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Lessons from Five Years of Industrial Reform in Post-Socialist Central and Eastern Europe

By Christian von Hirschhausen

Summary

This paper discusses the process of industrial reform in Central and Eastern European countries. Drastic reforms of the former socialist industrial units are inevitable, once monetarization has abandoned the socialist, non-monetary system of production and distributing goods. As a result of this systematic change, industrial production fell drastically in all CEE countries, between at least one third, up to 80%! Privatization is a necessary but by far not a sufficient policy to succeed the restructuring process. Socialist industrial units (VEBs) cannot be privatized as such. Therefore, each country developed its own strategy of creating new, capitalist enterprises out of the remnants of socialist industry; this we call the process of "enterprization". Among the CEE countries, we distinguish three modes of enterprization: 1) the East-German Treuhandanstalt-model of one single institution for active, decentralized restructuring; this is a unique case; 2) the "classical" approach to privatization through a central Ministry or agency, controlling privatization formally but often lacking control on its enterprises, 3) the mass-privatization approach of diversifying and diluting ownership and control, favoring informal holding companies and insider control.

1. Introduction

Industrial reform has become a central issue of economic policy and research in the countries of Central and Eastern Europe (CEE) and the former Soviet Union (FSU). Issues of industrial restructuring and enterprise reform were until recently underrepresented in the debate. This was partly due to the difficulties of conducting empirical field work, but also because macroeconomic issues of stabilization dominated the first years of post-socialism. In the early reform programs of 1990/91, the main condition to succeed structural reform had been rapid privatization. This approach has failed to bring about the expected results. Macro-stability has been achieved almost throughout the zone, but large-scale, or "deep" industry restructuring has lagged behind. In particular, it has today become evident that the success of structural reforms in post-socialism depends not only on the process of ownership change, but also on the institutional context governing the emergence of new enterprises and new enterprise networks. Reality has proved wrong the vision of a linear reform, a "transition", versus an optimal way of implementing governance structures by private agents. One observes, throughout the region, the emergence of an increasing variety of governance structures that are closely interrelated with the nature of the respective privatization program. The capacity of each country to design appropriate institutions to accompany the emergence of new enterprises will determine its medium-term development.

We apply our topic to the national strategies of industry restructuring carried out in the countries of Central and Eastern Europe. Though starting from a similar institutional basis, each of them has chosen a distinct privatization strategy, and a variety of mechanisms of enterprise creation and corporate control has emerged. Yet, one starts to identify similar and diverging patterns between them. A thorough analysis of national strategies and institutions of industry reform is a necessary condition for discerning the divergence of restructuring patterns that emerge gradually in Central and Eastern Europe.

Our argument goes as follows: we start out with a discussion on the very nature of the reform process, that we characterize not as a "transition" but as post-socialism (section 1). Indeed, there can be no "transition" from a socialist industrial unit to a capitalist enterprise. The post-socialist perspective sheds light on the specificity of the

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1 I am grateful to Will Bartlett, participants of the "4th Freiberg Symposium on Economics" (August 1995) and seminar participants at CERNA, the Centre for Industrial Economics at the Paris School of Mines, for comments on an earlier version of this paper. The usual disclaimer applies.
3 Portes (1994); EBRD (1994) and (1995).
transformation process under study. In section 2, we develop two central concepts of interpreting industrial reforms in CEE-countries: one is the *monetarization* that introduces a break between the socialist system and post-socialism; the other is the *process of enterprization* that consists of creating new enterprises and new enterprise networks. In section 3, we propose a classification of national patterns of industry restructuring. The East German case, dominated by the Treuhandanstalt approach of active restructuring through a state agency, is a unique case. A second approach has been to centralize the control on privatization in one governmental institution: Hungary, Poland, and Estonia have been examples. Finally, a third pattern can be detected in countries that have chosen mass-privatization and the dilution of ownership rights and control: examples are the Czech Republic, Lithuania, and Russia. In concluding we discuss the perspectives of industry reforms in post-socialist countries. We insist on the need to analyze the restructuring process in each of the countries individually, and to identify the link between the institutional framework of restructuring and process of enterprization.

2. The "post-socialist" versus the "transitional" vision of economic reform in Central/Eastern Europe

2.1 The emergence of issues of structural reform

After the breakdown of the Berlin wall in autumn 1989, economists were rapid to declare the period of reform that opened up a "transition" period, leading from socialism to — depending upon the author — capitalism, a market economy, a free economy or yet other terms. Though the steps to conducting the "transition" in an optimal manner were all but agreed upon, both the point of departure and the point of arrival of the transition seemed to be clearly identified: the point of departure, socialism, was considered as a "state planned economy" dominated by planification and public ownership; the point of arrival was supposed to be a market economy, dominated by decentralized decisionmaking and private ownership. Debates then developed upon the optimal sequencing of reform steps, in particular between price liberalization, macroeconomic stabilization and privatization. In most of these proposals, industry reform was limited to the issue of privatization, that is, the transfer of ownership rights of a given enterprise from public to private agents. While the most varying techniques of privatization were proposed, none of them called into doubt the possibility to transfer the ownership of the socialist industrial unit (i.e. the Soviet "predpriatие", the East German "VEB", etc.), the inefficiency of which was considered the major reason for the failure of the system.

