The Mass Privatization Process in Romania: A Case of Failed Anglo-Saxon Capitalism

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Abstract

The examination of property rights transformation in transition countries is highly consequential for claims about the variety of capitalism. The mass privatization process can help to move speedily towards an Anglo-Saxon system in which private property is widely dispersed. This distinctive privatization strategy, which was implemented in most East-Central transition countries, is examined in this paper from an institutional perspective. Using a case-by-case approach to the institutional and legal arrangements of the Romanian privatization, the present study finds that in Romania the mass privatization program failed to emulate the main features of a functioning Anglo-Saxon capitalist model, given the complicated institutional set up and the unwillingness of government to abdicate economic control. It determined a special form of post-socialist capitalism, in which political clientelism plays a major role.

Key words: *mass privatization, Anglo-Saxon Capitalism, investment privatization funds, political clientelism.*

JEL Classification: 057, P10, P52.

Introduction

This paper offers a tentative assessment of the Romanian mass privatization program (MPP) and explains why, contrary to initial expectations, this program failed to transfer assets from the state to private hands in a speedy fashion and to produce a large shareholder class, as found in the Anglo-Saxon capitalism (see Annex 1).

The starting premise is that the Anglo-Saxon capitalism would have been a right path to be followed by post-communist countries after several decades of totalitarianism and bureaucratic power that affected state legitimacy. Other arguments are linked to: the ever increasing budgetary difficulties met by these countries, due to the progress of economic reforms and enterprise restructuring; the background crisis of the European social model which waits for substantial reforms; the pressure exerted by the international financial organizations (International Monetary Fund, World Bank)[1] in the sense of an enhanced liberalization of markets in exchange of their indispensable financial assistance in the transition period. Moreover, the American model (consumption society, success and individual liberty, low unemployment) could represent an attraction for populations subject to a long period of economical and political deprivations.

Romania has been the object of relatively little systematic analysis and previous studies (Earle and Sapatoru, 1993; Earle and Sapatoru, 1994; Munteanu, 1997; Negrescu, 2000; Earle and Telegdy, 2002) have focused on the policies themselves and on the productivity effects of different privatization methods. They have not analyzed the relationship between privatization programs and the resulting varieties of capitalism[2]. In studies analyzing this relationship in the post-communist countries (such as Bohle and Greskovits, 2007; King, 2007) Romania is barely mentioned.

The examination of property rights transformation is highly consequential for claims about the variety of capitalism. Focusing on mass privatization, an important process that shaped the form of the new economy, this contribution is motivated not only by the lack of information concerning Romania, but also by the lessons that its experience may offer in the broader context of the approaches to different paths of transition to the market economy.

In order to attain these objectives, the paper is organized as follows. Section 2 describes the main features of the mass privatization schemes. Section 3, after presenting the institutional and legal arrangements of the Romanian mass privatization, identifies the barriers in their implementation. Section 4 analyzes the poor performance of the emerging capital market and the unfavourable circumstances in which the investment privatization funds operated. Section 5 refers to the political interference which greatly compromised the speed of the privatization process. Throughout sections 3, 4 and 5 arguments can be found concerning the failure of MPP in creating a functioning Anglo-Saxon capitalist system. Section 6 realizes a brief comparison with two other more successful countries – the Czech Republic and Poland and the last section provides the concluding remarks.

The features of mass privatization and the different programs of its implementation

The major purpose of any privatization method is the creation of effective private property rights in order to enhance the efficiency of enterprises. The appropriate privatization path depends on the goals that the government is seeking to attain, the individual circumstances

[1] In accordance with the Washington consensus (Williamson, 1989), these organizations advocated the neoliberal way as the right way in transition, with limited fiscal deficits, public expenditure priorities, tax reform, market determined interest rates, competitive exchange rate, import liberalization, similar conditions for FDI, privatization, deregulation, property rights.

