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PRIVATIZATION AFTER THE DEATH OF SOCIALISM: LESSONS FOR ISRAEL

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An Economic Triumph / The German Experience / Treuhand / Current Trends in Eastern Europe / The Czechoslovakian Strategy / Poland's Path to Privatization / Hungary's Head Start / The Lessons for Israel

[Editor's Note: On December 7-10, 1992, the Jerusalem Center for Public Affairs and the Konrad Adenauer Foundation sponsored a conference in Jerusalem on economic privatization. Israeli and European business and government leaders shared information on the European experience with privatization of state-owned enterprises, a step toward economic health urgently required in Israel as well. In this combined *Jerusalem Letter*, three conference participants report on recent privatization experiences in a number of European countries and their lessons for Israel.]

Manfred Gerstenfeld:
An Economic Triumph

The political victory of liberal democracy over Communism was mainly the triumph of one economic system over another. The market system knew how to get results, i.e., economic growth, because it understood how real people function. The Communist central planning system was based on a variety of assumptions of how people *should* function as invented by some armchair intellectuals. Yet even in the West people are unhappy with state and private business monopolies, and the inefficiency of the state's social services. They resent those who abuse the market.

In Europe this attitude of wanting more market rather than monopoly is expressing itself in many ways. The best examples among many are the Conservative governments in the United Kingdom which privatized a great number of state companies, even including the suppliers of water.

The one major European country that tried to go against the privatization trend found it could not. When French President Mitterrand and his Socialist party came to power in the early 1980s, he nationalized banks and some major industrial companies. Yet in 1986 the Socialists lost power to the center-right and while Mitterrand was still president, the Chirac government reprivatized parts of what the Socialists had nationalized. Today, no one talks seriously about nationalizing in France any more.

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The German Experience

Germany is a special case because it demonstrates best the victory of the market system. It also sends us clear signals of the new dangers this victory may bring if one is not careful. To a large extent, Germany has become a laboratory for the new opportunities and the new problems in today's post-Communist world.

In business terms, German unification basically means the acquisition of the "business failure" East Germany by the "success story" West Germany. Today, united Germany is managed by West Germans with a few token East Germans. The old East German politicians were sent home and West Germans were soon found not only in the key national positions, but also at the head of some East German *lander* (constituent federal states).

Klaus Konig:
Treuhand

The states of Central and Eastern Europe are presently about to leave socialism behind, transforming the natures of state, economy and society, and trying to find a transition from the centralized, state-planned and controlled economy to a market-oriented economic order. In the former German Democratic Republic (GDR) and the Federal Republic's new *lander*, a central institution has been set up to implement that transformation, the Agency Responsible for Privatizing Formerly State-Owned Industry in the GDR, called "Treuhandanstalt" or "Treuhand."

Treuhand has its origin in a decision taken by the then-GDR government in March 1990. With its establishment, Treuhand undertook trusteeship over the GDR's national property. The Unification Treaty concluded with the old Federal Republic of Germany laid down that the Treuhand Act should continue to apply with some modifications. Today, Treuhand is directly subordinate to the Federal Government.

According to the Unification Treaty, Treuhand's main function continues to be the privatization of state-owned property. This is to be accomplished bearing in mind the following objectives: enabling the largest possible number of enterprises to compete effectively, safeguarding jobs and creating new ones, assisting the recovery of enterprises and their structural adjustment to market requirements, as well as promoting the development of efficient corporate structures. Beyond these, there is a multiplicity of further tasks ranging from managing the property owned by the GDR parties and mass organizations to the disencumberment of agricultural producers' cooperatives. Two commitments deserve particular attention. Treuhand must liquidate businesses that cannot be rescued. Inevitably, the chances for revitalization will be assessed differently in such cases, provoking conflicts in particular with those threatened by the loss of their jobs. Secondly, property may be assigned to public ownership, mostly in the form of reassignments to communal bodies. For, measured by Western standards, the local administrative authorities in the former GDR owned an insufficient number of communal facilities and amenities and, from nursery schools to sports centers to cultural centers, had previously availed themselves of nationally-owned enterprises and cooperatives.