The last five years have proved wrong many a forecast on industry reform in the CEE countries. Though macro-stabilization has succeeded rapidly and small privatization was a success throughout the region, none of the countries has come even close to achieving the ambitious goals of *large privatization*, as defined in 1990/91. The slump of industrial production has been much sharper than expected, between 35 and 80 percent in all of the countries. Foreign investment has lagged way beyond the high expectations, at about $30 bn for the entire region only. Most of the privatization programs have encountered obstacles, be it the absence of buyers, inefficient governance structures in the process, or political considerations downpacing the process. Today, it is established that the recovery of industrial production is not necessarily related to the degree of privatization. The hypothesis of a "critical mass" of privatization (Laban and Wolf, 1993) has been invalidated: indeed, most of the reform countries with good macro-records (Poland, Czech Republic, Hungary) have done much to postpone privatization and liquidation in the early phase of reform. On the other hand, the "success" of the mass-privatization program in Russia (over 70 % of the "assets" sold in two years) has not necessarily favored domestic and foreign investors' interest in the restructuring process.

2.2 The "transitional" approach

The divergence between initial expectations on the role of privatization and the dragging process in reality has been subject to a number of analyses. Two fundamentally different approaches can be distinguished: the "transitional" and the "post-socialist" approach. One group of authors agrees that the initial vision of privatization was simplistic. Yet they maintain the "transitional" perspective, that is, the possibility of a gradual change between socialism and a market economy. In that perspective, there is a continuum of economic systems, ranging from central planning to liberalism. The only task, then, is to "push" CEE countries away from central planning and towards market principles.

Most of the authors supporting the transition hypothesis today add "institutional" explanations to the picture. Building on the institutionalist school (R. Coase, D. North, O. Williamson), they explain the obstacles to transition with the difficulties of political and economic institutions to adopt quickly to the new requirements of a market economy. Thus, Acs and FitzRoy (1994), inspired by the Japanese model, propose that increased employer participation in the process might accelerate the restructuring of large firms for which no external demand exists. Portes (1994) underlines that an overvaluation of ownership issues has led to premature asset stripping of potentially viable state enterprises. In agreement with Pinto et al. (1995), he

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8 Roland (1994).
proposes to watch after the establishment of efficient governance structures rather than to push through privatization for its own sake. Kocherivin et al. (1994) insist on the transaction links that are only slowly changing in the governance structure in industry, including commodity transactions, labour transactions, the role of the entrepreneur and capital transactions. In general, the reform process in Eastern Europe has led to the proliferation of institutional explanations of "the transformation crises".

Yet, all the institutional explanations share one essential point with the neoclassical equilibrium theory: they consider the current period as one of gradual "transition" from a state planned economy to a market economy with a given set of rules and institutions. Thus, their main divergence is on the speed of the "transition" only.  

2.3 The 'post-socialist' approach

The second approach consists of distinguishing the socialist system clearly from other systems of organizing the production and distribution of goods, and in particular to distinguish socialism clearly from the capitalist market economy. In that vision, the current reforms in CEE countries must not be seen as pre-determined by a final point of the so-called "transition". Rather, reform programs have to be adapted to the very point of departure of reform, i.e. the functioning of socialist industry itself. Hence, this second approach starts out with an attempt to characterize the socialist system correctly.

As early as 1920, Ludwig von Mises had provided a first reflection on how the socialism announced by Lenin would function in reality. As socialism was an attempt to abandon the use of money as an indicator of value, Mises concluded that under socialism, there could be no "economic" decisions, in the sense of reproducible, rational decisions based on economic calculation. Hence, there can be no gradual move, or "transition", from socialism to capitalism; rather, these two are irreconcilable. Max Weber (1921) and Boris Brutzkus (1921/22), contemporary to the work of Mises, arrived at similar conclusions. Sylvain Lazarus (1995) detected the incompatibility between socialism and a monetary economy in extensive field work in China and European post-socialist countries. To prove the incompatibility, Lazarus cites two key indicators of the socialist system: the submission of production under political control (and thus not under monetary control) and the separation between the value of production and the value of labour.

Our own field studies in over 100 industrial combines on the brink of socialism imply that these countries had largely succeeded to abandon the use of money as a universal equivalent, in substituting the exclusive power and control of the Communist Party. All major positions within the planning and the production units are named and controlled by the Party, according to the renown nomenclature-principles. Investment strategies were not geared toward the optimization of output, but at maintaining the political and social balance within a factory, a combine, a branch or an entire country.

Hence, there can be no "transition" from socialist industrial units after the introduction of reform. When socialism ends, the very working logic of socialist industrial units ends, too. One can say that as socialism disappears, so do the socialist industrial units. Rather than a transition, we therefore shall analyze industry reform in Central and Eastern Europe from a post-socialist perspective. The exercise should not be to define a priori a point B of arrival of the reform; rather, we need to clarify the point A of departure of reform, i.e. the functioning of the socialist industry, and then analyze the process of dismantling of this industry and the emergence of new enterprises. In the following section, we sketch out the two concepts that allows us to interpret this process.