[2] An exception is Cernat (2006), who analyzes the process of Europeanization, the varieties of capitalism (market-oriented Anglo-Saxon, Continental European and developmental capitalism) and the economic performance in Central and Eastern Europe. Cernat's book gave me ideas and inspiration to structure my study.

facing the enterprises and the economic and political context of the country. It should be noted that privatization is fundamentally a political process as well as a commercial and economic one. Privatization changes the distribution of power within a society, as it diminishes control of the economy by the state and government appointed managers.

The mass privatization differs in the procedure for, but not in the purpose of, classic forms of privatization (Pistor and Spicer, 1997). It is though one of the significant innovations in privatization techniques, avoiding the time and expense of case-by-case transactions; the general public is involved by distributing shares for free or in exchange for specially created privatization vouchers. The purpose of MPP in transition economies is that of creating a popular capitalism and of depoliticizing the economy (Schleifer and Vishny, 1994). By its very nature, mass privatization represents an attempt to move speedily towards an Anglo-Saxon capitalist system, whereby private property is widely dispersed. It was considered the best way to ensure the fairness of the process and a level playing field for all citizens. In this manner, the creation of "large-scale capitalism" is able to produce, in a relatively short period of time, a nation-wide shareholder class, as found in the Anglo-Saxon capitalism.

The mechanics of mass privatization programs are similar to another privatization method – the initial public offerings (IPOs)[3], except that vouchers are used to purchase shares, rather than cash. As a result, significantly less analytical time is required and disclosure requirements are greatly reduced.

Mass privatization promoters formulated several arguments for explaining the need for a rapid privatization. A case by case sale was too much time consuming (Lipton and Sachs, 1990) and a too important public sector was running then the risk of creating a crowding out effect, that is blocking investment in the private sector; the state would have continued to support sectors producing a negative value-added, meaning a PIB shrinkage rather than a contribution. The rationale for the mass privatization method was that the speed of privatization could be increased by overcoming the problems of insufficient demand due to low domestic savings and reluctance of foreign investors (Boycko, Shleifer and Vishny, 1994; Earle, Frydman and Rapaczynski, 1993).

Regarded as a shock therapy, mass privatization allows for a much quicker transition to a market economy. This is one of the major strengths of this method. Once an enterprise is in the private sector, management is provided with strong incentives to conduct business in a more efficient and profitable manner. This is because government subsidies will no longer be there for the inefficient to fall back on, and the threat of unemployment and bankruptcy become very real. Job security itself, for upper levels of management, will be a driving force for voluntary restructuring of inefficient enterprises. The shortened period factor increases the likelihood of a successful implementation because it provides opposition forces with little time to gain strength and attack. The time factor involved is critically important in the politically unstable environment of transition countries.

However, given the emphasis on broad based participation, a potential danger of mass privatization should be taken into account. The widely dispersed share ownership in privatized companies could result in a control vacuum (Frydman and Rapaczynski, 1994). Large numbers of investors with only small stakes would be unable to monitor the management of companies they own. The solution was the creation of financial intermediaries in the form of investment privatization funds (IPFs), which were thought to induce some Anglo-Saxon capitalist

[3] IPOs are the sale of shares directly to the public. Most of the privatization conducted in the UK during the 1980's was done through this method. Because the potential buying public includes a large number of unsophisticated investors, a lot of information needs to be prepared to conduct an IPO. IPOs have the virtue of stimulating interest among the general public in financial markets and increasing share ownership in society. The disadvantages of IPOs are that they do not bring new capital to the enterprise and do not bring in new managerial talent or resources. In addition, IPOs are very time consuming and expensive to conduct, and they generally require the existence of a formal stock exchange and broker network or other distribution mechanism to be implemented effectively. An extensive analysis of IPOs is provided by Gregoriou (2006).

characteristics with respect to the role played by equity markets. IPFs had the right to accept vouchers (coupons or similar privatization options) as payment for the rights they issued and to use them for acquiring shares in enterprises during privatization. A debate started around the form of these financial intermediaries and the way in which they would be created. Different mass privatization programs emerged across countries[4].