At its beginnings, Treuhand was called the world's largest holding company — with 4 million employees, 40,000 plants and business facilities, and landed property totalling almost 60 percent of the former GDR area. As of June 1992, 7,613 enterprises and parts of enterprises, 13,374 hectares of agricultural acreage, and 7,000 real property items had meanwhile been privatized. The resultant revenue totalled DM29.3 billion, capital investment commitments reached DM138.5 billion, and commitments for employment of 1,169,983 persons had been made. In particular, Treuhand attended to the establishment of small to medium-size businesses, since the de facto elimination of that sector of the economy is considered one central problem at the root of the GDR economy's lack of competitiveness. By the same date, 25,000 items of property of the GDR trading organization — 17,000 pharmacies, 550 bookshops, 600 cinemas, etc. — had been privatized.

In light of international economic interlacing and the strong presence of multinational concerns in West Germany, endeavors were made from the outset not to let the privatization of national property develop into a matter between purely German partners. Foreign investors were actively sought as well. By June 1992, foreign partners had bought 350 enterprises and plant divisions or had acquired equity investments in them. This included commitments to employ 99,277 persons and to make capital investments totalling DM10.8 billion. Reassignment of property to local authorities made progress, too. Many rural districts, cities and other communes have submitted applications to Treuhand for such property reassignment. Meanwhile, ownership of a large number of nursery schools, sports centers, vocational schools, polytechnic institutions, hostels for apprentices, cultural centers, outpatient clinics, restaurants, hotels, water supply and engineering services, local public transport services and, above all, land for economic activities has been reassigned to the local authorities.

Aid for business revitalization was granted by Treuhand in various forms — financial support, loans, guarantees, etc. — in all totalling over DM77 billion in 1991. In contrast to this, plants employing over 220,000 were closed down. Presently, about 1.2 million people are still employed by about 4,500 enterprises in the hands of Treuhand. In a great many of these, serious problems are being faced. Treuhand makes efforts to minimize the social consequences of restructuring by assuring the establishment of social compensation plans, by promoting staff qualification programs, and by supporting make-work schemes. Nonetheless, Treuhand was not spared becoming a kind of negative symbol for the grievous cost of the moribund GDR economy's transformation.

System change in the former GDR and in the new Federal *lander* was and is a peaceful process. Neither government authorities nor industrial enterprises were taken by force of arms. Demonstrations, token strikes, symbolic plant occupation actions, etc. did not surpass the scope of what may equally be experienced in times of crisis in the West German shipyard or steel-making industries.

The state monopoly over the formulation and enforcement of law was not violated in principle. One may call this a formal and legalist revolution. Accordingly, the task to be fulfilled by Treuhand is a gigantic legal work, if only for the number of cases concerned. With a view to the great pressure of time, under which the centralized, planned and state-controlled economy of the former GDR has to be transformed into a social market economy, such a piece of work could and can be managed only with a lot of legal pragmatism. Yet that pragmatism was founded on high legal and executive standards.

Thomas Apolte:
Current Trends in Eastern Europe

Prior to the breakdown of the socialist systems in Eastern Europe, the share of production by the state sector comprised between 80 and 97 percent, depending on the respective country. Only in Poland and Hungary did a remarkable private sector evolve during the late 1970s and 1980s, but even this was narrowly limited, mainly to activities in the service and small handicraft sector. Up to 1989, employment in any private firm was restricted to a few persons only. Consequently, even though the appearance of market socialism in Hungary suggested considerable economic freedom, the role of the private sector was not very important.

Only one thing seems to be sure about the decision-making process in an Eastern European state enterprise. The managers are considerably less interested in efficient use of the enterprises' assets than in market economies and even less than in traditional socialist economies. This is because there is no longer an institutional body which represents the interests of the capital in an enterprise. Managers of not-yet-privatized enterprises usually have no long-term chances of remaining at their present job or at a similar one. On the other hand, there is nobody who controls their behavior with respect to the use of the enterprises' assets. The only group which may cause the managers trouble are the workers.

