slovenia and the Czech and Slovak Republics – stands out because of more equal income distribution and less extensive poverty. The Asian FSU countries and Moldova are having more problems with poverty than are the other countries. Of the European transitional economies, unusual jumps in inequality have occurred in Estonia, Lithuania and especially Russia. The Estonian case is an example of the fact that rapid economic liberalization and relatively successful monetary stabilization do not necessarily lead to the best possible level of equality.

Reliable poverty and income estimates from Asian transitional economies are harder to acquire.[3] The *Human Development Report* estimates a rather low poverty rate of 12 for China (UNDP 1994). In the case of Mongolia and Viet Nam, which are both given human development indices by UNDP that are lower than those for any other transitional economy (UNDP 1996), some economic and social indicators, like daily calorie intake or real GDP per capita, signal the existence of more than average poverty in these countries.[4] Similar observations for countries not included in Figure 1 strengthen the view that inequality and poverty are also problems in the Central Asian FSU Republics.

Income inequality has grown because some income components are spread more unevenly, but also because of the changes in the structure of income. The causes of the first type have been changes in government transfer policies and, more importantly, the abandonment of centrally controlled wage regulations and the market's inability to allocate resources among industries in a way which would equalize wages after the removal of state subsidies. One of the most significant changes in the structure of income has been the fall in the share of wages and the rise in the share of capital and entrepreneurial income. In socialist economies, there was very little possibility to gain capital income. Nowadays, the share of capital income in some transitional economies is approaching the level in market economies. This is not surprising, since the share of privately owned property is mounting quickly. This aspect is particularly significant since the distribution of capital and entrepreneurial income, in other words, income which is derived from

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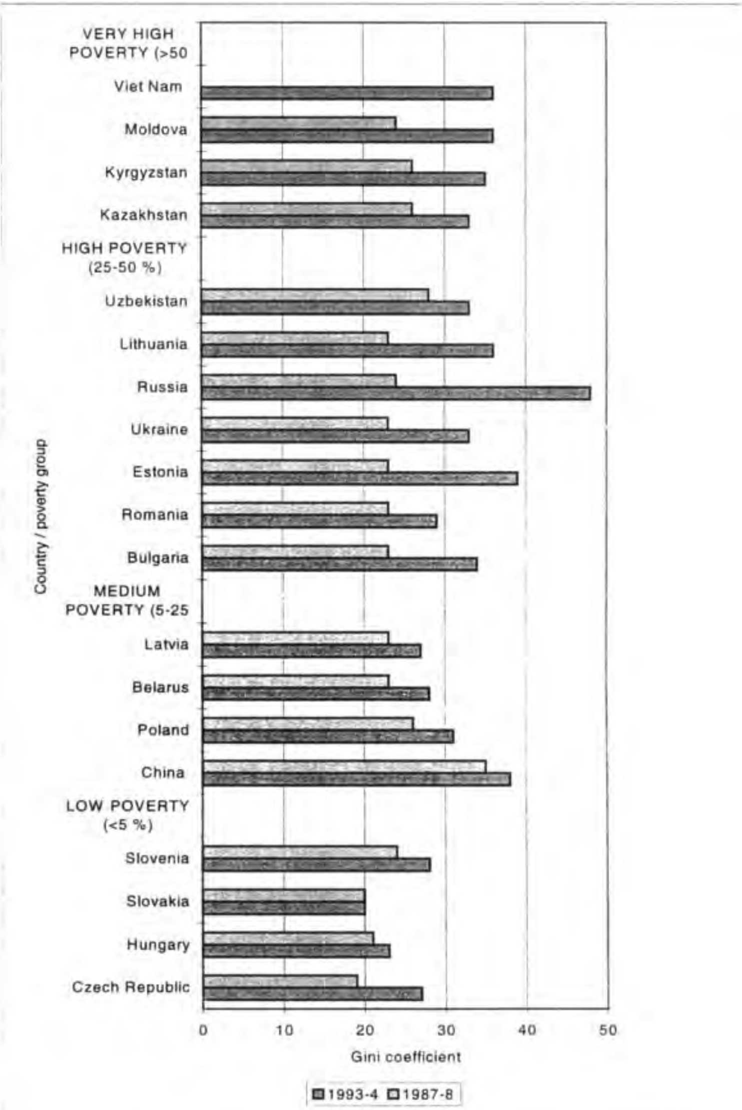
[3] The Chinese Gini coefficient (36) for 1993 is from the database presented in Deininger and Squire (1996). Alternative studies suggest an even larger spread in income distribution because of the difference between urban and rural areas. Zhang Ping (1996, page 12) has calculated a Gini coefficient as high as 43 for China in 1995.

[4] Poverty estimates based on a basket of consumption goods containing food items equivalent to 2100 calories per day set the Vietnamese poverty line at 51 per cent (World Bank, quoted in Irvin 1996).

FIGURE 1: INCOME DISTRIBUTION IN TRANSITIONAL ECONOMIES CLASSIFIED BY POVERTY GROUP



Sources: Deininger and Squire (1996), Milanovic (1996), UNDP (1994), World Bank (1996a).

the possession of physical assets, is predictably less equal than is the distribution of other kinds of income.

A decomposition of income inequality in four Central and Eastern European countries demonstrates this point. The share of wages in total income declined by 5-10 percentage points in Bulgaria, Hungary and Slovakia and by 17 percentage points in Poland (and even more in Russia) during the early 1990s. The significance of self-employment has risen even more substantially in all these countries except Hungary. The concentration indexes are in all cases lower for wages than they are for income from property, and the latter contributes significantly to aggregate income inequality in spite of its small share in total income.[5]

The relationship between asset and income distribution is a crucial one. During the transition, asset distribution has had a stronger than usual effect on income distribution because the share of capital income has risen. The inequality of income and the growth in poverty has also had an impact on the resale of privatized assets. The privatization programme is in most cases creating a large number of asset owners. If individuals have incomes which are under the subsistence level, not only will they have strong incentives to sell the assets, but they might be forced to do so at prices below market value. Therefore, poverty and an unequal distribution of income will not only be a consequence of unequal asset distribution, but also a cause of it. In addition to privatization, the distribution of assets is also influenced by the emergence of new private enterprises.

The shape of asset distribution is a very important factor in the transition process, because all income can be seen as returns on assets, either on tangible assets or on human capital. Generally speaking, it is hard to create a functioning market economy, if asset ownership is concentrated in the hands of a very small number of individuals. Not only will privatization have a strong influence on the distribution of income, but, even more important, the distribution of assets will be redetermined during the privatization process. For individuals brought up in a communist society, the loss of safe employment or other social benefits provided by the state sector cannot be offset by minor opportunities to enjoy the personal ownership of assets. It has already been shown that the transition has had significant destabilizing effects on the egalitarian distribution of income left over from communist times. If the distribution of assets turns out to be even more distorted and creates a notable distinction between those who possess assets and those who do not, the social acceptability of economic restructuring will become even more eroded.

[5] Concentration indexes for wages, self-employment and income from property in 1994 are: Bulgaria 31.1, 69.2, 42.2; Hungary 35.6, 32.3, 37.2; Poland 31.8, 44.1, 60,5 and Slovakia 25.2, 27.6, 51.0 (source: TransMONEE Database).

Although the privatization of state-owned property will definitely increase the aggregate wealth of households, the microeconomic benefits of the changes in wealth may not be so obvious. Because of the low initial level of personal property, presumably no-one will experience a decrease in asset ownership. Still, deprivation may arise especially among those who are left out of the privatization process or those who sell themselves out of it through a resale of received assets. With the emergence of the new owner class, those people on the lower end of the distribution will find their relative status worsened.

Of course, it is not only legal ownership which matters. The issue of property rights in transitional economies is a very complex one and has to be treated carefully. The legal shift in enterprise ownership from the public sector to the private sector did not automatically erase all the characteristics of social ownership. It has even been claimed that the level of employee influence in the enterprise decision-making process has remained at a very low level in spite of the growing share of enterprises owned by employees (Jones 1996). Not only asset ownership, but also the behaviour of enterprise managers after privatization is important for the welfare of workers. The various types of emerging capitalist models in transitional economies have affected differently the workers in formerly state-owned companies.

A situation in which the state has total control over all assets except human capital should be an ideal one for the creation of a society with completely equal asset distribution. Yet, in most of the transitional economies the distribution of assets seems to be quite distorted. The manner in which privatization is carried out is one decisive factor in the form asset distribution takes. However, asset distribution will also be affected in a way which is at least as important, if the privatized assets are resold shortly after privatization and if privatization creates a competitive environment with sufficient incentives for rational economic behaviour. The nature of the competitive environment is also significant in terms of the emergence of small private enterprises. When privatization programmes were drawn up, the primary goals were to raise the efficiency of production and create an enterprise management structure and legislation which would match the requirements of a competitive market economy. The goal of fostering an egalitarian distribution of privatized assets among all citizens was in most cases given less attention or completely disregarded. The more privatization was delayed and the worse the economic depression became, the more crucial the need for competent enterprise management and ownership became and the easier it became to ignore equality considerations.

The main topics of this paper are privatization, asset distribution and property rights. First, we define the expression 'asset' and the way to classify various types of assets. In section 3 we analyse the concept of property rights and the social significance of private ownership in centrally planned and transitional economies. In section 4, the difficulties in measuring asset distribution using purely quantitative methods are outlined. Since legal property rights do not always imply de facto ownership and because precise data on ownership are available only in rare cases, the complete process of the change in ownership during the transitional period will be described in this paper. We examine the initial conditions, the privatization programmes and their implications, the secondary markets for privatization vouchers and privatized property, and finally the advent of private enterprises in order to elucidate the nature of the distribution of assets and income in transitional economies. Section 5 presents the theoretical background for the equality effects of the privatization of tangible assets. With the help of this theoretical framework, in section 6 we evaluate the differences in the paths to privatization and the resulting asset distribution in transitional economies. In section 7 we draw conclusions, recognizing the depth of issues such as property rights and welfare changes.

In the empirical analyses contained in this paper, we do not include those Central Asian economies which have been affected by war during the transition period, namely, the three Caucasian countries and Tajikistan. In these countries, privatization, like most other transition measures, is hampered not only by economic, but also by political factors. The ownership structure is recovering from the effects of both the socialist regime and military conflicts, and the long-term outcomes are impossible to forecast at the moment.

2. THE DEFINITION OF 'ASSETS'

'Assets' are described in the SNA, the *System of National Accounts* (1993, page 217), as 'entities over which ownership rights are enforced by institutional units, individually or collectively and from which economic benefits may be derived by their owner by holding them, or using them, over a period of time'. There are many ways to classify various assets. They can be divided into financial and non-financial, produced and non-produced, or tangible and non-tangible assets, each of which can be subdivided. The capital accounts in the SNA rely on a very extensive classification consisting of a few dozen categories (see Tables 2.1, 2.2 and 2.3).[6]

The degree of classification is very much dependent on the statistical data available. For total assets, a study based on a classification of the sort used in the

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[6] For more detailed descriptions of various classes of assets, see *System of National Accounts* (1993, pages 217-22 and pages 305-14).

SNA might be feasible, but for the purposes of a study of asset and wealth distribution such a level of exactness is neither practical, nor necessary. Assets could be divided simply into land, housing, productive assets and financial assets. This sort of division was used in the 1988 Chinese household survey.[7] The first two categories, 'land' and 'housing', are small subdivisions in the SNA tables. 'Productive assets' include nearly all non-financial assets except land and dwellings, and 'financial assets' is the second main category of assets used in the SNA. Because of the limited sources of information, it might be difficult to measure every feature of the SNA in transitional economies. For example, the value of some intangible assets is extremely hard to gauge. In this study, we classify assets in a way similar to that employed in the Chinese household survey.