3. From socialist industrial units to new enterprises and enterprise networks: monetarization and enterprization

3.1 Monetarization and the end of socialist industrial units

If — as we have proposed — socialism was an attempt to abandon monetary values in the societal decision-making process, then socialism ends with the introduction of money as a universal equivalent, and a certain price liberalization; the sum of these two steps we call monetarization. Indeed, socialism ends abruptly and irreversibly with the introduction of a single and universal monetary standard. For most of the countries, the date of monetarization can be easily identified, as it coincides with the beginning of drastic macro-economic reforms: Poland

9 Schmieding (1993); van Ees and Garretsen (1994).
10 As Richet (1992, p. 17) puts it: "Every road leads to Rome. ... The process of trial and error will be long, and will cost more than anticipated; but the experience gained by the actors in today's transformations will enable them to choose the most effective organizational model."
11 von Mises (1949, pp. 696-697) expressed his idea like this: "The paradox of <socialist> "planning" is that it cannot plan, because of the absence of economic calculation. What is called a planned economy is no economy at all. It is just a system of groping about in the dark. There is no question of a rational choice for the best possible attainment of the ultimate ends sought. What is called conscious planning is precisely the elimination of conscious purposive action."
13 One way to "prove" this thesis is to retract the history of investment projects in a given industry in detail. It can be shown that, from a purely technical point of view, the investment decisions did not correspond to the proclaimed objectives such as scale economies, efficient sharing of work, etc. Rather, the contrary was often the case.
(January 1990), East Germany (July 1990), Czechoslovakia (January 1991), Russia, Lithuania, Estonia (January 1992). In other cases, it is more difficult to identify a precise date, but the year of qualitative change can be given: Hungary (1990), Romania (1991).

Monetarization introduces the possibility to value goods and factors of production according to the same standard. The consequences of monetarization are simple but drastic: the Party disappears as the sole organizer of production, and is replaced by a new criterion of economic activity: money. Monetarization reveals costs for previously non monetarized items: transport, energy, stocks, social services, labour, etc. All inputs suddenly acquire real costs. Where production was formerly non-monetary, questions of liquidity and cash-flow now dominate the management of production.

Monetarization means that the socialist industrial units and networks break up instantaneously. It became obvious that the production structure inherited from the socialist, non-monetary world could not be adapted to the post-socialist, monetary world. Socialism leaves behind the multi-functional industrial units, that were not designed to function in a monetary environment; these units thus became the industrial "remnants" of post-socialism. Though their physical structure (buildings, machines, people) remained the same, their very nature is transformed through monetarization.

The drastic reduction of industrial production in all post-socialist countries is a logical result of the shock of monetarization. Even if internal restructuring may have started earlier, it is the moment of monetarization that causes a profound reorganization of productive activities, accompanied by a corresponding drop in production. Table 1 provides an indication of the slump in industrial production of the countries concerned. Not one single country was spared from the pain: the cumulated drop in industrial production exceeded one third for all countries concerned; for some of them, it went over two thirds (East Germany, Lithuania, Albania).

Monetarization is the moment that triggers inevitable industrial reform. The year of monetarization marks the break between socialism and post-socialism. The figure provides some quantitative evidence: it compares the drop of industrial production with regard to the moment of introducing monetary reforms and price liberalization. The curves in the figure are "normalized" with regard to the year of monetarization, indicated as t0. In other words, the figure shows the development of industrial production for each country, relative to the year in which socialism was abandoned (t0).

Two characteristics come out quite clearly, that are common to all countries: first, the big depression of output occurs immediately in the year after monetarization. Output reductions are only very moderate in the periods t_1, t_2, etc., i.e. the last years of socialism. The important slump occurs right after t0, i.e. after monetarization. Second, the output curves then follow an elastic J-curve, with output picking up about three years after monetarization. This can

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Table 1

<p>| Industrial Production in Central and Eastern European Countries, 1989-1995 |
|---------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|</p>
<table>
<thead>
<tr>
<th></th>
<th>yearly change (%)</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>5.0</td>
<td>-7.6</td>
<td>-36.9</td>
<td>-44.0</td>
<td>-10.0</td>
<td>-2.0</td>
<td>n.a.</td>
<td>-80 %</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>-1.1</td>
<td>-16.0</td>
<td>-27.8</td>
<td>-15.0</td>
<td>-7.0</td>
<td>4.1</td>
<td>11.0</td>
<td>-53 %</td>
</tr>
<tr>
<td>Czech Lands</td>
<td>0.8</td>
<td>-3.5</td>
<td>-22.3</td>
<td>-7.9</td>
<td>-5.3</td>
<td>2.3</td>
<td>3.6</td>
<td>-35 %</td>
</tr>
<tr>
<td>East Germany</td>
<td>2.5</td>
<td>-50.0</td>
<td>-31.0</td>
<td>8.0</td>
<td>15.0</td>
<td>12.0</td>
<td>6.0</td>
<td>-66 %</td>
</tr>
<tr>
<td>Estonia</td>
<td>n.a.</td>
<td>-0.2</td>
<td>-9.5</td>
<td>-38.7</td>
<td>-27.0</td>
<td>-2.0</td>
<td>6.0</td>
<td>-60 %</td>
</tr>
<tr>
<td>Hungary</td>
<td>-1.0</td>
<td>-9.6</td>
<td>-18.2</td>
<td>-9.8</td>
<td>4.0</td>
<td>9.5</td>
<td>6.0</td>
<td>-34 %</td>
</tr>
<tr>
<td>Latvia</td>
<td>n.a.</td>
<td>-0.1</td>
<td>-0.2</td>
<td>-45.5</td>
<td>-29.7</td>
<td>-6.8</td>
<td>n.a.</td>
<td>-64 %</td>
</tr>
<tr>
<td>Lithuania</td>
<td>4.2</td>
<td>-2.8</td>
<td>-2.8</td>
<td>-50.9</td>
<td>-42.7</td>
<td>2.0</td>
<td>6.0</td>
<td>-73 %</td>
</tr>
<tr>
<td>Poland</td>
<td>-1.4</td>
<td>-26.1</td>
<td>-11.9</td>
<td>3.9</td>
<td>5.6</td>
<td>13.0</td>
<td>13.0</td>
<td>-36 %</td>
</tr>
<tr>
<td>Romania</td>
<td>-5.3</td>
<td>-23.7</td>
<td>-22.8</td>
<td>-21.9</td>
<td>1.3</td>
<td>3.3</td>
<td>5.0</td>
<td>-56 %</td>
</tr>
<tr>
<td>Russia</td>
<td>1.4</td>
<td>-0.1</td>
<td>-8.0</td>
<td>-18.8</td>
<td>-16.0</td>
<td>-21.0</td>
<td>-6.0</td>
<td>-53 %</td>
</tr>
<tr>
<td>Slovak Republ.</td>
<td>-0.7</td>
<td>-3.6</td>
<td>-17.6</td>
<td>-14.0</td>
<td>-13.5</td>
<td>6.4</td>
<td>10.6</td>
<td>-41 %</td>
</tr>
</tbody>
</table>