The various MPPs implemented in transition economies can be divided into three models (Pistor and Spicer, 1997): *Free Market Model*, *Restricted Market Model* and *Regulated Market Model.*

The *Free Market Model,* supported by Frydman and Rapaczynski (1994) and Boycko, Schleifer and Vishny (1995), offers the highest degree of choice for citizens as the primary voucher holders, but also for IPFs. The establishment of funds is left to market forces. The role of the state is typically limited to stipulating the procedure for establishing an IPF, including the conditions it must fulfill for acquiring a license to operate as an IPF. IPFs accumulate their voucher capital from individual voucher holders. Vouchers holders have the choice between investing their vouchers directly in privatized companies or using them to acquire shares in IPFs. Thus, IPFs compete against each other for voucher capital. IPFs acquire their assets in privatized companies in voucher auctions, where they compete also with other investors. Russia and the Czech Republic chose the *Free Market Model.* They were the first countries experimenting with the MPPs on a large scale.

The Restricted Market Model differs from the *Free Market Model* in the more limited choice offered to voucher holders. Voucher holders are precluded from investing their vouchers directly in shares of privatized enterprises. They may only choose among the existing IPFs or forego their investment option entirely. As a result, IPFs are typically the only bidders in voucher auctions. The degree of competition at these auctions therefore depends largely on the number of funds participating. IPFs in this model are privately founded as the *Free Market Model.* Kazakhstan as well Uzbekistan's MPP fit under this model.

The Regulated Market Model, supported by Lipton and Sachs (1990), does not leave the creation of IPFs to the market and in addition, regulates the structure – though not the specific composition – of the funds' portfolio. IPFs are privatized in the process of issuing shares to the public in return for vouchers. Vouchers holders may invest in IPFs only, not directly in enterprise assets. The composition of the IPFs portfolio is highly regulated. They may choose among different companies, but they are required to buy core stakes in a minimum number of companies, while in the remaining companies they acquire minority stakes. The composition of the initial portfolio may be changed through transactions on the secondary market, including swaps among the funds. However, the discretion of the funds to dispose of the core stakes is limited for several years. The only country that has endorsed the *Regulated Market Model* is Poland.

If the original MPP for Romania is included, one could add a fourth model, the *State Controlled Model.* However, as the label indicates, one may dispute whether the transfer of 70% assets from state ministries to a state controlled national investment fund deserves the name privatization. As we will explain in the following section, Romania enacted far reaching modifications of the initial Privatization Law (Law 58/1991) by adopting the Law for Acceleration of Privatization (Law 55/1995). It therefore seems to be appropriate not to include the original scheme in this classification.

[4] In Bulgaria, the Czech Republic, Latvia, Poland, Romania, Russia, Slovakia, Ukraine and several Central Asian economies MPP accounted for a substantial share of privatization.

Institutional and legal setting of the Romanian mass privatization

In early 1991, the National Agency for Privatization was created, with the aim to develop a privatization strategy and to monitor and control its realization. This agency was responsible for the implementation of the MPP.

In late 1992, the State Ownership Fund (SOF) – a conventional state holding organization - started operating and initially was the majority shareholder of all commercial companies, with a 70 percent stake in each of them. Its board of directors comprised the president of the National Agency for Privatization and members appointed by the president of the republic (five), the Parliament (six) and the government (five). Under supervision of Parliament, the SOF was initially plagued by constant changes in management and various organizational problems. It was then subordinated to the government.

Five private ownership funds (POFs) were established in 1992 as private organizations, which had separate territorial bases; therefore, competition between POFs was not introduced. Each POF was allocated 30 percent of commercial companies' shares on behalf of the public. In late 1996, these funds were converted into investment funds. Their board of directors was appointed by the Parliament and the government. Initially the most dynamic organizations in the privatization setup, they were sidelined in the MPP, for they were allowed to participate only after the subscription by individuals was completed.