In addition to the four asset types recognized in the SNA, a fifth class of assets, human capital, is certainly an important factor and should be taken into account in future research. An individual's human capital is the sum of certain kinds of intangible assets possessed by him or her. Its value depends on indicators like education, health and age. To obtain reasonable results, changes in the distribution of human capital have to be treated separately from other assets, which are easier to valuate in absolute terms.

Table 2.1: Classification of assets according to the SNA

Non-financial produced assets

<table>
<tr><td colspan="10">NON-FINANCIAL ASSETS</td><td>Financial assets</td></tr>
<tr><td colspan="9">Produced assets</td><td>Non-produced assets</td><td>See table 3</td></tr>
<tr><td colspan="2"><u>Fixed assets</u></td><td colspan="4"><u>Inventories</u></td><td colspan="3"><u>Valuables</u></td><td>See table 2</td><td></td></tr>
<tr><td>Tangible[1]</td><td>Intangible[2]</td><td>Matr. & supplies</td><td>Work-in-progress[3]</td><td>Finished goods</td><td>Good for resale</td><td>Metals & stone</td><td>Antiques & art</td><td>Oth. valuables</td><td></td><td></td></tr>
</table>

[1] Tangible fixed assets consist of i) dwellings, ii) other buildings and structures, iii) machinery and equipment and iv) cultivated assets.

[2] Intangible fixed assets consist of i) mineral exploration, ii) computer software, iii) entertainment, literary or artistic originals and iv) other intangible assets.

[3] Work-in-progress inventories consist of i) work-in-progress cultivated assets and ii) other work-in-progress.

[7] The results of the Chinese household survey (McKinley 1993) are briefly reviewed in section 7.

Non-financial non-produced assets

NON-FINANCIAL ASSETS								**Financial Assets**
Produced assets	**Non-produced assets**							*See table 3*
See table 1	Tangible non-produced assets				Intangible non-produced assets			
	Land[1]	Subsoil assets[2]	Non-cultiv. biolog. res.	Water resources	Pat.d entities	Leases & other transfer-able contr.	Purch-ased good-will	

[1] Land consists of I) the land underlying buildings and structures, ii) land under cultivation, iii) recreational land and associated surface water and iv) other land associated with surface water.
[2] Subsoil assets consist of i) coal, oil and natural gas reserves, ii) metallic mineral reserves and iii) non-metallic mineral reserves.

Financial assets

Non-financial assets	**FINANCIAL ASSETS**												
See tables 1 & 2	Mon. gold & SDRs	Currency and deposits			Secur. other than shares		Lo-ans		Shares & other equity	Insuranc e techn. reserves		Other accounts	
		curre ncy	trans frbl. dep.	other dep.	ST	LT	ST	LT				Trade credits & adv.	Other

Memorandum items: Consumer durables, direct foreign investment.

In the former socialist economies education was provided by the state and was given a high priority. As a result, enrolment rates in socialist economies were higher than those in other middle income economies, and the number of university students per 10,000 population was higher than it was in Western Europe (see Cornia et al. 1996, pages 14-19). The transition changed the educational system radically, and this may have serious long-term effects on the distribution of human capital. However, in this paper, the distribution of human capital is disregarded, not because of its insignificance, but because human capital is certainly worth a more detailed look than is possible in the present context.

Certain durable consumer goods, like cars, televisions or washing machines, are often used as indicators for wealth. In the SNA, consumer durables are a memorandum item and are thus not classified as assets in this study. Because of the unique nature of consumer goods relative to other assets, consumer durables can be left out of this study without loss of accuracy, although taking them into account would probably raise the observed equality. A more precise look at the SNA definition of assets supports this view: no financial benefits can be obtained from consumer durables by using them or by receiving property incomes, and they cannot serve as a profitable storehouse of value.

A further classification problem evolves when state-owned companies are turned into joint stock companies. When the productive assets of a state-owned company are transferred to a joint stock company, a new type of assets is being created in addition to the productive assets: the shares of the company. The shares are classified as the financial assets of physical persons. For this study, the value and distribution of shares are among the most meaningful issues. The value of the productive assets of a company is not necessarily directly measurable through the value of shares (see later).

3. PROPERTY RIGHTS AND THE SOCIAL SIGNIFICANCE OF PRIVATE OWNERSHIP

'Property... is a much vaguer and complicated concept than is usually imagined and, as such, it is more a subject of inherently 'unscientific' historical and political inquiry than an object of theoretical economic analysis.' (Frydman and Rapaczynski 1994, page 172)

Property rights are an important matter in former socialist economies, since these economies offer an unusual example of rapidly changing ownership rights. In the economies in transition, changes in legal ownership have not always gone hand in hand with changes in de facto property rights.

Sun (1996, page 10) describes 'property rights' as 'sanctioned relationships among people or organizations that arise from the existence of scarce goods, pertain to their use and are sanctioned by norms, customs and laws.' He mentions three elements which are included in the concept: 'control rights', which basically means the right to utilize the asset, 'return rights', that is, the right to capture benefits from the utilization of the asset, but also the responsibility for any negative outcomes, and 'alienation rights', that is, the right to buy or sell the asset or portions of the asset or to transfer all or part of the other two sorts of rights mentioned above to someone else. Sun's definition recognizes both the legal aspect and what may be called the 'cultural aspect' of ownership. The existence of all three kinds of ownership rights is anything but obvious in any given case of private ownership. In the instance of socialist or transitional economies, this problem is by no means insignificant.

Although privatization principally involves the legal transfer of property rights from the state to individuals, the recognition of different kinds of ownership rights actually becomes even more complicated during and after the process. A completely new system of private property rights has to be developed in the society. Especially in the privatization of big and medium sized state-owned enterprises, it is important to understand precisely which elements of property rights are being transferred. Furthermore, the whole issue of privatization must be handled very cautiously. The experience with the privatization of state-owned enterprises in Western market economies cannot be applied in transitional economies as such.

The importance of private property to a nation which has not had it for generations is extremely hard to evaluate. In socialist economies, private ownership for individuals was not perceived as very essential. The material and social advantages provided by the socialist state were regarded as more important than private ownership; indeed, in a way it was considered as a substitute for private property. Secure housing was provided at very low prices; full employment was guaranteed, and the state subsidy system kept the prices of most consumer goods low. When the state gave up most of its assets and abandoned the planned economy, it could no longer provide secure employment, cheap housing and large subsidies for industry, agriculture and private consumption.

It might be said that privatization will cause a major shift in asset ownership from the state to individuals, thereby increasing the wealth and welfare of the private sector. However, an examination of the entire transition process reveals that much more is involved than merely a change in legal ownership. The way in which the new entrepreneurs will behave and the way in which the interests of workers and other stakeholders are dealt with must also be considered. Important social aspects, like secure employment and wage policies, can be treated in many different ways. If there is full employee control, then the interests of workers will tend to be favoured directly. On the other hand, if there is shareholder control of an American type, then the profits of owners will tend to be protected. The way in which different interests are balanced is not dependent only on the distribution of legal ownership, but also on the type of capitalism that emerges.

The emergence of a shareholder or stakeholder capitalism is a very crucial event, especially in terms of the transfer of rights.[8] When a huge number of companies

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[8] For a discussion about the classification of various types of capitalism, see *The Economist* (1996).

changes hands, a battle for control over assets and other benefits of ownership will undoubtedly emerge, regardless of the original aims of privatization. From this point of view, it is also important to understand, that privatization is not performed without complexities. Frydman and Rapaczynski (1994, pages 174-76) list three factors which render privatization and the ownership transformation process complex in transitional economies.

(i) The conveyance of a particular 'vested type of entitlements' may be hampered by the role of the state as both rulemaker and as a player in the privatization process and by the absence of certain self-enforcing mechanisms which are essential for the institution of ownership. The state, former officials of the state or enterprise managers may be unwilling to surrender all their control over some assets, leaving the new owners unsure of their rights in regard to the privatized assets. Therefore, a change in purely legal ownership may not be sufficient to bring about a new respect for property or as an incentive for reasonable economic behaviour. Frydman and Rapaczynski claim, rightly, that these self-enforcing mechanisms, which already exist in market economies, are more important for the new system of ownership than are any changes in the legal system.

(ii) Changes in ownership must not be seen as purely economic events. In the centrally planned economies, the allocation of scarce resources among different industries and enterprises was distorted by the noxious behaviour of state officials. There is no reason to believe that this kind of behaviour will vanish immediately following a legal change in the form of ownership. Instead, the possession of assets must also be seen as a political phenomenon.

(iii) Not only is ownership changing, but also management and governance must be completely reorganized. There is no superior method to accomplish this, but the way in which ownership and management are linked will have an impact on the future significance of private property.

As a fourth factor, we could add the simple fact that privatization in transitional economies involves not merely one or two big companies. Practically all state assets are being privatized at once or over a very short period of time. A privatization of this magnitude has never been undertaken before.

Because of these complications, not all enterprises are privatized according to government plans. The so-called 'business nomenklatura', which consisted of certain managers of state-owned enterprises, was in the final years of socialism able to collect wealth and political power. Instead of taking part in the legal privatization programme, some managers declared themselves owners of the companies. In transitional countries with weak central governments and corrupt local leaders, this was possible, especially when the nature of private property was not yet understood by the majority of the population.[9] Obviously, this sort of behaviour led to the creation of a new privileged class. The unclear, overlapping and even contradictory property rights upon which socialist enterprises were based rendered it very difficult to carry out privatization in a fair and just manner. More or less justifiable claims to enterprise ownership could be made by several individuals and institutions (Johnson 1991). Spontaneous privatization must not be seen only as illegal behaviour by the communist nomenklatura, but as a phenomenon made possible because of the vague property rights existing in socialist economies.

One should not expect every transitional economy to become a market economy according to the models prevalent in Western Europe. Several kinds of new economic systems, based on differing concepts of private property, will be born out of the former socialist economies. This means that the economic behaviour of individuals must be interpreted with care. In some situations, the acquisition of private property may not be preferred over immediate consumption, even if the prospects for increasing wealth through asset ownership might seem extremely good. This sort of consideration will especially affect the resale market for privatized assets and could lead to huge changes in wealth distribution during the first years following privatization.

The importance of control rights and proper incentives for rational economic behaviour boost the significance of the new private sector. In the case of former state-owned enterprises, changes in control rights and in corporate governance do not occur overnight, and the inefficient and inequitable enterprise management system of the socialist era may not be completely dismantled for many years yet. On the other hand, new enterprises are being created according to the current rules and the competitive environment, and the new companies are less likely to be as complicated as were the typical enterprises in centrally planned economies.

4. DIFFICULTIES IN THE MEASUREMENT OF ASSET DISTRIBUTION

'[W]ho works with capital statistics... must be blind for difficulties, blinded by statistical enthusiasm, otherwise he would never be able to complete his calculations' (Erik Lundberg, quoted in Spånt 1975).

Not only is the physical distribution of assets an insufficient welfare indicator, to measure it precisely with credible instruments may also be impossible.

[9] For example, see Saizew's (1994) study of the new Russian entrepreneur class.

There are several methods and parameters, like the Gini coefficient or the decile ratio, that are frequently used in wealth distribution studies. Research on income distribution is performed quite frequently, and the relevant data are rather readily available, for example, in the form of tax statistics or household budget surveys (HBS). However, some kinds of numeric statistics on asset distribution are difficult and sometimes impossible to find. This problem is apparent even in countries with developed capital markets and sophisticated statistical capabilities. In a study of countries in which the extensive private ownership of assets has existed for less than a decade and statistical registration is still in its infancy, the problems become even more perceptible. Gauging the distribution of assets requires a great deal of creativity in the development of research mechanisms.