The workers in turn have usually improved their influence on the enterprises' decision-making process during the time of the erosion of the central planners' power. As long as they do not individually hold a considerable amount of transferable enterprise shares, they are primarily interested in higher wages at least in the short run. This means that they normally vote for the highest possible wages per worker and are not willing to bear the cost of any investment. Whether it is for modernization or only for capital reconstruction, workers have no incentive to allocate private resources into an enterprise from which the individual does not know if he will ever be able to draw future benefits. Furthermore, to avoid possible internal conflicts within the worker's councils, they tend to preserve the structure of an enterprise as it has evolved in the past.

Due to the power of the worker's councils, on the one hand, and the missing representation of capital interests, on the other, the managers tend to a strategy of passive conflict avoidance. Hence, in the case of market liberalization, they delay the necessary adjustment of the intra-enterprise structure and try to save the enterprise without greater restructuring as long as possible. Costs are only reduced in those fields where conflicts are unlikely to occur and investments are mainly avoided. In the ensuing time until the enterprises cannot be saved without restructuring, managers as well as other members of state enterprises start to make private use of the enterprises' assets, both legally and illegally. In fact, during the transformation process, nobody really knows what is legal and what is illegal.

The enterprises' market environment is usually to be seen as a monopoly. As far as enterprises in the industry do not enjoy direct monopoly power, the old socialist networks of enterprises and managers will assist them in making use of certain kinds of cartels in order to push back emerging competition. Together with the effects of traditionally oversized plants, the monopoly or quasi-monopoly power can be utilized by the managers in order to run their strategy of conflict avoidance and enterprise survival. However, the largest financial cushion can be built up if the managers maximize short-term revenue rather than profit. The total costs, which in socialist enterprises are traditionally far above their minimum, can thus be maintained on their high level even after the imposition of hard budget constraints.

As a consequence, enterprises' output will drop and prices will rise drastically compared to both the future market equilibrium and the former situation under central planning. But what is more for the economy as a whole, revenue-maximization means that input is bound up in large state enterprises instead of being reallocated according to market demand. As long as there is no restructuring of property rights, this type of behavior will be maintained and, in the long run, even deepened.

Privatization schemes as they are usually applied in Western market economies are obviously inappropriate since they are much too time consuming. Privatization in Eastern Europe thus needs another type of strategy, which takes into account the necessity of a higher speed, the lack of capital markets, and the shortage of savings available for purchasing enterprises.

The Czechoslovakian Strategy

The Czechoslovakian strategy is widely viewed as one of the most interesting in a former socialist country. It intends to distribute shares of large enterprises free of charge to the population with the help of a voucher system. Each citizen has the right to acquire a book with 1,000 points worth of coupons, paying only an administrative fee. The enterprises earmarked for privatization are put on a list and the citizens divide their points among the enterprises as they wish. The final value in points of a single share of the respective enterprises will be calculated through a multi-stage process and the shares will be distributed accordingly.

Since there is tremendous uncertainty about the enterprises' value, the government has given permission to found private investment funds which hold the coupons and, later on, the shares, and undertake the administrative matters for the private "investors." Since this was made possible, numerous such investment funds have been founded and the initially low interest in coupon books has dramatically increased.

However, as interesting and bold as the Czechoslovakian privatization strategy is, several problems can hardly be denied. The original timing has already been given up, since the whole preparation process was more time-consuming than expected and the interest of the population was low at the beginning. Many of the investment funds have been founded by dubiously qualified gamblers and, finally, there are not yet enough enterprises sufficiently prepared. Consequently, the initial euphoria and the hopes for a more rapid privatization of the large-scale enterprises has by now been replaced by a more dispassionate view. But nevertheless, as far as those problems will be solved in the future, Czechoslovakia might have developed an all-in-all workable and, what is more, a more rapid alternative to traditional privatization schemes. Unfortunately, this will probably be true only for the Czech, but not for the Slovak republic, as they were divorced at the beginning of 1993 and it is very likely that the Slovak republic will abolish the voucher-based privatization.