The first MPP (1992)

Under the Privatization Law (Law 58/1991), all commercial companies are open to privatization through a wide range of market methods, including trade sales, open auctions, open and limited tenders, initial public offering, and management-employee buyouts (MEBO). The law's two main features are:

a) More than 15 million certificates of ownership were distributed free of charge to all Romanian adults, as the counterpart of the 30 percent stakes held by the five POFs in each commercial company. The certificates were freely tradable among individuals and could be converted into shares of commercial companies belonging to the funds, retained as ownership interests in the funds, or later converted into shares of successor investment funds. It is very suggesting that on the certificates it was not mentioned which POF they belong to. Thus, each Romanian citizen owned a tiny fraction of each POF, which is clearly ludicrous (Telegdy, 2002). The shares belonging to the SOF could only be sold for cash; and

b) Simple management-employee buyouts were offered for the speedy privatization of small enterprises (fewer than 500 employees) with the sale price based on the adjusted net worth derived from commercial companies' balance sheets. The shares of the POFs typically were exchanged against certificates collected by employees, 15-20 percent of the SOF's shares were paid in cash, and the balance was payable in installments over two to six years, bearing an annual interest rate of about 25 percent at a time of much higher inflation. This simplified process proved popular with employees, managers and trade unions, and in late 1994 was extended to larger enterprises.

The initial program was a partial failure and the certificates could not be readily exchanged for shares. The following barriers can be identified:

a) The supply of enterprises and the organization of the process were not properly provided for. The certificates had already been distributed, but the SOF and the POFs (the shareholders) did not start operating until the first quarter of 1993, and there was no mechanism for distributing and trading shares in large quantities. As a result, very little happened until 1993 (only twenty-two enterprises were sold at a pilot privatization program);
b) An inherent conflict of interests deserves to be mentioned in this process: the POFs managers, bent on maximizing the value of their portfolios, were not keen on

exchanging worthless certificates for shares in their best enterprises, but they were less inhibited about getting rid of shares of nonperforming firms. The public took the opposite view but could do little to influence the process.

c) Sometimes, the SOF and the POFs were at odds, with the SOF more inclined to restructure poorly performing enterprises and sell good ones, and the POFs preferring the opposite approach. With few exceptions, certificates could be exchanged for the private funds' shares in an enterprise when the SOF agreed to sell its shares in the same enterprise.
d) The opportunity of selling vouchers to somebody else was extensively used by the population, which rather preferred the proceeds for consumption than for company shares in enterprises with uncertain business perspectives. This practice led to a significant concentration of vouchers in the hands of a small number of wealthy Romanian investors who later could have acquired large stakes in commercial companies with these discounted certificates, including the MEBO privatization.
e) An allegedly large portion of certificates was traded at a price below the initial par value of 25,000 lei, far bellow the adjusted value (upwards of 300,000 lei) calculated by the POFs.

By mid-1994, the government decided to revalue state-owned assets and raised the asking price of the shares by an average factor of four to five. This move was intended to compensate for inflation over the previous three years and to neutralize the certificates purchased by the wealthy persons. This development is essential to understanding why the government introduced a second and more confusing type of voucher when it could have used the certificates already distributed to develop a proper MPP. This governmental intervention against the market forces, namely the reevaluation, immediately priced the shares of commercial companies out of the market, and privatization ground to a halt. Only in late 1994 and in 1995-1996 did the speed of privatization recover, in part because of agreements between the government and international organizations – including the World Bank, which extended a $280 million financial and enterprise sector adjustment loan.

The first round of privatization which started in 1992 led, within four years, to the divestiture of 2,871 state-owned enterprises, or about 46 percent of the number available for privatization and 21 percent of employment (see Table 1).