(i) A widely employed method for the collection of data on personal income and wealth has been HBSs. Surveys on wealth distribution have been performed in many transitional economies. An HBS has the advantage that a researcher can ask for exactly the kind of information which is needed for his project. However, nationwide household surveys always face the problem of reliability and validity. There are issues which cannot be neglected, like sample selection, the drafting of survey questions which do not suggest certain answers and which are not obscure, and the acquisition of reliable responses. The last of these three issues is of great importance in the former communist countries. Factors which are beyond economics, such as the historical and political background, explain the suspicions individuals feel towards those who ask for any sort of personal information. Even in countries with more liberal political regimes, the interpretation of survey data on income and wealth is never easy. Because of the fear of the tax authorities, for instance, survey data on personal income and asset ownership frequently suffer from underreporting.[10] The biggest limitation on HBS data for the analysis of asset distribution is the fact that, though very simple, most household surveys on wealth distribution in transitional economies have concentrated on the distribution of income, not of assets.

(ii) A second commonly employed method is the use of data collected for the purpose of the taxation of property. The advantage of tax data is their availability, although even this advantage is less apparent in transitional economies. Spånt's survey on asset distribution in Sweden relies for the most part on tax statistics.[11] The use of property tax data to measure asset distribution has many drawbacks. Not all assets are taxable, and a study based only on data on taxable assets is not representative of the distribution of all assets. Spånt has calculated that the wealth

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[10] The problem of underreporting is raised, for example, by Cornelius (1994, page 9), who assumes that the amount of poverty in Lithuania is overestimated because of the underrecording of income in HBSs. Studies on Russia have indicated that total income measured by income statistics is two times higher than total income calculated on the basis of HBSs.

[11] For detailed results of the study, see Spånt (1975).

tax is paid on only 9 per cent of all financial and non-financial tangible assets (excluding human capital) in Sweden. The figure is probably even smaller in the transitional economies, because they possess less developed taxation systems. The distribution observed on the basis of taxable assets is assumed to be more equitable than the actual asset distribution (Spånt 1975, page 66).

An even more significant limitation of wealth tax data is the fact that a cutoff point is normally set on the value of property that can be taxed. To what extent this reduces the number of individuals taken into account depends naturally on the cutoff point, but in most market economies only a small percentage of physical persons possess an amount of wealth that exceeds it (for example only around 3 per cent in Sweden in 1969; Spånt 1975, page 67). The share of property tax income in government revenue is by no means larger in transitional economies than it is in market economies.[12] We can therefore assume that property taxation is a potential tool only for the examination of the distribution of taxable assets of a small number of wealthy individuals in transitional economies.

Since some assets yield income, statistics on capital income taxes could be used to measure the distribution of some assets. Not only for the reasons mentioned above, but also because of the fact that the profits of an asset by no means tell the whole story about the value of the asset, capital income is likewise not an ideal yardstick of asset distribution.

Moreover, while it may be possible to determine how certain assets are distributed among certain groups of individuals, one must be careful in estimating the value of these assets. The tax value of many assets is sometimes only a poor indicator of the market value of the asset and therefore of asset distribution. Likewise, changes in value over time must be studied with care.

(iii) Spånt has calculated estimates for asset distribution based on capital tax settlements taken from a sample of tax return forms. In this way, he has included all wealth classes and achieved a more precise picture of the distribution of various kinds of assets. A survey like this would also generate more accurate results in transitional economies, but questions about underreporting and failures in statistical accounting methods and tax collection must be raised. Furthermore, the practical implementation of these sorts of surveys in a rather large number of transitional economies has so far not been possible in this context.

(iv) Other statistical sources for the analysis of asset distribution include land records and industrial censuses. For these sources, underreporting is probably much less pronounced than it is for tax statistics and HBSs. Nonetheless, the

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12 See IMF (1993, page 43).

problems of validity and of data collection in transitional economies are not completely solved.

In summary, there are major problems in the collection and analysis of exact numeric data from HBSs, property tax information or investigations based on tax return forms. The difficulties involved in such research would most probably be very great, and the results not particularly accurate. Moreover, tax legislation and the collection of statistics are still in their infancy in transitional economies, and this renders it extremely difficult to find sources which cover all the categories of assets and population classes required. And even if this kind of data is available, the results will be biased because of inconsistencies in the valuation of assets, differences in tax legislation and problems related to underreporting. This last is the most restrictive factor on the use of HBSs for the examination of asset distribution.

5. DISTRIBUTIVE ISSUES DURING THE TRANSITION: A THEORETICAL PERSPECTIVE

Because of the problems in the collection of data on asset ownership among households, we will now try to discover in a more analytical fashion the causes of wealth inequality and the effect on asset distribution of various exogenous and policy-related factors in transitional economies. In this way, not only the distribution of legal property rights, but also the whole process of change in property right regimes and the social significance of ownership during the transition will be analysed.

Given the initial distribution of assets in centrally planned economies, the changes in asset distribution during the economic transition are being determined by two steps which have been taken. The first is the privatization of formerly state-owned property that for some assets is defining long-term ownership structures, but for others only the short-term distribution. In the latter case the second step, the resale of privatized assets, has to be taken into account. Moreover, new enterprises are emerging that have at least partly been built up using capital which was not formerly state-owned property and that are more capable of implementing corporate governance and the distribution of de facto property rights of a market-economy type. For both the resale of privatized property and the emergence of new enterprises, the development of financial markets is of key importance.

It has to be stressed that our initial analysis of privatization deals chiefly with de jure property rights. In general, de facto property rights are far more important than appears from such an analysis. Major decisions concerning not only asset owners, but also the much larger number of people affected by the actions of big enterprises, are made according to the control rights exercised by the various people in enterprises. Therefore, we will first deal with the privatization of legal property rights, and then later, in connection with secondary markets and new enterprises, we will discuss other types of property rights, economic incentives and the competitive environment.

5.1 Initial conditions: the explicit and implicit distribution of assets in socialist economies

In terms of equality in asset distribution, two different measures from the period before the transition are important: first, the share of private ownership and private activity in the economy and, second, the extent of the autonomy of enterprises in production and decision making.

The communist economy recognized three kinds of ownership: state ownership, collective ownership and private ownership. Almost all assets were owned either by the state, or collectively. According to Western legal principles, state-owned assets would not be owned by any private person and collectively owned assets would be owned equally by all members of the collective. For a determination of actual ownership, such a view is certainly insufficient.

According to Sun's definition of property rights (see earlier), with the exception of a small group of decision makers in the central government, no individual possessed any property rights over any state-owned assets. Individuals had no alienation rights and only very limited return rights over collectively owned property.[13] The level of control rights possessed by the members of cooperatives varied among individuals and among enterprises. In most cases control over collective enterprises remained firmly with the central government.[14] So-called 'private property' in socialist economies consisted mainly of small plots of agricultural land, housing and small family businesses. Alienation rights over these assets existed only in rare cases. On the other hand, the differences in the control rights exercised over state-owned, collectively owned and privately owned housing were meagre. In most cases housing was free, or at least rents were heavily subsidized, which made the cost of living almost the same for everyone. Lifetime tenancy in state-owned housing was seen as a public right (UNICEF 1995, page 77). Individuals could also exercise significant return rights

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[13] For the sake of simplicity, the possibility of enjoying such non-economic benefits as the right to live in one's own home is not included here under return rights.

[14] For example, see Frydman and Rapaczynski (1994, pages 102-06) and Demekas and Khan (1991, pages 3-9).

over the economic benefits derived from private land or from small family enterprises.

Since most private property in socialist economies consisted of small farm plots, small family companies and private housing, the chances for individuals to amass significant assets were minor. Therefore, growth in private ownership can be expected to increase equality. The more private property there is in an economy, the more people there are to share it and the fewer people there are who left out of ownership. The extent of private ownership must be measured separately for different assets or, at least, estimated on the basis of the level of private activity in the various branches of an economy. The hypothesis that the aggregate wealth was distributed equally is supported by a look at the restrictions on private activities and private ownership. For instance, one could compare the maximum size of private plots. The legislation and the empirical evidence regarding the power of employees and managers in state-owned enterprises reveal, for the most part, the way in which the control over some assets was distributed.

Ownership was important not only in the legal sense. The existence of control rights were of special significance, since return rights and alienation rights were extremely rare. This factor concerns more than anything else the privatization of state-owned enterprises. The more power one has in the decision making process within an enterprise, the more one is willing to be financially involved in the enterprise. If big enterprises are privatized and turned into joint stock companies, the possibility to possess control over the enterprise can be a decisive incentive for the retention of ownership. Control rights are also important in the maintenance of certain social assets, like good working conditions and safe employment, even if workers do not become the owners of their companies.

Rapacki (1996) claims that those countries which permitted strong labour unions and management control over big state-owned enterprises were in a disadvantaged position, because the possibility of rapid top-down privatization was limited. At least in terms of equal asset distribution, this disadvantage is debatable. What is lost in the speed and efficiency of privatization will be gained in the availability of shareholders knowledgeable about management and in the stronger incentives for the retention of ownership. Although delays in the implementation of privatization are generally harmful, if they are caused because of negotiations over the best way to share management and the benefits of distribution and not by financial, bureaucratic or political issues, the lag will not cause much damage, at least in cases where future shareholders acquire more insights into company management.

schemes, insider privatization will, at least in the short term, lead to a relatively wide distribution of wealth, the equality effects are not that simply judged. If shares are given out only to employees free of charge or at an extremely low price (for example, to offset the loss of employment security), then the unemployed, students and those under working age become outsiders. Even more importantly, values and capital/labour ratios vary remarkably among enterprises, and this renders the position of employees in the more valuable firms privileged, although in most cases enterprises with huge capital/labour ratios, like electricity plants, have been privatized through voucher schemes rather than through pure insider privatization.

Insider privatization will also bring the initial prices of enterprises several steps further from maximum-profit pricing than will the direct sale method. Therefore, the privatization of big and medium sized companies creates an unequal distribution of shares in the long run, although it enables the participation of a large number of employees at the outset. Other disadvantages of insider privatization are the absence of outside investors and the privileged position of enterprise managers.

In summary, while voucher privatization can be considered as an equalizing method and restitution mainly as an inequalizing method, direct sales and insider privatization are theoretically more complex and should be examined carefully. Direct sales will exclude a large share of the population from asset ownership, but the valuation of assets in auctions will bring the prices of assets closer to maximum-profit pricing. Insider privatization gives many individuals the possibility for legal ownership, but the long-term effects are not very favourable. Experience has shown that insider privatization, at least in the magnitude of the Russian case, has increased inequality. In practice, all European transitional countries have used a combination of these four privatization techniques, whereas in China long leases and marketization without a legal transfer in property rights have been the most common way to cut the state's involvement in industry and agriculture. In most cases, equality considerations have not been seen as so important for enterprises which could be sold at a competitive price either to domestic, or to foreign investors. Since the aggregate book value of state-owned assets has been much greater than has the purchasing power of citizens, it is, however, obvious that most of assets have been privatized through means other than the direct sale.

5.2.2 The Chinese property rights reform

Because of its uniqueness, we will discuss the Chinese property rights reform separately. China has been fostering a more market-oriented economic system more or less since the end of the 1970s. The distinctive feature in the reform of property rights in China has been the transfer chiefly of de facto, rather than legal, property rights.