Sources: EBRD Transition Report, 1995; OECD-Short Term Economic Indicators; BMWi (Hrsg): Wirtschaftslage und Reformprozesse in Mittel- und Osteuropa, 1995.
be seen in the figure: \( t_1, t_2 \) and, occasionally \( t_3 \), continue the production decrease. Starting from \( t_4 \) and \( t_5 \), approximately, production then witnesses the upward slope of the J-curve.

### 3.3 Enterprization and the definition of property rights

Given the break-up of the former logic of production, it is clear that privatization is a necessary but not a sufficient instrument to setting up new, competitive enterprises. No capitalist entrepreneur will ever be interested in taking over a multifunctional industrial "remannt" of a former combine. The identification of ownership rights is a first, unavoidable step: corporatization — in the sense of creating ownership — has been carried out rapidly throughout the countries\(^\text{16}\). But privatization — in the sense of creating new private entrepreneurs — has been a success in small-scale operations mainly. It has not been enough to create a dynamic of restructuring among the new owners of the former socialist industrial units. In addition, experience shows that there are no established ways to reform, adapt, or restructure these ruins into new viable enterprises.

As the concept of privatization has proved to be of little practical use in the analysis of industry reform, we propose to develop another one, changing the angle of attack: instead of studying the process of ownership right transfers of the industrial remnants, we propose to analyze the process by which new capitalist enterprises emerge in the post-socialist context. As an enterprise we understand a unit that decides on production, investment and employment under a well-defined capital constraint. Capitalist enterprises did not exist in socialism. Therefore, they have to be created from scratch in post-socialism. As this process is about creating new enterprises, we shall call it the process of enterprization\(^\text{17}\). The issue of post-socialist industry restructuring, then, is to create, from the ruins of the socialist industrial combines, new enterprises, able to survive under the new monetary regime. This process — enterprization — need to be analyzed in the context of the emergence of new networks of enterprises, that are formed under the new monetary and competitive constraints\(^\text{18}\).

\(^\text{16}\) Frydman, Rapaczynski, and Earle (1993).

\(^\text{17}\) Bomsel (1995).

\(^\text{18}\) Two empirical studies on enterprization have been finished recently: Rouvez and Coco (1995) show that in the Russian military combines, enterprization leads immediately to the creation of a large number of new enterprises; in that sense, enterprization has nothing in common with the socialist approach to "conversion" of the late 1980s, where only the products were converted, but not the industrial structures. Bomsel et al. (1995) carried out an extensive case study on enterprization in the former East European steel industry. They show that the quickest way to attract private capital for investment to the steel industry is to facilitate the disintegration process: "...there is no technical taboo regarding enterprization: it can affect any piece or function of the plant if there is a potential for business (a market), an investment opportunity and if the piece or the function can be clearly isolated from the rest." (p. 14).
The post-socialist approach that we propose implies three working hypothesis concerning the process of industry reform:

- the fundamental problem is not a mere question of ownership; the strategy of defining new ownership relations (corporatization, privatization) needs to be consistent with the process of enterprization;
- there will be no enterprization nor emergence of new industrial networks without a redefinition of the former productive activities, both within the former factories as well as across entire branches. The industrial structures that emerge have not much to do with the old, socialist networks. In particular, there is not just one (best) solution to the restructuring, but a variety of forms of industrial organization may emerge (e.g. the integrated firm, a hierarchical network, an industrial district, etc.);
- an efficient strategy of enterprization is not only a result of "good" management, of new technology, access to credit, foreign investment etc.; it also depends on the capacity of the state to structure and to control the process of dismantling and of new enterprise creation.