Table 1
Cash Privatization in Romania, 1992-1996

	Original number	Year privatized					Total	As a share of original stock (percent)
		1992	1993	1994	1995	1996		
Commercial companies	6,291	1	264	595	623	708	2,871	46
Small	3,124	1	247	500	342	1,068	2,158	69
Medium-size	2,459	0	15	87	237	279	618	25
Large	708	0	2	8	44	41	95	13
Capital (billions of lei)	9,060	0	46	330	1,759	1,421	4,145	
Small	240	0	26	73	195	558	959	
Medium-size	1,824	0	13	228	910	547	1,882	
Large	6,996	0	8	28	654	316	1,304	
Employment (units)	4,040,757	72	76,843	181,438	316,195	282,432	856,980	21
Small	497,069	72	51,624	82,571	43,890	65,690	243,847	49
Medium-size	1,753,828	0	11,984	68,118	162,235	161,499	403,836	23
Large	1,789,833	0	13,235	30,749	110,070	55,243	209,297	12

Source: World Bank (1997a)

The second program of mass privatization

Under the Law for acceleration of privatization (Law 55/1995), new free vouchers were issued to all adult Romanian who did not use up their certificates in buying shares during previous privatizations. Each voucher was given a face value of 975,000 lei, and each certificate still outstanding, a face value of 25,000 lei. The government agreed that the street price for the certificate purchases had been close to 25,000 lei, making it fair to restore their par value of 25,000 lei. In the meantime, the revaluation of assets and of the capital stock of enterprises, and the introduction of new vouchers worth 975,000 lei, considerably reduced the purchasing power of the original certificates, hurting those wealthy investors who had (legally) purchased them at a discount.

The new vouchers were nominative and could not be transferred or sold. This is where things start getting complicated. The aggregate value of the vouchers and certificates distributed was calculated to be equal to the stock owned by the POFs – that is, 30 percent of the capital stock of commercial companies not yet privatized.

Starting on 1 October 1995, the free subscription of shares was done in three steps:

- First, individuals were given three months to exchange their vouchers and certificates against shares or to entrust the POFs to do so on their behalf;
- Second, the POFs were then allowed, over one month, to collect vouchers and certificates left unused;
- Third, the POFs bid for the remaining mass privatization shares with the vouchers and certificates collected over the four previous months. But as a result of a poorly organized public promotion campaign, the paucity of information provided on enterprises, and public apathy and skepticism, the subscription period for individuals had to be extended by three months, up to 31 March 1996.

The subscription accelerated markedly in its final days, and 15.4 million Romanians (93 percent of the voucher holders) exchanged their vouchers and certificates for shares by the time

it was completed. Of the subscriptions, 14.5 percent entrusted their vouchers and certificates to the POFs and 85.5 percent bid directly for shares in enterprises. In April 1996 the POFs collected unused vouchers and certificates and did their own bidding for shares left over after individual subscription. The deadline for the redemption of vouchers and certificates was 30 April 1996, and the subscription process ended on 30 June 1996.

Despite the potential importance of the 1995-1996 program, which offered shares in nearly 5000 companies to citizens in exchange for vouchers, little information has been made available to the public on its outcomes. Analyzing a comprehensive database of companies in the MPP, Earle and Telegdy (1998) found that an average of only 18.7 percent of the shares of the companies were actually transferred to Romanian citizens, and only 7.8 percent of the companies in the program were majority privatized (on a size-weighted basis). They estimated that mass privatization accounted for only about 5.5 percent of the state-owned enterprises assets in the country, despite the enormous hype about the program from the government. In 1997, after the massive wave of privatization during 1995-96, 58% of industrial production still took place in the public sector (OECD 2002). The following sections will try to identify the factors which determined such an outcome and to explain why the Romanian MPP was a case of failed Anglo-Saxon capitalism.

The poor performance of the emerging capital market

An exogenous factor linked to mass privatization is the development of the domestic capital market. There is a natural link between privatization and the development of the capital market and the secondary share trading. Equity markets are important because they allow new owners to buy and sell shares, a recognition of their property rights. The capital market also provides external discipline for newly privatized public companies with respect to the provision, research, and analysis of information on these companies, as well as the movement of the companies' shares prices in response to their performance. Moreover, investors' rights are best protected through well-regulated markets (Lieberman, 1997). The capital market also provides a means for strong enterprises to raise permanent or long-term capital through new equity and bond issues.