The Chinese land reform which started in 1978 involved the distribution of small plots of agricultural land to families without the legal transfer of full property rights, but through long leases. However, in the research on asset distribution, land leased for several decades can be treated as private property. In effect, the leasees of the land acquire the right to allocate economic resources (Zhang 1996, page 5), meaning that they acquire significant control and return rights over the land, and lack only the alienation rights. The Chinese economic reform began to focused on urban enterprises some years later. The goals were similar, and the ownership of enterprises remained with the state, but managers and workers acquired more control and return rights. Only in the 1990s has something which can be called 'privatization' in the European sense been starting slowly. This has also involved the transfer of legal property rights and alienation rights to individuals. The share of private property income has, however, remained at a negligible level even in recent years (ibid., page 22).

The Chinese HBS in 1988 was the first effort to study the distribution of assets in an economy in transition from socialism to the market economy. Although the research was carried out only in the rural sector and although the case of China is difficult to apply to other transitional economies as such, we will point out some of the results and features of that survey. Of the four groups of assets (housing, land and productive and financial assets), land and housing were distributed the most equally, with Gini coefficients of 31 and 49, respectively (McKinley 1993, page 118). Similar results can be expected in rural areas in other transitional economies, because these two groups of assets are essential for each individual, and equal distribution will therefore be preferred. Among urban populations, we can expect an equal distribution of at least the housing stock.

The most unequally distributed assets in China were financial assets, with a Gini coefficient as high as 86 (ibid., page 118), a fact which has also been observed in other transitional economies. When stock markets emerge rapidly and there are significant market imperfections, the rise of inequality is more probable in areas in which quick profits can be made and in which a new type of ownership rights appears. One should keep in mind, however, that the privatization of enterprises has also been carried out in a way which is quite different in China. In China, collectively owned township and village enterprises have retained a significant role.

The Chinese study also found that all four groups of assets were less equally distributed than were assets on aggregate. This appears very reasonable. It was not the goal of the privatization process to distribute all groups of assets equally, but rather to offer citizens a choice in the ownership of various kinds of assets. The mass privatization programmes represent a good example: usually privatization vouchers could be used to purchase housing, land, or shares in enterprises. Therefore, the unequal distribution of one group of assets does not necessarily mean that assets in general were unequally distributed.

5.2.3 Key issues: The valuation of assets and the speed of privatization

(i) The valuation of assets

It is essential to raise one general problem in privatization: the valuation of assets. We can realistically suppose that the book value of the capital stock of a transitional economy is about 200 per cent of GDP. It is obvious that, with annual net savings rates at around 10 per cent of GDP or even less at the beginning of the transition process, the market value of state-owned assets could only have been a fraction of the book value if the assets were intended to be sold to domestic investors. Therefore, a rapid privatization of state-owned assets would lead to a huge undervaluation and partially to giveaways. In most transitional economies foreign investors have been a welcome feature, but only to some extent. No country wishes to transfer too large a share of its assets to foreign owners.

One would expect that the lower the prices of assets, the greater chance that individuals with lower incomes will have to purchase the assets and the more equal the distribution will be. Therefore, an undervaluation of assets per se should not increase inequality. On the other hand, Chilosi (1996) points out that those who are wealthier and more well endowed with financial resources benefit the most from the opportunity to purchase assets at a price which is lower than the maximum price they would be willing to pay. This means that maximum-profit pricing would also be the ideal solution in terms of equity. Whether the undervaluation of privatized assets is equality-increasing or equality-decreasing is not so simple to determine. The decisive factor is the secondary markets. If the undervalued assets are not expected to be resold and if the opportunity to purchase them is offered on an equitable basis during privatization, then undervaluation will give more people the possibility for private ownership and hence increase equality. In the case of assets for which secondary markets exist, undervaluation, although being fair in the short run, can be an equality-decreasing factor in the long run.

Small privatization involves assets which are not liquid and which have a non-financial value for the owners, or, in other words, assets for which no active secondary markets exist. The purchase of some of these assets is more likely to include resale prohibitions. The results of small privatization generate reliable information about the distribution of these assets even in the longer run.

Furthermore, small privatization does not change the character of the assets in question, unlike the situation when the ownership of joint stock companies is registered in the form of shares. In the former case, tangible assets are privatized as tangible assets, and individuals acquire not only ownership, but also direct control. In the latter case, individuals become owners of financial assets and often acquire practically no control over the productive assets. The acquisition of control over the asset is a strong incentive to retain the asset. The incentive to retain ownership is even stronger if the asset is controlled by the new owner even before privatization.

Because of secondary markets, the issue which presumably causes most inequality in asset distribution is the privatization of big state-owned enterprises. Liquid assets, like shares of newly formed joint stock companies, might change hands many times during a short period after the initial privatization, and in that case the scope for a radically concentrated ownership structure is evident. For these assets, in addition to an examination of the privatization process, a closer look at the functioning of resale or secondary markets is required. Still, the short-term distributional effects are not unimportant, although the long-term distribution of the shares of big joint stock companies will be determined mainly after the secondary markets have developed.

Table 5.1: Differences between small privatization and the privatization of big and medium sized state-owned enterprises

	Small privatization	**Privatization of big SOEs**
Control rights of assets transferred with privatization	Yes	High variability
Liquidity of assets	Low	High
Distribution determined by privatization	Long term	Short term
Effects of undervaluation	Equity-increasing	Equity-decreasing
Recommended valuation	'Equitable undervaluation'	Maximum-profit pricing

Table 5.1 summarizes the main differences between small privatization and the privatization of big and medium sized state-owned enterprises (SOEs). The crucial difference is the type of asset valuation which ought to be used in the privatization process to achieve the best possible equity. The claim that the

'equitable undervaluation' of assets (meaning undervaluation and the equal opportunity for every citizen to purchase assets) is the best way to achieve small privatization is based on the assumption that, when assets are cheaper, more people have the chance to become owners and the property therefore becomes more widely distributed.

The positive equality effects of the rapid privatization of 'small' assets are similar to those resulting when the initial share of private activities is greater. The further privatization proceeds, the more private owners emerge, because nobody will have the opportunity or the incentive to obtain huge amounts of property. Another significant issue is the number of people involved in privatization. A giveaway or below-market-price sale of firms to the persons controlling them or of plots of land to small-scale farmers will exclude those individuals who are not working, like children, pensioners and students. Therefore, certain groups will lose, when others benefit from being able to purchase assets at prices below value. Nevertheless, if carried out in an equitable manner, small privatization is likely to create a permanently unconcentrated distribution of those assets included in the process.

(ii) The speed of privatization

The speed at which privatization is initiated and carried out will partly determine the equality resulting from the privatization in the case of big and medium sized SOEs as well. Chilosi (1996) says that privatization 'can lose momentum' if it is not undertaken in a timely manner. Delays in the privatization process will offer decision makers more opportunities to behave in a corrupt fashion. This point is especially important in the case of big state-owned enterprises, for which the possibility of management to affect a change in ownership will grow with time if the state is unable to proceed with privatization. Enterprise managers who know that the enterprise is going to be privatized, but who do not know when this will occur have a motive to take care primarily of personal interests and are 'not committed to enterprise development before property questions are settled' (Wang 1996). For example, in Russia and in some other countries like Moldova, delays in the privatization process have been a factor in spontaneous privatization and the misuse of managerial power.

Regional and sectoral differences in the timing of privatization are also important. In many countries, enterprise privatization has been carried out with regional lags, or the privatization of some groups of assets (especially land) has been delayed. High inflation will erode the purchasing power of the vouchers in the slower regions and decrease equality. If some sectors of the economy are privatized more slowly than are others, those working in these sectors will naturally suffer, especially if insider privatization is favoured.

5.2.4 The decollectivization of agricultural land

Private housing was already quite common in the socialist era, and the structure of housing ownership is not expected to create a significant bias in overall wealth distribution. The bulk of small enterprises in transitional economies are new private enterprises and thus have not been created in the privatization process. Therefore, the privatization of agricultural land is by far the most important area for the implementation of small privatization.

The privatization of farm land will include the transfer of control rights and is most egalitarian if the land is divided into small units, that is, decollectivized. Mathijs and Swinnen (1997) have developed a model of land decollectivization in Central and Eastern Europe and derived a series of factors which affect the decollectivization process. Decollectivization is formally dependent on the decisions of collective farm members. Mathijs and Swinnen argue that the degree of decollectivization is influenced by output prices, risk, labour productivity of collective farms, the privatization model of agricultural land and the cost of leaving the collective.

A rise in the prices of agricultural output improves decollectivization, as does an increase in the ratio of the output prices received by individual farmers to the output prices received by collective farms. This implies that an improvement in the agricultural transition process has a positive effect on decollectivization. There are two reasons to justify this. The terms of trade in the agricultural sector deteriorated during the first years of transition, but development has been more favourable recently. Moreover, during the early transition period, the prices received by collective farms can be assumed to have been higher those received by individual farms, because collective farms had advantages in economies in scale and in closer contacts with up- and downstream industries and because of market imperfections. These advantages diminish with the improvement in market conditions, and they can be further weakened by government regulation. If we assume that, under uncertain market conditions, collective farms can manage risk more effectively than can individual farms, the conclusions are similar. Macroeconomic stabilization and the creation of more efficient market conditions render the preservation of collective farms less attractive and have a positive effect on decollectivization.

The high labour productivity of collective farms has a negative effect on decollectivization. This is obvious because a break-up of efficient and productive farms is less reasonable than a break-up of inefficient production units.

Privatization in favour of the former members of a collective instead of outsiders has a positive effect on decollectivization. This assumption is logical, since individuals who have expertise in farming are more likely to continue farming and increase their own control rights over assets by reducing the unit size of the farms. Outside owners have neither the skill, nor the incentive to invest in stronger property rights.

Finally, if the costs which emerge when one leaves the farm collective – that is, the exit costs – are high, it is logical that decollectivization will be hampered. The privatization of productive assets in the agricultural sector affects the exit costs, as do regulations which concern the withdrawal procedure. The factor intensity of collective farms is also an element. If the farms are labour intensive, this will keep the exit costs relatively low and hence improve decollectivization.

5.3 The role of secondary markets and new enterprises

The privatization patterns discussed above influence the short-term distribution of assets. However, this is not necessarily the case over the long term. Some assets are given out free of charge or sold at extremely low prices. Therefore, it can be expected that these assets will be resold and that the resale process will have serious equality effects. Secondary markets[16] will affect wealth distribution for two reasons: the distribution of assets will become more unequal, and the value of the assets will be higher than the prices during the privatization process.

The development of financial markets can be assumed to be the decisive factor for the functioning of secondary markets. Two other factors – the distribution of other than legal property rights and the emergence of new enterprises – must also be considered. Thus, it is possible to create a model for the changes in asset distribution during transition from a planned economy to the market.

5.3.1 The concentration of the distribution of assets

The redistribution of assets after the privatization process is dependent on the behaviour of individuals and on changes in the prices of assets. Rapid inflation and the fall of output caused a decline in real wages. Because of different time preferences, some shareholders are more willing than are others to prefer present consumption to future income. Besides, people who had lived in socialist economies all their lives were not used to private ownership and could not possibly have precise information about the future value of their assets (see earlier).

The rise in poverty and income inequality can easily spawn a vicious circle and become a major component in the spread of inequality in wealth. When some

[16] In this context, the term 'secondary markets' will be used to describe any resale of privatized state-owned property or of privatization vouchers.

people acquire more productive capital than do others, their relative capital income will rise, and they will be more willing to operate in secondary markets, which were imperfect during the first years of transition and could provide almost limitless opportunities for quick profits. This means that failures in privatization programmes and the restructuring of the government transfer system can, at their worst, help generate narrow asset distribution. Of course, the impact of the initial wealth situation can be smoothed out by offering better opportunities to obtain credit. Although real interest rates for loans were negative in several countries during the early transition period, loans with a maturity of more than one year were rarely available. The banking systems in many countries suffered because of bad loans, which led to increasing difficulties in the supply of investment credit. The development of the banking sector has boosted credit opportunities and stabilized interest rates, and hence more people have been given the chance to operate in capital markets.