4. Diverging patterns of national strategies of industry restructuring

4.1 Similar point of departure, diverging restructuring strategies

Though each socialist country had its peculiar history of development between the late 1940s and 1990, the institutional structure of industry was similar in all of them. The "sharing of work" according to socialist principles had indeed imposed some sectoral specialization. The general patterns are well known: Czechoslovakia expanded its heavy engineering and military industries, Poland specialized in coal, steel and shipbuilding, the GDR developed specific capacities in machine building. Within the Soviet Union, too, some specialization took place, i.e. in mining and heavy engineering in Ukraine, or in electronics in Latvia and Lithuania. Russia retained almost all scientific and technical knowledge a well as most of the final assembly.

Besides the sectoral specialization, we know today that the operating mode of socialist industrial units were similar all over the Eastern Bloc. The Soviet Union had succeeded in imposing a homogeneous model of the non-monetary, multifunctional industrial units all over Eastern Europe. Attempts to reform socialism gradually, i.e. without destroying the fundamental pillar — the non-monetary coordination by the Party — were doomed to fail. Thus, when socialism broke down, all countries shared the same model of industrial organization. None of them possessed an intrinsic advantage over others, stemming from sectoral specialization or attempts of reform.

Each Central and Eastern European country has then chosen its specific path to organizing and controlling the process of industry reform; privatization programs and the institutional structures have never been identical between two countries. Nonetheless, similar patterns are slowly emerging between certain groups of countries, which allows us to establish a first classification of national strategies of restructuring. At the risk of being schematic, we shall present the three basic patterns that have emerged so far: 1) the German Treuhandanstalt-model of one single institution for active, decentralized restructuring; this is a unique case; 2) the "classical" approach to privatization through a central Ministry or an agency, controlling privatization formally but often lacking efficient governance on its enterprises, 3) the mass-privatization approach of diversifying and diluting ownership and control, favoring informal holding companies and insider control.

4.2 East Germany: decentralized, active restructuring by the Treuhandanstalt

East Germany is an extreme case where the responsibility for enterprization and for controlling the process has been carried by one single institution, the Treuhandanstalt (THA). Its history is the most enlightening case on the initial misconception of the real issues at stake in post-socialist restructuring: when the THA was created in March 1990, it was supposed to become the privatization arm of German unification. Yet it became quickly evident that the socialist "factories of the people" ("VEBs") were not privatizable as such. After the shock of monetarization in July 1990, almost none of the former VEBs would have survived as such on the European market.

The THA therefore had to change its strategy: in the declaration of March 1991, it agrees to "assume full responsibility as the owner of its enterprises, including restructuring". Two major policy implications were derived from this reorientation of strategy: first, the Treuhandanstalt created 15 decentralized and largely independent regional agencies all over the country. Second, it made its personnel directly responsible for the restructuring of particular VEBs. To this end, it accelerated the integration of West German and European managers — up to a maximum staff of 5,000 in 1992. Thus, rather than simply trying to sell off industrial units from its Berlin headquarters, the Treuhandanstalt could attack the restructuring of each factory directly on-site. 19

The Treuhandanstalt has been the major institutional innovation in order to cope with the burden of industry

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19 A hands-on example of enterprization in East German industry is provided in v. Hirschhausen (1995): the former steel combine "Maxhütte Unterwellenborn". In this case, one of the largest factories of the GDR, employing 7,200 in 1989, was entirely torn apart in the course of post-socialist restructuring. Today, almost 2,000 jobs exist in about 20 enterprises in the "industrial district of Unterwellenborn", the core activity of which is an entirely new steel plant, built by a foreign investor.
restructuring in East Germany. It quickly adapted to the changing external conditions and created a large number of new enterprises in East Germany, channeling vast federal financial flows. The results of the second phase of the Treuhandanstalt have been considerable: the agency has proceeded with the split-up of 2.500 socialist VEBs, and actively pursued the creation of about 14,000 new enterprises; 1.5 million new jobs have been created (against 3.4 million in the VEBs at the time of the GDR)\(^2\).

Of course, here stands also the limit of the German example: the specificity of Germany is not, as it has been widely argued, the massive monetary support from the West, but the fact that the Treuhand has been the only institutional innovation of reunification, while all traditional state structures were simply expanded from the old Federal Republic. In other post-socialist countries, where the legal and institutional frame has to be totally re-invented, the implementation of a the Treuhand-model is impossible.

4.3 The classic, centralized approach (Hungary, Poland, Estonia)

Most of the countries of Central/Eastern Europe have opted for a "classic" centralized approach to industry restructuring. The centerpiece of this approach is an ambitious privatization law and a Ministry charged with carrying out large-scale privatization: first through corporatization, i.e. the setting-up of state-owned enterprises, second by selling these enterprises — as such — to the highest bidder. This approach is called classic because it is based upon the standard privatization programs in Western Europe, notably in Great Britain, during the 1970s and 1980s.

The underlying condition of the centralized privatization is that state-institutions are capable of evaluating the restructuring potential of "their" enterprises, and exert the control of a real owner, seeking a dividend on their capital. Both conditions have only been partially been fulfilled. First, it has turned out that the units herited from socialism were everything else than enterprises, but heterogeneous, multifunctional socialist industrial units. Thus, privatizations did not take place in the technically most efficient factories, but in those — few — in which the identification of potentially lucrative productive functions was immediately possible.