Poland's Path to Privatization

Poland has principally chosen a path of non-traditional privatization, too. But it is in no way as clearly formulated as in Czechoslovakia, even though the first non-Communist government started with great enthusiasm at quite an early stage. Already in February 1990, the government presented a first draft of a privatization law to the Polish parliament, the Sejm. But here, the radical reformers ran into stiff opposition. The law was rejected by the parliament, and nearly half a year went by until a new law could pass the Sejm. Moreover, this new law, which is still valid, was rather non-obligatory and, consequently, could not have any clarifying impact in the dispute of the different groups about the most appropriate way for privatization. Hence, the privatization of large-scale state enterprises has still not really begun.

Following the latest plans, shares of industrial enterprises will be distributed in great packages to investment and pension funds as well as to workers. For that, the 400 largest Polish enterprises are to be given the legal status of joint stock companies. Simultaneously, at least 10 to 15 investment funds are to be founded, again with the status of joint stock companies, the management of which should be taken from abroad or at least be persons of "public reputation." From each of the 400 enterprises, 30 percent of its shares are to be distributed to one of the investment funds. Another 30 percent will initially be left as state property, 10 percent are to be freely distributed to the workers, and, finally, the remaining 30 percent will be distributed to pension funds and to those investment funds which do not hold the entire 30 percent share of the respective enterprise. The shares of the investment funds can in turn be acquired by the population through a voucher system. Indeed, however radical this fast reorganization of property rights might appear, it is not at all sure that it will ever come about. Until today, only 200 enterprises have been earmarked and sufficiently prepared, and the political controversy about this or any other kind of privatization has still not come to an end.

Hungary's Head Start

Although Hungary has a long and partly successful tradition of economic reforms as well as a good reputation as a competent and reliable partner in the West, privatization in Hungary is no less problematic than in other former socialist countries. Hungary's privatization process is guided by two strictly obeyed principles: First, there will be no mass privatization in the sense that enterprises or shares of them would be given away for free to individuals or intermediate institutions. Second, there will be no restitution of pre-socialist structures as in Czechoslovakia or Eastern Germany.

The first steps of privatization had already been taken by the Communist government. As early as 1989, new laws approved by the parliament made it possible to reorganize state enterprises as private business corporations and, later on, to privatize them. This is still the legal basis on which enterprises can be privatized today.

Privatization schemes in Hungary are traditional in the way familiar to the West. The initiator must be either a potential foreign investor or the enterprise's staff. In this sense it is originally a kind of case-by-case privatization. But since this was seen as too slow, the government decided to actively intervene in the process of privatization, mandating that groups of 20 to 50 large enterprises be prepared for privatization and then sold in one step. However, the privatization of the first package of enterprises was accompanied by serious difficulties which have not yet been overcome. By the end of 1991, not even one of the enterprises in the first package put together in the fall of 1990 were sold. The speed has somewhat accelerated, but it is still seen as too slow.

On the other hand, privatization in Hungary is not seen as so urgent as in other post-socialist countries. This is so because internal restructuring in the mid-1980s to meet world market requirements has already shown some success. Consequently, the change in the property rights structure in Hungary is not as dramatic as elsewhere. Moreover, direct foreign investments in 1992 will total some $1.5 billion, which is slightly more than the direct investment in all the other Eastern European countries combined.

Manfred Gerstenfeld:
The Lessons for Israel

We in Israel must introduce more of the market system, but we must do it our own way. We have so much headway to make with abolishing bureaucracy and introducing more competition that the idea of a free market in Israel is a totally theoretical one. Israel has to sell off as many government companies as possible. Fortunately, we do not have to go as fast as the Treuhandanstalt, but we should be able to learn something from its experience. Israel is still so remote from a free market economy and we are so far behind in eliminating bureaucracy and letting the market play that we can make much progress without any disasters happening or overshooting our Israeli mark.