One possible reason behind the sale of assets or bad investments in assets is lack of knowledge. Since the whole concept of gains from private ownership was vague, there was no way that all individuals could have had perfect information about how to invest their privatization vouchers. In many transitional economies investment funds were an important institution in the privatization process. Most governments encouraged the formation of these funds, but in some countries the significance of investment funds has been minor. Many individuals distributed the privatization vouchers to different investment funds and minimized their risk. The existence of investment funds certainly encourages those with less information about capital markets to invest in asset ownership. As long as the investment funds are working efficiently and have no other purpose than the maximization of profits or the minimization of risk for portfolios, they can be seen as an equality-increasing factor. On the other hand, recent events in Albania have shown that all companies which can be classified as investment funds have not had the expertise or even the will to allocate investments efficiently. Even in the more developed transitional economies the ability of investment funds to influence decision making in the enterprises in which the funds are shareholders has remained limited.

Privatization laws can include prohibitions on the immediate resale of certain assets. In some cases the resale of vouchers is forbidden or limited. Whatever may be purchased with the vouchers in auctions can usually be resold without restriction. These kind of prohibitions will improve the resulting equality in asset distribution. However, if privatization vouchers are considered financial assets similar to bonds or securities, then a portion of the population will sell themselves out of the privatization process right away at the beginning.

The most important issue which determines the resale of assets is the transfer of de facto property rights and the establishment of the proper kinds of incentives for ownership and efficient economic behaviour. Especially for financial assets like shares of joint stock companies, control rights over the asset are not an obvious element. Even though ownership of a company was in some cases viewed as a compensation for lost worker benefits, like secure employment and relatively easy working conditions, the ownership itself might not be seen as a benefit, if the worker cannot influence any decisions concerning the company. The existence or absence of these incentives and control rights will have an effect on the analysis of different privatization methods and on the timing of these methods. If enterprises are privatized before any management restructuring has been initiated, the de facto ownership structure will not change radically, if at all. As a consequence, there may be few incentives for outsiders or even for company employees to purchase the company shares. The equalizing effects of voucher privatization will disappear if the only assets which can be purchased with the vouchers are the shares of companies which operate according to 'old' ownership and control patterns. Again, the benefits of the direct sale method may be higher, since strategic owners can be expected to undertake the reconstruction of enterprise management more rapidly than will the old nomenklatura. However, even if favourable incentives and a liberal, competitive environment are created by direct sales, these will not equalize the initial unequal distribution of property.

5.3.2 Changes in the price and value of assets

The unwillingness or inability of some individuals to retain assets can lead to a situation in which the share of asset owners in the population is very small.

The difference between the initial price and the real value of assets widens the wealth gap between those who own assets and those who do not when the prices of shares increase. A concentrated asset distribution caused by the resale of assets alone does not necessarily lead to rising inequality in wealth distribution, since those people who sell their assets are paid for what they sell.

A problem typical in transitional economies was the fact that the price for which some assets were sold was far below the profits which could be attained through the retention of the ownership of that asset. The possibility for asset resale may generate more inequality than does the privatization process itself. The nominal value of shares will partly be determined by privatization policies. The initial valuation of an enterprise is the basis for the value of shares in capital markets. There is no sure way to determine the exact book value of an enterprise which was state owned under socialism, and in most cases that was not the intention. The price at which shares were sold during privatization was, on average, undervalued. That the maximum-profit pricing of liquid assets is also an ideal solution for distributional purposes can be proved through an examination of the profits which can be gained by the acquisition and possession of assets during the transition process.

Let 'V' equal the real value of an asset and 'P' equal the price at which the asset can be purchased during the privatization process. The profits made during the privatization process by a purchaser of the asset is 'V-P'. In some cases P was equal to zero. This meant that the individual who acquired the asset during the privatization process will make a profit equal to the value of the asset.

A zero value for P has two kinds of negative distributional effects. Those persons who are left outside the privatization programme will lose relatively more. If the resale price in secondary markets for the same asset is 'S', then the profit which can be made by buying in secondary markets is 'V-S'. If P is low, it will be a signal for secondary markets with imperfect information about the asset's value to keep S also low[17], fostering greater profits for the even more limited group of persons operating in secondary markets. However, S is assumed to be equal to or higher than P, so that assets will not be resold at a loss. The inequality caused by the change in the value of assets will occur in two stages.

If the value of the assets is already known during privatization and maximum-profit valuation is used, then P = V and V-P = 0, so that privatization has no distributional effects. In most cases, both P and S were significantly lower than V, a fact which gave secondary markets an important role. P will be determined either directly by national property funds, or by supply and demand during privatization auctions or tenders.

The determination of S is a more complex issue. One factor is the supply and demand of the assets of individuals. These are determined by income, savings rate, the availability of information and the motivation for the possession of the assets. Another important factor is the functioning of financial markets, especially of stock and capital markets. The more rapidly capital markets are liberalized, the more people have the chance to operate in secondary markets and the more quickly S moves towards V, thereby weakening the likelihood that secondary markets will become a major basis for an unequal asset distribution.

The conclusions about the distributional effects of privatization and secondary markets are not very encouraging. Restitution and direct sales have distributed property unequally from the outset, and insufficient enterprise restructuring, the

[17] Another view is that a free giveaway of a large amount of shares will in the extreme case turn an excess supply of shares into an excess demand and make it possible for the privatization funds to boost the price of the remaining shares. In this case we assume that those shares which were given out during privatization also end up in secondary markets and hence a free giveaway does not reduce the supply of shares and enable a price increase.

Table 6.1: Initial conditions of the private sector in transitional economies

	Private agric. land, % of total[1]	Share of agric. in GDP (90)[2]	Share of private income, %[3]	Management control of employees
Good possibilities for private ownership				
Croatia	~80	..	10	significant
Hungary	11	13	10	significant
Poland	75	8	22	significant
Slovenia	~80	..	10	significant
Viet Nam	*up to 75	39	#44	practically good
Weak possibilities for private ownership				
Belarus	#75	28	5	very limited
Bulgaria	13	18	9	limited
Czech Rep.	#4	6	4	weak after 1968
Estonia	4	20	8	very limited
former GDR	#1.5	..	*5	relatively good
Kazakhstan	..	42	..	very limited
Kyrgyzstan	..	43	..	very limited
Latvia	2	22	7	very limited
Lithuania	#over 30	33	12	very limited
Russia	*3	20	3	very limited
Slovakia	#4	6	4	weak after 1968
Ukraine	*4	30	7	very limited
Uzbekistan	..	44	..	very limited
Repressed possibilities for private ownership				
Albania	4	28	*0	none
Mongolia	..	17	negligible	negligible
Romania	14	18	3	none
Strong private agricultural sector				
China	*20	28	*0.5	small
Moldova	#20	42	5	very limited

Sources: [1] IMF (1992), OECD (1995), Europa Publications (1992), Griffin and Saith (1981), Prust et al. (1990), Probert and Young (1995), Mathijs and Swinnen (1997), Boote and Somogyi (1991). * = income, # = output. [2] World Bank (1993). [3] Milanovic (1996), IMF (1992), Monck (1995). * = employment, # = output.

Viet Nam was by far the most liberal of the three Asian countries dealt with in this study. Although the concept 'private ownership' had no politically acknowledged status before the early 1990s, the share of private production was estimated to be as high as 44 per cent of GDP. Not only the possibility for private ownership, but also employee control in SOEs was greater in Viet Nam than it was in China, Mongolia, or the more orthodox East European communist states, although outside-of-plan enterprise activities were possible largely because of the complex structure of enterprise governance (Probert and Young 1995). The weakness of enterprise management control did not necessarily have positive consequences in, for example, the case of spontaneous privatization. The situation of private agriculture in Viet Nam was similar to that in China, with 5 per cent of collective agricultural land permitted for private use, and in some cases more than half of the income of villagers came from these private activities (Tria Kerkvliet 1995).

The various possibilities for the acquisition of the ownership of agricultural land and small enterprises and control rights in state-owned enterprises in the socialist economies are summarized in Table 6.1.[19] Three classifications are used in the table to describe private ownership in the transitional economies: the importance of private agriculture, the share of income from private activities (or private output) and the extent of employee participation in enterprise management. Moreover, three countries had relatively substantial private income from the rural sector, but a negligible private sector in other areas of the economy.

Although the classification seems rough, the differences among the categories are quite clear. Only three East European countries – Hungary, Poland and Yugoslavia – took significant steps towards more liberal ownership regimes before the end of the 1980s, while in Viet Nam the communist ideology never reached the level of implementation that it achieved in the most orthodox centrally planned economies. The countries which did not introduce private property rights are also easy to identify. In Europe, Albania and Romania were the most centralized both economically and politically and offered no possibility for private ownership other than small farm plots. The situation was similar in China and Mongolia. Nonetheless, the private agricultural sector in China was estimated to produce as much as one fifth of the income of the rural population (Griffin and Saith 1981, page 16). In addition to China, the share of the private rural sector was 20 per cent in Moldova.

6.2 Privatization in Eastern Europe and the FSU: The legal transfer of property rights

In Eastern European transitional economies and in the FSU, the legal transfer of property rights through privatization, together with the liberalization of enterprise legislation, has been the major technique employed to try to increase the efficiency of formerly state-owned capital. However, the actual road taken to

[19] Housing was provided by the state or by state-sector employers in most countries, and rent was well below market level. The significance of the ownership of housing was not very big, and the privatization procedure for housing differed in most cases from that for other assets. Therefore, we have not included the initial differences in the ownership structure for housing in the table.

privatization has been anything but identical in all countries. Likewise, the speed of the privatization of state-owned property has varied a great deal.

6.2.1 Observed approaches to privatization

Although all transitional economies used a combination of approaches to privatization, one or two methods were in most cases dominant. Certain characteristics, like privileges for company employees and partial asset giveaways, existed in all countries. The main distinctive features were the status of insiders and the implementation of voucher schemes. The differences in the profitability of various big SOEs were huge, and valuation problems were evident. Especially the most inefficient big enterprises have been unable to attract investors because of the obsolescence of the physical capital stock and the urgent need for restructuring.

In some countries mass privatization has been very successful, but in others it has not been started at all. China, Croatia, the former GDR, Uzbekistan and Viet Nam have not yet introduced any sort of voucher regime. Other countries included in this study have produced some kinds of vouchers. The voucher regimes of Hungary and Ukraine can hardly be classified as 'mass privatization' programmes. Participation was very restricted, and the vouchers were primarily offered as compensation for property lost during the communist era. In Hungary, vouchers were not employed as a way to privatize large amounts of state property for the benefit of a large number of citizens, but rather as a substitute for the restitution of physical assets (OECD 1995, page 113).

The coverage and successes of various voucher programmes are summarized in Table 6.2. A free giveaway of vouchers to all citizens regardless of age was the case in Mongolia, Slovenia and nine FSU countries. The voucher schemes of Kazakhstan, Russia, Slovenia and Mongolia were the most successful at least from the point of view of equality. A major share of privatization was carried out by the distribution of assets free and equally among all citizens. Other giveaway voucher programmes were less equitable, because there were problems in distribution, or lack of attractiveness, or because the value of the vouchers distributed was dependent on age, years of employment or other criteria.