Second, the capacity of the state institutions to act as real owners and to impose a budgetary constraint on their enterprises, was necessarily limited. Among the reasons was the lack of industrial experience, the understaffing of the agencies and the informational asymmetry between state agencies and industry. Initially, it was planned that foreign investors and banks rapidly take over a controlling role, but this has been only rarely the case. Consequently, large-scale privatization had not the radical effect on restructuring that it was supposed to have in the 1990 reform programs.

How have different countries dealt with the obstacles to the classic, centralized approach? Hungary has been the first to abandon its initial strategy, decided in 1990, in which a central governmental organ — the State Property Agency (SPA) — had the sole task of corporatizing state enterprises, then of selling off as many of them as possible. In early 1992, the disappointing results of the privatization program caused the government to reconsider its industrial policy. It set up a new agency, supposed to take over the management and the financing of the non-privatizable factories: the State Asset Management Company (SAMC), which was given the responsibility of managing Hungary's 160 largest state-owned enterprises (accounting for 40% of industrial employment). SAMC employed right from the beginning a large staff of qualified managers, working under specific incentive schemes, including management contracts and the possibility of leasing restructured enterprises. An Investment and Development Bank (IDB) was supposed to finance the newly created private enterprises as well as the former factories under restructuring\(^2\). Furthermore, Hungary tried to reinforce management buy-out (MBO) and employee ownership (ESOP) schemes. These internal restructuring methods had been limited in the first approach, as the government feared a repetition of the spontaneous and often anarchical "auto-privatizations" of 1990.

In Poland, too, the results of the first three years (1990-92) of large privatization were considered disappointing. The Sectoral Privatization Program had failed to identify the most efficient enterprises in each sector and to privatize them. By mid-1992, the obstacles to restructuring had become evident. Only about 100 out of several thousand industrial units had been corporatized and privatized. One attempt to reorient the strategy was the Pact of the public enterprise, negotiated between the Ministry of Labour, the Association of Employers, and the ten main labour unions. The enterprise pact — signed in February 1993 — sought to facilitate the conditions for restructuring by actively integrating two new players in the process: the labour unions and the banks. Apart from the enterprise pact, a mass-privatization program was finally decided in 1995, as an attempt to accelerate the privatization process\(^2\). Whether it will significantly increase the private sector share in value

\(^{20}\) Breszinski (1992), Brücker (1995). The price of the operation has been extremely high: instead of attaining the expected profit of DM 600 billion, the Treuhandanstalt accumulated a loss of about DM 250 billion! The initial shock on the labour market is only slowly abating: in September 1995, the rate of "persons without regular employment" was 22% (down from 32% in late 1991), 10% of which are persons in "state-financed temporary measures" (reconversion, technical education, early retirement, etc.). The unemployment rate in the New German Länder was 14.7% (Employment Observatory East Germany, 1995).

\(^{21}\) Henderson, et al. (1995). Examples of the branches in which restructuring and enterprization will be carried out by the state include the aluminium industry, the steel industry and parts of the agro-industrial-complex.

\(^{22}\) Blaszczzyk (1995).
added (still as low as 38% in 1994) is another question. Clearly, in Poland enterprization can succeed not only in private but also in state enterprises.

Estonia has chosen the most radical strategy of structural adjustment among all post-socialist countries in Central/Eastern Europe and the former Soviet Union, inspired by a monetarist "shock-therapy" approach. Though the Estonian Privatization Agency (EPA) has failed to carry out the Treuhandanstalt-approach that it tried to emulate initially, it proceeded rapidly with the selling and liquidation of its industry (1993-95). More than 50% of the tender privatizations to core investors were completed by 1995. In mid 1996, EPA only faces one dilemma: what governance structure to apply to the stock of some dozen former combines, that were formally converted into "state-enterprises", but which are in reality controlled by nobody? Several means of enterprise privatization exist: the tendency favored by the Ministry of Finance is to replace EPA as the organizer of privatization by financial intermediaries. As a result of the shake-out of the banking system in 1993, and the strict regulation on financial activities, the Estonian banking system has reached a state of maturity unmatched by other post-socialist countries. Together, the state-run Compensation Fund, the private investment funds, and the Ministry of Finance is to replace EPA as the organizer of privatization to core investors were completed by 1995. In mid 1996, EPA only faces one dilemma: what governance structure to apply to the stock of some dozen former combines, that were formally converted into "state-enterprises", but which are in reality controlled by nobody? Several means of enterprise privatization exist: the tendency favored by the Ministry of Finance is to replace EPA as the organizer of privatization by financial intermediaries. As a result of the shake-out of the banking system in 1993, and the strict regulation on financial activities, the Estonian banking system has reached a state of maturity unmatched by other post-socialist countries. Together, the state-run Compensation Fund, the private investment funds, and the predominantly private banks seem to emerge as the core institutions of the Estonian model of a finance-dominated economy.