During the fourth quarter of 1996 the Romanian POFs were transformed into fully private closed-end investment funds, owned by those who decided to entrust to them their vouchers and certificates. These funds are regulated under a legal and regulatory framework designed and supervised by the National Securities Commission. Their performance can serve as a mirror for the overall success – or failure – of mass privatization.

Although in theory the mass privatization scheme should have introduced several Anglo-Saxon capitalist features with respect to the role played by the private investment funds and a well-functioning stock market, in Romania the results were disappointing. The capital market, as a privatization mechanism, was insignificant (see Table 2).

Table 2
Evolution of the Romanian privatization process

	1993	1994	1995	1996	1997	1998	1999	2000	2001
Number of companies in SOF/APAPS portfolio, beginning of the year[5]	5937	6291	7602	9010		5554	4330	3149	1444
Number of companies privatized during the year	265	604	648	1388	1304	1267	1854	1341	127
By size[6]									
-Large	2	12	30	25	35		82	24	19
-Medium	24	110	268	238	150		589	247	19
-Small	238	472	322	984	978		1183	1070	89
By privatization method									
-MEBO	261	519	43	14					
-Direct negotiations	4	85	605	1006	1064	244	1337	1235	19
Auctions				455	231	991			92
-Sales on the capital market					9	32	64	106	16
Sold share by year in constant prices (1995 prices), bn lei	144.3	471.4	1840.0	920.4	603.3	741.3	824.3	525.9	617.8
Companies sold to foreign investors	1	1	5	4	44	96	83	38	
Proceeds from sale to foreign investors - $ mn	2	3.9	15	15.5	403.8	608.1	57.1	7	

Source: State Ownership Fund, APAPS.

In the Romanian MPP, the creation of POFs – quasi governmental investment funds, was not conducive to a functioning secondary market or to the efficient representation of equity rights for their shareholders (two crucial elements for the efficient functioning of an Anglo-Saxon capitalist model).

[5] The SOF was replaced by APAPS (the Privatization Authority) in 2001. When the SOF was liquidated, not all of its shareholdings were transferred to APAPS. 809 enterprises were transferred to the corresponding line ministries. The number of companies in SOF portfolio was fluctuating not only due to privatization, but also as a result of reorganizations. Companies were split into several smaller units, or sometimes smaller units were rebundled.
[6] 1993-97, for some privatized enterprises their size is not reported in the data.

The investment privatization funds were thought to provide important functions as financial intermediaries in the newly emerging capital markets. Thriving on the returns of their original investments, it was expected that they could attract additional capital from households and allocate them to the most productive use. Mass privatization would have fueled the development of stock markets given the large supply of tradable equity created during the process of corporatizing the former state owned enterprises and offering their shares to the public. The investment privatization funds were conceived to play a key role as market makers. However, they operated in the following adverse circumstances:

a) *Little dividends from companies*

The funds have earned little cash flow through the collection of dividends from the companies in which they invested. They had therefore difficulties in ensuring the proper payment of dividends to the shareholders. The most important barrier was the difficult financial situation of the companies themselves. Many companies needed cash to restructure and adapt to new market conditions, and could not afford to pay dividends to shareholders.

b) *Lack of confidence in financial intermediaries*

This derived from the negative experience of the Romanian population with the nascent financial markets during privatization. Besides the low returns on the voucher investment, there is another important explanation. Some unlicensed investment companies took advantage of the loose regulatory environment of the privatization period to attract cash investments from the Romanian population. Great promises of return attracted millions of Romanians to invest in these financial schemes.