Most Eastern and Central European countries restricted mass privatization to adults, leaving out some 25-30 per cent of the population. In addition, obtaining vouchers in Albania, Bulgaria, the Czech Republic, Poland and Romania included a fee, which discouraged the participation of many individuals. Belarus had two different voucher schemes, mainly because the first one was more or less a failure; the second one covered about the same share of the population as did the bulk of the programmes in other countries.

Table 6.2: Mass privatization in transitional economies

Countries which have a voucher programme			
	Vouchers free	**Coverage of programme †**	**Success of programme**
Albania	N	A, 60%	50% of eligible people covered
Belarus	Y	A, 65%*	1994 programme unsuccessful
Bulgaria	N	A, 80%	poll: 1/3 will not participate
Czech Rep.	N	A, 77%	75% of adults, 58% of all,
Estonia	Y	A, 73%	not significant in total privatization
Kazakhstan	Y	E	87% of privatization
Kyrgyzstan	..	E	..
Latvia	Y	E	slow, unequal distribution
Lithuania	Y	E	covered 1/3 of assets
Moldova	Y	E	0.45 of 4.35 in 1994
Mongolia	Y	E	95% obtained vouchers
Poland	N	A, 70%	not very significant
Romania	N	A, 70%	67% distributed 92
Russia	Y	E	97% vouchers used
Slovakia	N	A, 77%	..
Slovenia	Y	E	1.8 of 2 million included
Countries which have no voucher programme			
China			
Croatia	Direct sale with discounts to managers and employees		
GDR	Direct sale to strategic investors		
Hungary	Compensation notes to a small percentage of population		
Ukraine	Vouchers to a very limited group of people		
Uzbekistan	At 1994, only 4,400 investors in joint stock companies		
Viet Nam			

Sources: Abeywickrama (1996), American Embassy, Sofia (1996), Böhm (1995), Cengic (1996), Monck (1995).

† A= adult citizens over 18 years of age, percentage of people over 18 (demographic data from UNICEF 1995). E= every citizen regardless of age. * Figure concerns the second voucher scheme from 1996.

The extensive participation of company insiders in privatization is not surprising and has been common in practically every transitional economy. The significance of the role of insiders in privatization is harder to evaluate. Conclusions about the share of insider ownership cannot necessarily be drawn from the contents of the privatization programmes, and estimates of the share of insider ownership certainly include a data problem. The legal or information privileges of insiders are used in different ways. Most countries introduced privileges for insiders in big and medium sized firms. In the Russian case and to some extent in the Polish case there are signs that ownership and control rights were concentrated among a small number of enterprise managers, but also in most other countries company managers have benefited from insider privatization more than has any other group. On the other hand, there is barely any evidence that non-managerial employees would have benefited greatly from manager-employee buy-outs.

The following classification of the privatization methods used in various transitional economies concerns mainly big and medium sized SOEs. It classifies the countries according to five privatization models: equitable voucher schemes, insider-dominated voucher schemes, a combination of direct sales and vouchers, direct-sale-dominated privatization, and delays in big SOE privatization. Because of its uniqueness, Russia will not be included in any of these categories, although it would fit very well into the second category, adjusting for the cumbersome side-effects of spontaneous privatization. Russia introduced a voucher scheme which was extremely fair to the extent that every citizen received a free voucher of equal value. However, the privatization of enterprises involved noteworthy privileges for employees and managers, and the implementation of the programme included regional and sectoral lags (Saizew 1994) and severe political difficulties. Because the aim of this paper is to study cross-country distribution, better and more detailed descriptions of the complexity of Russian privatization can be found, for example, in Desai (1995), Popov (1996) and Sutela (1996).

The privatization models can be ranked according to equity. A privatization which emphasizes fair and free giveaways of a large share of state-owned assets is clearly the most equitable. The combination of direct sale and vouchers still includes a reasonable number of the equity effects of a voucher scheme and can be ranked in front of the insider-dominated voucher scheme, which will, for the most part, distribute property in terms of the interests of managers and employees. The direct sale method, in spite of its efficiency gains, should be considered rather inequitable from the perspective of short-term asset distribution, not least because this category includes countries which have no voucher scheme. In the worst case, there have been delays in large-scale privatization, a great deal of 'momentum' has already been lost, and the creation of a just and functioning private sector has become extremely difficult.

(i) An **equitable voucher scheme** has been implemented in the Czech and Slovak Republics, Kazakhstan and Mongolia. A large part of state-owned property was distributed free of charge (except in the Czech and Slovak Republics, where the price was well below the value of the assets and low enough for a large share of the population to be able to participate) to the entire population. Every citizen had the chance to gain ownership in a SOE, and the programmes were designed well enough to attract most citizens. Hence, in the short term, state-owned assets were distributed in the most equitable manner.

(ii) Bulgaria, Latvia, Lithuania, Moldova, Poland and Romania can be classified under the **insider-dominated voucher scheme**. The coverage and equity of the voucher programmes were not at the same level as they were in the countries in the preceding group. In addition, the majority of the shares in big and medium SOEs have remained under the control of company managers and employees. This can have dramatic consequences in the long term, but cannot be viewed as just even over the short term.

(iii) A **combination of direct sales and vouchers** was used in Albania and Slovenia. Both countries included a large share of the population in their relatively widespread mass privatization programmes, but also invited foreign and domestic strategic investors to participate in the privatization process.

(iv) The **direct sale** method was dominant in Croatia, Estonia, Hungary and the former GDR. All countries also included a restitution programme in their privatization. These countries (also Croatia, if adjustments are made for the effects of the civil war) have achieved very positive results in economic restructuring, to which the decision to privatize most former SOEs to strategic investors have definitely contributed. However, these countries are expected to pay a price for the rapid restructuring through a very concentrated distribution of assets. Hungary and Estonia have been able to attract more foreign investment than has any other transitional economy (Cornia et al. 1996, page 7), and this has had mainly positive equality effects.

(v) For political or economic reasons, the mass privatizations in Belarus, Ukraine and Uzbekistan have met with difficulties, and the **privatization of big SOEs has been delayed** to a large extent. In Ukraine this has been due basically to the unstable economy and large budget deficits, while the authoritarian policies of the ruling class in Belarus and Uzbekistan have discouraged the rise of the private sector.

6.2.2 Privatization methods and external debt

A few comments should be made about de novo firms, the direct sale method and the price governments may have to pay to create an equitable distribution of assets. The advent of new enterprises has been seen as mainly positive from the distributional point of view as well. Firms in the new private sector have been able to create new jobs and to employ the work force which is being released from former SOEs (see Konings, Lehmann and Schaffer 1996). This is one reason more to encourage the establishment of the new enterprise sector and to consider the rapid rise in the number of de novo firms as positive and equality-increasing.

One advantage of the direct sale method is the fact that it allows maximum-profit pricing for most assets. This has positive long-term equity effects. Another advantage is that, unlike restitution and voucher privatization, a direct sale of enterprises yields income to the state. Insider privatization also produces income for the government, but because this approach usually includes significant benefits for the purchasers of the assets, the income is much smaller. If the income which is gained from direct sales can be used to create new jobs in the state sector or in the private sector through subsidies, or to offer social benefits as a compensation for those who lose their jobs during the restructuring process, the disadvantages of the concentrated distribution of assets will be at least partly offset. Nevertheless, this possibility exists only if the government is not forced to use the profits from the sale of its assets to cover its liabilities, that is, external debt.

Table 6.3: Public and publicly guaranteed long-term external debt stock as a per cent of GNP in 1989 and 1994

	Debt/GNP 1989, %	Debt/GNP 1994, %		Debt/GNP 1994, %
Romania	0.5	10	***Former Soviet Union***	
Albania	0	11	**Estonia**	2
China †	2	16	**Azerbaidjan**	3
Czech Rep.	8	21	**Latvia**	3
Slovakia	7	22	**Lithuania**	4
Poland	44	43	**Uzbekistan**	4
Mongolia	0	53	**Belarus**	5
Hungary	60	55	**Ukraine**	6
Bulgaria	44	91	**Armenia**	7
Viet Nam ‡	216	143	**Moldova**	9
Russia ¦	8	22	**Kazakhstan**	12
Former Yugoslavia			**Kyrgyzstan**	13
Croatia	..	7	**Turkmenistan**	14
Slovenia	..	10	**Tajikistan**	28
Macedonia	..	33	**Georgia**	33

Source: World Bank (1996b).
† 1989=1980, ‡ 1989=1991, ¦ 1989=1990.

Table 6.3 shows the public and publicly guaranteed long-term external debt stock as a percentage of GNP in Central and Eastern Europe (including Russia), China, Mongolia and Viet Nam in 1989 and 1994 and in the republics of the former Yugoslavia and former Soviet Union in 1994. Before the transition, only Hungary, Poland, Bulgaria and Viet Nam had an external public debt stock of over 10 per cent of GNP, while most countries had no debt at all, partly because of the different political circumstances.

In the first half of the 1990s Poland and Hungary were able to reduce their external debt, while in Bulgaria the problem deteriorated. In the European FSU republics, former Yugoslavia, Albania and Romania, the external debt was not a problem, with debt/GNP ratios below or around 0.1, but in the Czech and Slovak Republics and Russia the external debt stock was more than one fifth of GNP. Mongolia experienced a rise in the debt stock from practically zero to over 50 per cent of GNP.

A comparison between the developments in external debt and the privatization models tells an interesting story. Countries which privatized chiefly through a voucher scheme and thereby gave up the possibility for government revenues (the Czech and Slovak Republics, Russia, Kazakhstan and Mongolia) are all suffering more or less from a deteriorating debt problem. Croatia, Estonia, Albania and Slovenia, where the direct sale method was used more extensively, have not seen their external debt stock rise to more than 11 per cent, while Hungary has been able to cut the large debt stock inherited from the 1980s. This implies that equity in the privatization of assets has been partly achieved at the cost of a worsening government balance and hence could lead to losses in other kinds of state-provided benefits.

6.2.3 The speed of privatization

Rapid privatization leads to a growing share of private output. Table 6.3 shows that the private sector already contributes more than half of the output in about one dozen transitional economies. The table is not trying to rank the countries by their performance, and I am perfectly aware, that a blind recognition of these kinds of estimates is dangerous. It also has to be pointed out that in some countries the growth of the private sector must be accredited to the growth of the new private entries rather than privatization. Still, table 6.4 definitely leads us to the right track by showing how some countries are proceeding with the revival of the private sector while others are struggling, to say the least.

However, countries have problems in different areas of privatization. Therefore, a sectoral decomposition of privatization performance is necessary. The privatization of small and medium enterprises was clearly the main objective of all transitional economies (with the probable exception of only Moldova). Successful 'small privatization' is an indicator of the equality of the distribution of these assets (see earlier). Also, a quick start to big SOE privatization has positive distributive effects, because it prevents corruptive behaviour and enables a rapid recovery of the private sector. The neglect of one region or one sector can have dramatic distributive effects. Table 6.5 summarizes the privatization process among big and small enterprises[20], land and housing.

Table 6.4: Estimates of the share of private output in transitional economies in 1995

Share of private output	
86%	Slovenia (1994)
70%	Czech Republic
60%	Albania, Hungary, Latvia, Poland, Slovakia
55%	Lithuania, Russia
50%	Estonia (1994), Mongolia
45%	Bulgaria, Croatia
35%	Ukraine
30%	Romania (1994)
25%	Kazakhstan, Moldova (income)
15%	Belarus

Sources: Böhm (1995), UNECE (1996).

Tables 6.4 and 6.5 show the following.

(i) The assets of the former GDR have practically all been privatized. The economic situation in the former GDR is largely determined by the regulations of the Federal Republic, and a comparison with other transitional economies is therefore extremely complicated.