4.4 Mass-privatization and the emergence of "post-socialist industrial holdings" (Czech Republic, Lithuania, Russia)

The third "idealtype" of corporate governance in post-socialism emerged in the countries in which mass-privatization was the dominant element. The unorthodox method of mass-distribution of ownership rights to the entire population or to factory insiders had been preferred for several reasons, among them the populist appeal, fairness and equity, individual involvement, the speed of operation, the simplicity of administering, finally the understanding that "classical" privatization carried out at the British rhythm would take at least 2,000 years. Indeed, the countries opting for mass-privatization achieved privatization rates way beyond those of the other countries. Technically, the distribution of vouchers to the population, and the conversion of vouchers into shares has been carried out rapidly. Also, from a point of view of collecting information available to economic agents, mass-privatization seems to be more efficient than the classical methods: the greatest possible quantity of information inside and outside the enterprise concerned is in fact collected.

It can not be concluded, though, that mass-privatization leads immediately to clear and efficient governance structures. Rather, what has happened in the three countries, is the concentration of ownership rights in the hands of employees/managers and a few investment funds. The degree of insider control largely exceeds the expectations. The concentration of ownership rights is the result of an absence of regulation during the first months of the program. Investment funds — often promising unreasonable rates of return — have easily accumulated a large number of vouchers and shares, and now own large parts of industry. This tendency is reinforced by the involvement of banks, who may intervene to support the investment funds financially. Thus, a peculiar form of ownership-control institution has emerged, that we call the "post-socialist industrial holding company".

In the Czech Republic, the "privatization of the economy" (V. Klaus) seemed to have carried out consequently in 1992 and 1993: 2,500 former socialist industrial units were rapidly mass-privatized. Once the first euphoria had settled, though, it turned out that more than 50% of the ownership rights were in the hand of only nine investment funds, seven of which were owned by public banks. In order to weaken the shock of monetarization on industry, the government decided not to apply any bankruptcy procedure during 1992-94, keeping unemployment at an exceptional 4%. Restructuring and factory closures are carried out by the funds, but under the auspices of the World Bank. From 1995 on, it might have been reasonable to have delayed serious restructuring until a period of rapid economic growth made this process easier to get accepted socially.

In Lithuania, it might be particularly the early haste in privatization that forces the state to play a long-lasting, active role in restructuring. While pushing through mass privatization as quickly as possible, the government ignored to control the process properly. Having refused to define the criteria it sought to apply for the restructuring of former socialist combines — be they state-owned or mass-privatized — it was forced to bail out the entire package of 260 insolvent units in 1994. Today, an important question is the future regulation of the private investment funds: if the funds — in particular the 8-10 post-socialist industrial holdings companies — remain "closed-ended" — with a very limited control on entry and exit to the fund — their capital participation in any one enterprise will be severely restricted, and thus the role that they might play in the restructuring of their enterprises. On the contrary, the "open-ended"-option, transforming the investment funds into open stock-companies controlled by the Securities Commission, might allow them to play an important role in future enterprise privatizations.

Russia, too, chosen a strategy in which the state was completely absent in the first phase of the split-up of com-

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23 Pinto (1995), citing several cases of efficient corporate governance in state enterprises.
24 Sachs (1994).
<table>
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<th>Privatization Approach</th>
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<td>1) German Treuhandanstalt</td>
<td>active restructuring - Treuhandanstalt as decentralized restructuring agency - institutional framework imported from West Germany - heavy involvement of external investors</td>
<td>direct control on each state enterprise - industrial restructuring controlled from outside (first THA, then investors)</td>
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<td>2) &quot;classical approach&quot;</td>
<td>centralized - state-administered - one central Privatization Ministry - little involvement of banks/financial markets</td>
<td>lack of governance on state-enterprises - little foreign control</td>
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<td>3) mass-privatization approach</td>
<td>wide distribution of ownership rights - &quot;privatize the privatization&quot; - little regulation</td>
<td>vouchers, decentralized auctions - state agencies become more important after 2-3 years</td>
<td>dispersion of ownership, increasing insider control - creation of post-socialist industrial holding companies, and finance-industrial groups - private/public conglomerates, insider-controlled</td>
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In a state of high macroeconomic and political instability, it decided to give the workers collectives a saying in the process of enterprization of productive functions, but also of social functions that the state was unable to provide (unemployment benefits, housing, social security). The mass privatization of 1993 was an attempt to decentralize the decision-making from the centre into the former industrial units. This process was required to make privatization socially acceptable, yet it has lead to dominant insider control and little investment. It was clear from the very beginning that the privatization — achieved at 70-80% in October 1994 — would only be a first step of the process. Today, concepts of enterprization are developed primarily by those agents who are able to link some parts of the large existing capacities to the solvent demand. Indeed, traders — domestic and foreign — are playing a much more active role in industrial restructuring than foreign investors. The state is slowly regaining control of the processes, either through its right to veto individual enterprise projects, or — on a larger scale — by setting up so-called "Financial-Industrial Groups" that are supposed to coordinate the restructuring activities in entire branches.

### 4.5 Perspectives: convergence or divergence

Table 2 summarizes the patterns between privatization approaches and emerging governance structures. As already stated, one can only analyze the how and the why of restructuring pattern, i.e. deploy a positive approach. A normative judgment cannot be given: first, the restructuring process is still in full swing, and quantitative evidence is not available. But, more important, there is just no single indicator with which to judge the "success" or the "failure" of restructuring and enterprization. Empirical evidence does not provide clear results neither: Russia, for example, is certainly the leading country as regards privatization statistics, but is this of any significant help? Hungary is unbeatable in foreign investment, Poland is ahead in the growth of industrial production, the Czech Republic boasts...