We want more competition almost everywhere, not just in government or in the economic sector. It is, for instance, not necessarily a disaster if state-run television in Israel cannot meet the competition and disappears. The list is endless of where in Israel a more market-oriented approach can do good. It is the case both in the business world and in social services. We want our hospitals to have a balance sheet. If Israel will ever have a decent environmental policy it will have to use market instruments. To sum up the essence of the lessons for Israel, it is important for us to learn from the Western world and at the same time to apply these lessons in our own way to our own very specific situation.

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★★★ NEW BOOKS FROM JCPA ★★★

Resisting Reform: A Policy Analysis of the Israeli Health Care Delivery System

Gerald Steinberg and Etta Bick

On a per-capita basis, Israel has the largest number of physicians in the world, and as a percent of GNP, its spending on health care is comparable to Western Europe. Nevertheless, the system is characterized by chronic overspending; frequent strikes and work stoppages by physicians, nurses and other personnel; and long waiting periods for diagnostic and surgical procedures. The disjuncture between resources and level of services is a clear indication of inefficiency in management and organizational failure.

Over three-quarters of the Israeli population is insured by and receives primary care from the Histadrut's Kupat Holim Clalit (KHC; General Sick Fund), and this organization is examined in detail. Also analyzed are the structure and operations of the other major health service providers, including the government hospitals operated by the Ministry of Health, and the smaller sick funds and private providers. In addition, for the first time, the changing role of Israeli health consumers is considered.

Many commissions have been formed to recommend changes in the health care system, and many reports and recommendations have been issued, but with little impact. This study sought to understand the sources of this resistance to change and recommends measures based on this analysis.

Contents: The Structure of Medical Care in Israel; The Ministry of Health; The KHC and the Histadrut; Structural Causes of the Crisis in the KHC; The KHC and the Government; Complexity and Centralization in the KHC; The History of Reform Efforts in the KHC; Reducing Surgical Queues: A Case Study; Alternatives to Public Medicine: The Private Sector; Conclusions and Recommendations.

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A Double Bond: The Constitutional Documents of American Jewry

Edited by Daniel J. Elazar, Jonathan Sarna and Rela Geffen Monson

While the United States Constitution is justly celebrated, Jewish organizational and synagogue constitutions are usually relegated to the bottom drawer, to be taken out only when fine points of procedure have to be clarified. Nevertheless, looking at these constitutions comparatively and over time reveals a great deal about how Jews have adapted themselves and their institutions to American society, while at the same time trying to maintain their relationship with the Jewish political tradition.

This volume is a joint effort of the Center for the Study of the American Jewish Experience of the Hebrew Union College-Jewish Institute of Religion and the Center for Jewish Community Studies of the Jerusalem Center for Public Affairs.

Part I discusses the overall content of the constitutional documents and the values exemplified by them. Part II applies content analysis to specific genres of constitutions in order to illuminate small parts of American Jewish history. Part III includes examples of constitutional documents of synagogues, major Jewish organizations, federations, and immigrant associations, reflecting the several eras in American Jewish history.

Contents: Part I — The Constitutional Documents of Contemporary Jewry: An Introduction to the Field – Daniel J. Elazar; What is American about the Constitutional Documents of American Jewry? – Jonathan D. Sarna; What is Jewish about the Constitutional Documents of American Jewry? – Rela Geffen Monson; Part II — "That Will Make You a Good Member": The Rewards of Reading the Constitutions of Jewish Immigrant Associations – Hannah Kliger; Yemenite Jews on American Soil: Community Organization and Constitutional Documents – Nitza Druyan; Part III — Synagogue Constitutions; Constitutions of Major Jewish Organizations; Constitutions of Jewish Federations; Constitutions of Landsmanschaften and Family Associations.

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