(ii) The Central-East European countries (the Czech and Slovak Republics, Hungary and Poland), the Baltic countries (Estonia, Latvia and Lithuania) and, somewhat surprisingly, Albania have proceeded quickly in privatizing state-owned capital. The small enterprise sector, land and housing are now almost completely in private hands. The biggest differences among these countries are in the big SOE sector. The Baltic and especially the Albanian case imply that rapid privatization was preferred to the detriment of enterprise restructuring.

(iii) The former Yugoslavia is a case by itself. Slovenia has arguably the largest private sector in the former socialist bloc. This is due not only to privatization, but also to the emergence of many new enterprises. Other former Yugoslav republics have suffered from the long civil war, and their performance relative to that of Slovenia during the transition is therefore weak from many points of view.

[20] Because different data sources are used here, there is no exact size limit for small enterprises. In general, 'small enterprises' are companies which are controlled by their owners and hence not expected to be resold on secondary markets.

However, the privatization in Croatia seems to be proceeding approximately in line with, for example, the performance in Bulgaria.

Table 6.5: The privatization process in transitional economies

	Big & medium enterprises	Small enterprises	Land	Housing
Albania	started 1995	95%	completed	completed
Belarus	10% (1994)	..	no legal ownership	..
Bulgaria	10%	..	93% (1994)	<50%
Croatia	..	83% (1994)	almost complete	almost complete
Czech Rep.	50%	100%	almost complete	almost complete
Estonia	74%	90% (1993)	slow	..
former GDR	~100%	100%	92% (1994)	..
Hungary	75%	>90%	0.5 million land owners	..
Latvia	46%	70%	3/4 of output	about 1/2
Lithuania	57%	>90%	completed	..
Moldova	27%	<10%	..	about 1/2
Mongolia	41%	65% (1992)	..	slow
Poland	32%	>90%	90% private	..
Romania	13%	25%	completed	..
Russia	55%	70%	slow	>50% (1995)
Slovakia	..	>90%	80% (1994)	..
Slovenia	..	..	..	..
Ukraine	..	20%	slow	..
Uzbekistan	..	95% small	slow	almost complete
Viet Nam	..	..	rapid, corrupt	..

Sources: IMF (1996), OECD (1995), CCET (1995), Goskomstat, Böhm (1995), Tria Kerkvliet (1995), Abeywickrama (1996), Monck (1995), Wang (1996), Warsaw School of Economics (1994), Klugman (1996), Kolodko and Nuti (1996), Mathijs and Swinnen (1997).

(iv) Russia, Mongolia, and to some extent also Bulgaria have shown fair results in their efforts at privatization in spite of less favourable initial conditions. Most of the small enterprise sector is in private hands, although there have been difficulties in the land (Russia) and housing (Mongolia) sectors. In Russia the mass privatization of the big enterprise sector was perhaps too hasty relative to the reforms in management structure. It is noteworthy that in Mongolia, unlike any other Asian non-FSU transitional economy, the primary focus in enterprise reform has been on privatization (Rana 1995, page 149).

(v) The other European transitional economies – Belarus, Moldova, Romania and Ukraine – are having difficulties with privatization. These difficulties are mostly related to the big SOE sector, although, for example, in Belarus the implementation of the land ownership law was delayed. In Moldova the problems are concentrated in the small enterprise sector, while the privatization of big enterprises was seen as more privileged (Böhm 1995, page 266).

(vi) Privatization in the former Central Asian republics of the FSU is lagging well behind that in other transitional economies. Wars and less liberal political regimes, on the one hand, and difficulties with government budgets and overall economic performance, on the other, have delayed the start of privatization. In many cases, it is too early to draw any conclusions about the future distribution of assets, since most assets are still more or less controlled by the state.

(vii) Viet Nam has the largest rural sector among all transitional economies. Although the agricultural privatization process is proceeding relatively quickly and in a generally fair manner, problems with corruption have complicated the privatization of the enterprise sector (Tria Kerkvliet 1995). As in China, enterprise reform has focused on the commercialization of the state sector and the creation of new enterprises, rather than on privatization. Offering more power to enterprise managers has not led to the expected results, but has eliminated government control over most SOEs (Rana 1995, pages 151-52).

6.2.4 The decollectivization of agricultural land

Although some countries have privatized most agricultural land, the process has not been completed in others. Moreover, privatization has not in all cases led to the break-up of big farms into smaller units and hence to a transfer of full control rights. The empirical results of a study of ten countries are summarized in Table 6.6.

In addition to the table, some indicators can be observed for countries not included in the research so as to arrive at estimates for the share of decollectivization.

(i) Negative developments in the terms of trade in the agricultural sector have mostly been stabilized, and improved market conditions have reduced the differences in risk between collective and individual farms in all Central and Eastern European countries. In some FSU republics the incentives for collective members to start individual farming are still much smaller because of the unstable macroeconomic environment. This implies a more promising environment for decollectivization for the Central-Eastern European transitional economies in comparison with the FSU republics. Although the price differentials and risk factors might also be high in the Asian transitional economies, the methods for the privatization of collective farms employed there have been more favourable for the creation of small private farms than have the methods employed in Europe.

Table 6.6: The share of agriculture in total employment in 1993 and decollectivization indexes

	Share of agriculture in total employment, 1993	Decollectivization index[1]
Albania	53	95
Latvia	17	80
Lithuania	23	60
Romania	36	47
Estonia	8	38
Bulgaria	22	36
Czech Rep.	5	20
Hungary	9	13
Former GDR	..	11
Slovakia	7	5

Source: Mathijs and Swinnen (1996), pages 24-25.
[1] Decollectivization index = (IND94-IND89)/(100-IND89), where IND89 (IND94) is the share of individual farms in total agricultural land in 1989 (1994).

(ii) The relationship between the productivity of collective farms and decollectivization is negative, which explains the high decollectivization indexes of Albania and Latvia and the low indexes of Hungary and the Czech and Slovak Republics. However, reliable estimates of farm productivity are hard to acquire from the FSU republics, and therefore it is difficult to reach any further conclusions in that regard.

(iii) A high share of the agricultural sector in employment has two kinds of positive effects on decollectivization. First, it is an indicator of low development in the use of technology, and this implies high labour intensity, which again implies low exit costs.[21] Second, the more people employed in the agricultural sector, the more farm land can be transferred to insiders. In addition to the countries with a high share of agricultural employment shown in Table 6.4, other transitional economies, like Kazakhstan, Kyrgyzstan and Moldova, are also expected to have this 'advantage of backwardness' during farm decollectivization.

[21] A more reliable estimate of labour intensity is the man/land ratio, which is also used by Mathijs and Swinnen (1997) and which is another indicator explaining Albania's successful decollectivization.

Thus, in the absence of reliable estimates for all countries on output prices and farm productivity, we can claim that countries with stabilized macroeconomic conditions and a large share of agricultural employment have greater scope for farm decollectivization. However, the most important conclusion is that the privatization of farm land into private hands per se may not tell the whole story. If large privatized collectives continue to operate as big units, as seems to be the case in relatively urbanized countries like the Czech Republic, Slovakia and Hungary, the distribution of rural assets and control rights can become more skewed. On the other hand, the assumptions for countries with high labour intensity in agriculture are dubious, since these countries have less stable macroeconomic conditions. The effect of low exit costs and low initial productivity on decollectivization might be partly neutralized by risk factors.

6.3 Secondary markets and new enterprises

For certain assets, like shares in big and medium sized SOEs, the results of privatization will be short lived (see earlier). Three kinds of variables indicate the changes in asset distribution after privatization: the possibilities for individuals to retain the assets, changes in the prices of assets, and willingness to resale the assets. Even more importantly, asset distribution is influenced by the advent of newly established firms.

The opportunity to participate in resale markets was varied widely among individuals in different countries. First, the fall in income forced a part of the population to sell their property. The poverty and income distribution estimates presented in section 1 are suitable indicators of the extent of 'forced asset resale' (see later also).

Second, credit for investments has not been available to everyone, and interest rates have varied. Because the markets for the supply of credit were incomplete and mainly arose because of factors other than the cost of credit, we will compare developments in financial markets rather than analyse the changes in real interest rates. No transitional economy has capital markets which are at all in line with West European or American standards from the viewpoint either of size or of regulations. With the exception of the Czech Republic, the market capitalization rate as a percentage of GDP is far from the corresponding rate in the market economies (World Bank 1996b, page 108). Lavigne (1996) ranks the five Visegrad countries ahead of the Baltic countries, Romania and Bulgaria. Other than these ten countries, no countries are included in the comparison, but it seems apparent that the capital markets in other FSU countries are not more developed, but are most likely less developed than are the capital markets in any of the countries mentioned.

Practically all transitional economies are moving towards a West European and Japanese type of stakeholder capitalism, in which few large banks are shareholders in big enterprises, while maintaining notable control rights in the enterprise. The only exception seems to be Russia, where the banking sector is spread out, and the relationship between firms and banks is much less pronounced (see Popov 1996, pages 45-47). The intention behind the mass privatization in the Czech Republic was to foster the American model of dispersed capitalism, but actually the country ended up in a situation similar to that in most other countries. This latter kind of shareholder capitalism is generally considered less equitable than is stakeholder capitalism, adding to the impression that the Russian transition has not been very egalitarian.

Investment funds were intended as a means to encourage people to invest their vouchers and to minimize the risk to their portfolios. The significance of investment funds varied. A significant role for investment funds was usually connected with an excessive voucher scheme. For example, in Belarus, Estonia and Ukraine, investment funds played hardly any role, whereas the Czech voucher programme was based on the existence of investment funds. In Moldova, three quarters of those participating in the first stage of mass privatization did so through investment funds (Böhm 1995, page 268), and the privatization of big and medium SOEs in Poland and Slovenia also involved the strong presence of investment funds. On the other hand, in Mongolia investment funds were not important, in spite of a broad form of voucher privatization. The case of the investment funds in Russia would again deserve a completely separate study. In spite of their visible presence, these investment funds cannot be judged in the same way as, for example, the Czech investment funds. Another interesting case is Romania, where all investment funds were controlled by the state and were to play a substantial part in big and medium SOE privatization at least during the early stages (ibid., page 331).

In many studies, the rise of de novo enterprises has been viewed as the driving force behind the private sector development and management restructuring in the economies in transition (for example, see Dobrinsky 1996, page 403; World Bank 1996b, page 106), and this research has claimed that the increase in the number of de novo firms has also had positive distributional effects.

In addition to the change in ownership rights from the state to private hands, there are two significant features of the enterprise sector in the former centrally planned economies following transition: the increase in the number of enterprises and the decrease in the average size of enterprises. A case study of Hungary demonstrates the immensity of this change. In Hungary in 1989, 5,100 companies[22] out of a total of 13,600 had less than 20 employees. Six years later the corresponding figures were 640,000 and 665,000, respectively (Központi Statisztikai Hivatal, 1995 and 1996). A comparative study of Central and Eastern Europe (excluding CIS) suggests that the situation was similar in all European transitional economies (Eurostat 1996). The share of enterprises with more than 50 employees is negligible, and most of the enterprises have been created from scratch. The only countries where the share of big and medium sized enterprises, as well as of privatized enterprises, is non-negligible are the Baltic States and Albania, in which the number of enterprises is clearly smaller than it is in other countries in the study. While it is usually impossible to distinguish active enterprises from inactive ones in enterprise registration data, these numbers nevertheless indicate that the new private sector is rising at an enormous speed, especially in Eastern Central Europe.