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27 Financial-Industrial Groups (FIG) are most often created upon governmental decree, combining industrial factories, banks, import-export organizations and state Ministries. Their efficiency in organizing the enterprization process is doubtful. Cf. Bomsel (1994); Bomsel and Rouvez (1995).
low unemployment, and Estonia succeeded the most radical shift from trade with the East to trade with the West. Who would dare to declare any of these countries the most successful? And would it matter, anyway, in terms of economic analysis?

What one can say, though, is that the convergence theory, which was popular in the early days of post-socialism, can already be dismissed. Today, there is no reason to believe that any convergence will emerge in the restructuring process of post-socialist countries. Nor can the term "post-socialist" be dropped already: the lack of capitalist market economy institutions, and in particular the lacking capital markets, indeed continue to characterize the enterprization process throughout the region. Divergence therefore also dominates the comparison between restructuring processes in CEE and Western European countries.

Finally, what perspectives do the CEE countries face in terms of industrial restructuring? Whether outsider or insider-dominated privatization, the lack of capital will continue to dominate the restructuring patterns in the near future. Macroeconomic stabilization — some CEE countries are close to one-digit-inflation rates — can only gradually created conditions conducive to massive capital flows into industry. In the FSU countries, such as Russia and Ukraine, enterprization and modernization will continue to depend on auto-generated capital. In no case can vertical industrial policies invert the process of dismantling of socialist industrial structures, they can only render the process more costly. On the contrary, horizontal industrial policies, i.e. policies creating conditions conducive to restructuring for all enterprises of a branch or a region alike, are needed. Horizontal industrial policies can simplify the administrative and fiscal obstacles to entrepreneurial activity, take over the social functions from the factories, reduce the discrimination against small and medium enterprise creation, pursue a medium-term R&D policy and enhance the development of infrastructural projects.

5. Conclusion

Industrial restructuring in post-socialist countries has not evolved as expected in the 1990/91 reform programs. While macro-economic stability has been achieved rapidly, the pace of industry restructuring has lagged behind. In particular, it turns out that privatization in itself is an insufficient measure to assure the transformation of socialist industrial units into profit-oriented, capitalist enterprises. We contend in this paper that the apprehension of industry restructuring needs to take into account the post-socialist specificities of the current reforms. We propose as the red line of analysis to study: a) the collapse of socialism and of socialist non-monetary networks of production through monetarization and price liberalization, and b) the emergence of new capitalist enterprises and networks of enterprises, i.e. the process of enterprization. Our hypothesis is that the institutional framework of enterprization directly impacts the nature of industry restructuring.

We identify three basic modes of enterprization and the link between privatization and governance of the restructuring process: 1) the Treuhandanstalt-approach in East Germany, where privatization of unbundled parts of former combines was accompanied by active, decentralized restructuring of each individual factory; 2) the "classic approach", where centralized privatization agencies face difficulties in controlling the management of their corporatized state-enterprises, and thus the restructuring process; 3) the mass-privatization approach, where the state declines responsibility for intervening in the process, letting emerge alternative structures of governance, and in particular mixed public-private industrial holding companies.

While the patterns of macroeconomic reform have been largely similar throughout the countries of Central/Eastern Europe, industry restructuring has not. The analysis of national strategies and institutions of enterprization is a necessary condition for discerning the divergence of restructuring patterns that emerge gradually in these countries.
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Zusammenfassung

Lehren aus fünf Jahren Industriereform in den post-sozialistischen Ländern Mittel- und Osteuropas

Dieser Beitrag analysiert den industriellen Reformprozeß in den Ländern Mittel- und Osteuropas. Der Reformprozeß auf Betriebsniveau wird durch die Monetarisierung des Systems ausgelöst, d.h. die Einführung eines Wertäquivalents (Geld) und eine weitgehende Preisliberalisierung. Der Systembruch bewirkte in sämtlichen Ländern den Einbruch der Industrieproduktion (zwischen einem Drittel und 80vH!). Die Privatisierung hat die ihr 1990/91 zugedachte Rolle nicht vollständig ausfüllen können, d.h. den Reformprozeß schnell und effizient zu gestalten. Sozialistische VEBs können nicht als solche privatisiert werden. Daher mußte jedes Land seine eigene Methode zur Umgestaltung entwickeln. Diesen Prozeß der Schaffung neuer, kapitalistischer Unternehmen aus dem industriellen Erbe des Sozialismus bezeichnen wir als "Unternehmisierung". Generell können drei nationale Strategien zur Unternehmisierung unterschieden werden: 1) das deutsche Treuhandanstalt-Modell einer Agentur für aktive, dezentralisierte, individuelle Umstrukturierung; dies ist eine einzigartige Konstellation; 2) den "klassischen" Privatisierungsansatz durch ein Privatisierungsministerium, welches formell für die Eigentumsreform verantwortlich ist, in der Praxis aber oftmals keine effizienten Kontrollstrukturen aufbauen kann (z.B. Ungarn, Polen, Estland); 3) die Massenprivatisierung, in der Eigentums- und Kontrollrechte diversifiziert und verdünnt werden, wodurch die Bildung (oftmals informeller) Holdinggesellschaften sowie ein starkes Maß an Insider-Kontrolle gefördert werden.