

Distributional Impact of Privatization: Transition Countries

The Distributional Impact of Privatization

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- 1. I used to work for the World Bank. In May, 1990, I took part in the first official mission of the Bank to what was then Czechoslovakia. In Prague, we met with Vaclav Klaus, at the time Minister of Finance in the Czechoslovak Federal Government, and Dusan Triska, the principal architect of the soon-to-be-famous Czech voucher approach to privatization.**
- 2. Regarding privatization, their essential message was the need for speed. In line with a number of other first generation reformers in transition countries—Anatoli Chubais in Russia, Mart Laar in Estonia, Leszek Balcerowicz in Poland—Klaus and Triska were convinced that rapid, mass privatization was essential: (a) to cut the links between the state and productive firms, (b) to create quickly a mass of property owners who would support further reform, and thus (c) make the transition to capitalism irreversible, and prevent any possibility that the communists could return.**
- 3. There were a few in those early days who questioned the need for speed regarding privatization. The respected Hungarian economist Janos Kornai argued in his 1990 book, *The Road to a Free Economy*: “The point now is not to hand out the property, but to place in the hands of a really better owner.”**

But his position was discounted; it was seen as perhaps applicable to evolutionary Hungary but unsuited for the bulk of transition countries which were still more or less stuck in central planning. In most places, in most cases, speed won the argument; transition governments—and the supporting international financial institutions, the European Union and the bilateral donors—opted for mass rapid privatization.

4. As we have seen, privatization is everywhere a highly contentious topic; it has been particularly so in the transition region. The deep falls in production, the slow or feeble return to growth in most countries, the corruption and unfairness found in so many sales transactions, especially of the highest potential firms, the failure to fulfill the many overblown and optimistic promises that were made about privatization at the outset of the process (the Russian “voucher would be worth a Lada car” being perhaps the most famous)—all this produced a popular and critical backlash against privatization in general, and its distributional and social effects in particular.
5. We have heard here today three interpretations of the results. The perspectives are quite different: Regarding Russia, Svetlana Glinkina writes from a political/economy point of view; in Georgia, Roman Gotsiridze deals persistently with the legal foundations, or lack thereof, for market operations and privatization; and for Ukraine, Michael Bleyzer and Edi Segura present the view of the private investor, albeit with a good dash of economics thrown in.

6. The thrust of Dr. Glinkina's paper is that inequality grew greatly in Russia in the 1990s. She argues that privatization, while only one of several threads of the explanation for worsening distribution, was nonetheless an important contributing factor. The main distributional impact of privatization reviewed by Dr. Glinkina is the effects on labor: employment levels, pay rates, terms of service. As in Ukraine, the finding is that privatized firms tend to shed labor to a higher degree and at a faster rate than state-owned firms (but note that state-owned firms were also shedding labor through the 1990s). But, again as in Ukraine, wage rates for those skilled or lucky enough to find jobs in the privatized firms tend to be much higher than in state firms.
7. Moreover, workers in privatized firms were much more likely to receive their wages on time. In fact, at points in the 1990s, wage arrears were so widespread as to make meaningless the employment statistics—you might be officially classed as employed, but if you had not been paid in six months or so, it certainly did not seem like it.
8. So, privatization increased the chances that a worker would lose his/her job. The distributional impact is offset by the generally higher wages received by those in privatized, and new entry firms, but not by enough to make much difference. Thus, the increased unemployment brought about by transition in general and privatization in particular is a prime contributor to the perceived increases in inequality in the transition region.

9. There are some observers of transition—Andrei Shleifer and Anders Aslund come to mind—who ask, “so what?” Their argument is that central planning was destroying industrial assets, that private owners were desperately needed to put the firms back to productive work; and that this necessitated lower costs and fewer jobs. If this means increased inequality, so be it: it is the unavoidable and, it is hoped, temporary price that has to be paid for getting these economies moving forward. They are especially scornful of the idea that there was some third way, some alternative reform mechanism between central planning and mass, rapid privatization, available to policy-makers; and they would agree with Vaclav Klaus, who way back in 1990 contemptuously dismissed this idea by saying “the third way is the shortest route to the Third World.”
10. This argument works fairly well the Czech Republic, a country that had been a flourishing market economy before 1938, a country that was geographically, historically and institutionally a part of capitalist Europe. The argument is less powerful in a country like Georgia. Dr. Gotsiridze. Supported by Ambassador Kenneth Yalowitz, indicts, scathingly, the privatization process in Georgia as thoroughly corrupt, unfair, and inequitable—but he also provides lots of examples of how public enterprise performance is corrupt, rotten and inequitable.
11. The question is whether the halting of privatization, in an attempt to build good legal institutions and proper policy before embarking on ownership change, would have done any good? There is not much evidence presented in

these three papers to support such a view. In fact, the Ukraine story suggests the opposite—countries are better off if they get on with the painful but necessary task of shifting to private ownership.