Another way to estimate the growth of de novo firms is to assume that the emergence of the new private sector has been most widespread in those countries which have been able to establish modern financial markets and a liberal legislative framework for enterprises. Several studies have attempted to use rankings or various indexes to quantify liberalization and performance in the transformation process in transitional economies. The ranking contained in Lavigne (1996) and the private sector entry liberalization indexes offered by De Melo, Denizer and Gelb (1996) provide some elements for a comparison of the development of the de novo enterprise sector. Both studies rank the Czech Republic, Hungary and Poland among the most liberalized transition countries. Slovakia, the three Baltic States and the former Yugoslav Republics are ranked ahead of Bulgaria, Romania, Albania and most countries of the CIS. The South-East Asian countries and the CIS countries were not included in the ranking by Lavigne. The liberalization indexes supplied by De Melo, Denizer and Gelb give a rather pessimistic picture of liberalization in the FSU, except for the Baltic States, Russia and Kyrgyzstan, which are ranked just ahead of the South-East European countries. The private sector entry liberalization indexes for Viet Nam and Mongolia are in line with those for the Visegrad countries.

It is obvious that these kinds of rankings and indexes are somewhat controversial, but they can be assumed to indicate the proper direction. In addition to current developments in the investment climate, the initial conditions play a significant role, since the new private sector will most probably arise in countries which have a history of private entrepreneurship. This explains the significance of de novo firms in Slovenia and the other republics of the former Yugoslavia, as well as in Poland and Hungary. Bulgaria, Romania and the republics of the former Soviet Union (with the exception of the Baltic States) suffer from corruption and

[22] Companies are described as 'institutions with legal status'. This includes enterprises, limited liability companies, companies limited by shares, and cooperatives.

the overregulation inherited from the communist era. Countries which have not succeeded in reforming the political system, like Belarus, Albania and Uzbekistan, can be considered to face the most difficulty in the creation of an efficient new private sector.

7. NEW PATTERNS IN OWNERSHIP STRUCTURE

The creation of new private property rights and the transfer of state-owned assets to private hands are some of the main features of the transition process in the former centrally planned economies. During the transition period, the objectives and performances have, not surprisingly, varied remarkably among countries. The process of change in ownership has not been completed in any of the countries, but we can already draw some conclusions about the way assets are being distributed among citizens.

7.1 The various paths to change in ownership structures

Seven different paths for the development of private ownership and the distribution of property rights can be identified from the indicators discussed in theory in section 5 and in empirical form in section 6. Certain countries must be excluded from this categorization and handled as special cases, since some of the features of the situation in these countries do not permit a general analysis. The classification is based on three main issues in the distribution of private property rights and changes in the distribution of assets. First is the method chosen to privatize the land, housing and small enterprises which were not already in private hands under the socialist regime. Second is the fairness of privatization policies, especially the privatization of big SOEs. Third is the potential for gain following the redistribution of assets after privatization, as well as the potential for the development of the new private sector, as indicated by the development of capital markets and differences in poverty levels.

I. Rapid and equitable changes in property rights

- The initial conditions for the establishment of private property rights in the transition period were favourable, or there were at least some efforts to expand private ownership in the socialist era. The establishment of private property was undertaken rapidly during the first transition years.

- Privatization has been quick, equitable and characterized by good voucher schemes which included the vast majority of the population.

- The role of investment funds was significant, allowing the participation of and the minimization of risks for those who lacked expertise or information in making investments. Financial markets are relatively well functioning, and there is very little poverty. The investment climate is favourable, and the new private sector is emerging quickly.

Countries: The Czech Republic, Slovakia, Slovenia.

II. Rapid, but inequitable privatization; functioning capital markets

- The initial conditions for the creation of private property rights during the transition period were favourable, and private ownership was relatively extensive in the socialist era. The establishment of private property was started rapidly during the initial transition years.

- The privatization of big and medium SOEs, carried out mainly through direct sales, did not encourage the participation of the bulk of the population. The voucher scheme was non-existent or insignificant. The share of foreign ownership was non-negligible.

- The financial markets are developing more rapidly than, or at least as rapidly as, those in other transitional economies. This means that the possibility for an increasingly concentrated distribution of assets is modest. In addition to the privatized enterprise sector, new private firms are being created quickly.

Countries: Hungary, Croatia, Estonia.[23]

III. Rapid insider-dominated privatization

- The initial conditions for private ownership were promising, or at least the first transition years proved that the country was willing to move quickly towards a market economy with dominant private ownership.

- Voucher schemes covered a large part of the population, but generally the privatization process among big and medium SOEs was characterized by the strong, privileged participation of insiders, leading to a less equitable ownership structure.

[23] The initial economic and political conditions of Estonia might not have been as favourable as those in Hungary or Croatia. Nevertheless, one cannot ignore the geographic and historical position of Estonia (and of the other two Baltic nations). These enabled the private economy to emerge much more rapidly in Estonia than it did in other FSU republics.

- Financial markets are developing at a reasonable speed relative to most other transition economies. Poverty is more widespread than it is in countries like Hungary and the Czech Republic, but (at least in Latvia and Poland) less widespread than it is in the transition economies on average.

Countries: Poland, Latvia, Lithuania.

IV. Bad initial conditions, equitable privatization process

- The private economy was greatly repressed during the socialist era. The privatization of land, housing and small enterprises was undertaken with reasonably modest delays, but the speed has left room for improvement.

- The privatization of big and medium SOEs has been fairly equitable, and the voucher schemes have covered a large share of the population. On the other hand, in most cases, privatization was started before the necessary restructuring of enterprises had been undertaken.

- Financial markets are still in very bad shape, and there remains the possibility that the equitable results of privatization will be compromised by a redistribution of assets due to extensive poverty and the lack of institutions providing information and economic assistance for investments. Enterprise restructuring has not proceeded in line with the change in property rights. Poor regulation in capital markets may lead to chaos, as the crisis caused by the 'investment funds' in Albania in early 1997 has shown.

Countries: Albania, Mongolia, Kazakhstan.

V. Slow and insider-dominated privatization

- The initial conditions were anything but ideal, and the speed at which land, housing and small enterprises have been privatized has been slow.

- Relative to the slowest reformers, there has been moderate progress in the privatization of big and medium SOEs. Voucher schemes have been employed, but they have not attracted a large share of the population. Because of the relatively strong participation of insiders, the ownership structure of former SOEs is less equitable than it is among the slowest reformers.

- The development of financial markets is well behind that among the most rapid reformers. The secondary markets for enterprise shares may and probably will change the ownership structure radically. Also, the rise of the new private sector is problematic, because of the poor competitive environment. Poverty is discouraging asset ownership among many citizens.

Countries: Bulgaria, Romania, Moldova.

VI. Procrastinators

Unfavourable initial conditions, and little progress in almost all areas of privatization. Moreover, political instability and the unwillingness of the political elite to reform the economy have led to a very negative investment climate. The establishment of private property rights has been severely delayed.

Countries: Ukraine, Uzbekistan, Belarus.

VII. Russia

A comparison between Russia and the other countries is very difficult, not least because of the size of the country. Russia has two thirds of the population and covers 2.5 times the area of the 18 countries classified above. In Russia, the increase in private property was very restricted during the socialist era. Privatization has been surprisingly rapid, but it has not yet reached the level of privatization in the Visegrad countries. Privatization policies have been generally equitable, but the privatization process itself has been very much insider dominated. Many large SOEs were privatized before any restructuring was carried out, and the de facto property structure, especially the distribution of control rights, has not changed much. Capital markets are at the moment very weak. All of these factors bring Russia close to path V, but, in addition to the size of the country, issues like political inconsistency leading to corruption and spontaneous privatization, extreme poverty and income inequality and huge regional differences in privatization performance leave no alternative other than a separate classification for Russia. Moreover, Russia is heading towards an 'American' model for capital markets, with an unconcentrated banking system. This is adding to the instability of capital markets.

Because of the sheer impossibility of controlling the huge privatization process, it is very easy to regard Russia as the country having the least equitable distribution of assets. Nonetheless, the principles of Russian privatization have been equitable, and the speed of small privatization (with the exception of land reform) has not by any means been the slowest among all transitional economies.

Special cases

The former GDR has been politically and economically integrated into the German Federal Republic. Regional differences in wealth will definitely exist for some time between the former East and West Germany, but basically the former GDR is already a modern market economy.

The developments in Macedonia, Bosnia-Herzegovina, Yugoslavia, Caucasus, and Tajikistan have been severely affected by war and cannot be judged objectively at the moment.

The development of property rights in China has been discussed separately. Although Viet Nam has been mentioned in some issues in the previous two sections, both agricultural and industrial reform has been accomplished in a way similar to that in China, with the focus on commercialization and management restructuring rather than on privatization.

7.2 Conclusions

One of the most fundamental changes caused by the economic transition is the transfer of state-owned property into private hands. The process includes not only changes in legal ownership rights, but a completely new system of property rights is emerging within the economy. The privatization of state-owned assets must be planned so as to foster efficiency and productivity. Moreover, an equitable distribution of assets is at least as important in the move towards a new market-oriented economic system.

The structure of the economy at the start of transition has affected the speed of changes in property regimes and privatization, but the resulting distribution of assets will be determined mainly by privatization policies and developments in the secondary markets for privatized assets. An even more essential factor is the rise of new enterprises which do not have the rigid management structures inherited from the socialist era.

To create a fair distribution of assets, a rapid and coherent privatization of 'small' assets, like land, housing and small family enterprises, is essential. In the privatization of big and medium sized state-owned enterprises, the privatization method adopted plays an important role. The most equitable way to privatize involves the distribution of free privatization vouchers to all citizens, while restitution and a direct sale of enterprises to the highest bidders will certainly exclude the majority of the population from private ownership. A privatization which transfers ownership to company employees will likewise shut out students, the unemployed and people working in highly labour-intensive professions and create inequalities among the remaining participants, because of differences in schemes among the various enterprises. Because of the effects on the external balances of governments, the fairness of voucher privatization and the unfairness of the direct sale method can be questioned in the long run. The latter method generates revenues for the state that can be used to establish compensations for the losers in the privatization process, but the former does not. The direct sale method is also the best way to achieve efficient prices for the shares of enterprises, and this fosters long-term equality in the distribution of assets.

The secondary markets for privatized assets can completely alter the profile of the distribution of property resulting from privatization. Especially if individuals acquire no control rights over the assets which they have obtained during the privatization process and if income inequalities and poverty are widespread, a majority of the population will not have the incentive to remain owners of private property. The establishment of investment funds, restrictions on the resale of some assets and the development of capital markets which enhance the opportunities to finance investments and raise the prices of assets to market value as quickly as possible are among the steps which will be essential in offsetting the inequality-increasing effects of secondary markets. The restructuring of enterprise management, preferably before privatization, and the liberalization of the competitive environment so that free entry is allowed for new enterprises are necessary steps for the establishment of control rights for shareholders. In this way, de novo firms, which are on average much smaller than the former SOEs and supposedly exhibit a more equitable distribution of assets, can develop more quickly.

The empirical evidence has shown that income inequalities have arisen in the economies in transition. Although an exact measurement of the distribution of assets is extremely difficult, a portion of the rising income inequalities can be attributed to the rising share of capital income. On the other hand, rising income inequality has led to gaps in the opportunities possessed among individuals to participate in the process of the privatization of all state-owned assets. In some countries privatization policies have tended to block the increase in inequality by offering every citizen the chance to obtain state-owned assets for free, while in others the appearance of efficient strategic investors has been preferred at the expense of equality. In the worst cases, privatization has been undertaken with insufficient speed, and the creation of new private property rights has lost momentum. Most assets still remain in the hands of a privileged few. Only a few countries have been able to start a rapid build-up of the financial markets needed to prevent the further concentration of ownership induced by imperfections in capital markets.

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