The most well known was Caritas. Caritas was a Ponzi scheme which was active between April 1992 and August 1994. It attracted millions deponents from all over the country who invested more than a trillion lei (between one and five billions USD) before it finally went bankrupt on 14 August 1994, having a debt of 450 million USD. This scheme labeled itself a "mutual-aid game" (hence the name "Caritas", meaning charity in Latin) which had the purpose to help the impoverished Romanian during the transition to capitalism and promised eight times the money invested in six months. The proposed return rate might seem ridiculously high, but given that the country was suffering from heavy inflation (over 300% yearly), and that Romania's citizens were not used to modern financial instruments, almost nobody saw the scam during the early stages of the "game" (Verdery, 1995). Eventually Caritas failed to gather enough money to continue its activity, being able no more to pay back the money for those who deposited them in this scheme.

Another case is that of FNI (National Investment Fund). By 2000, 345,000 investors had total assets of more than 191 million USD in the mutual funds. One company, the National Investment Fund, accounted for 87% of the investors and 75% of the sector's total assets. Following a newspaper article alleging that a change in valuation rules was likely to lead to a decrease in the value of the FNI's assets, large sums began to be withdrawn from it, and when the FNI withheld payments to depositors, panic increased and the managers fled the country. Confidence in the rest of the financial sector plummeted and there was a flood of withdrawals from Romania's leading bank, the Commercial Bank (BCR). The collapse of the FNI affected around 300,000 investors. Angry protesters accused the National Bank governor, Mugur Isarescu, claiming that FNI investments had been guaranteed by the state and as a central bank governor from 1990 to 1999 he must have known about was going on and should have done something about it. This was in fact not the case. The central bank was not responsible for the commercial contracts concluded by banks, nor was it required to regulate or monitor investment funds[7].

c) *An excessively cumbersome institutional setup*

Concentration of decision making is crucial in the design of a coherent MPP. A single institution should be responsible for decision-making (Stilpon, 1997, p. 20). In Romania there

[7] More details about the FNI affair can be found in Gallagher (2005).

was no single authority in charge of strategy, preparation, and implementation. Instead, three organizations, often with overlapping areas of action and with divergent views and interests, shared responsibility. The government did not control the SOF or the POFs, and the National Agency for Privatization lacked clout resources to impose its leadership. Institutional conflict affected privatization in Romania.

Admittedly, voucher privatization is criticized for determining a very dispersed ownership structure. By its institutional design, the Romanian resulted in an even more dispersed ownership than voucher privatization in general. According to the Law 55/1995, coupons were non tradable and this impeded the emergence of any blockholder, be that individual or institutional. The very term "mass privatization" is improper when only about two-thirds of the commercial companies were included in the program, and in each one the state retained 40 or 51 percent of shares for the latter direct sales.

Another institutional barrier that diminished the bulk of shares transferred to private hands was the asymmetric treatment of excess supply and excess demand situations (Telegdy, 2002). If in a company the demand for shares was larger than the amount of privatizable shares, the amount of privatizable shares was divided by the amount demanded, and each citizen received an even smaller fraction of the shares than in the case of a perfect match. Of course, this could be treated as some market mechanism: the more demanded shares are more expensive. But this "market" rationale was not followed anymore in the case of an excessive supply: each demander received the face value of his share, leaving a part of the privatizable shares in state ownership. As a consequence, the outcome of this provision was the partial privatization of the companies, with an extremely dispersed private ownership structure with only one owner in a controlling position: the state (Earle and Telegdy, 1998).

d) *Unwillingness of government to proceed with speedy privatization and abdicate economic control*

Not enough shares in enterprises were offered to ensure that the state relinquishes control. In both the initial and the second attempt at mass privatization, only 30 percent of the shares offered in the program were exchangeable, in aggregate, against free vouchers and certificates. As a result, there is a risk that too many enterprises will remain under the control of the SOF at the end of the process. A larger percentage of shares should have been offered for exchange against vouchers and certificates – say, 60 percent or more – to ensure that the SOF relinquishes control in mass privatization enterprises.

e) *No indication of the market price of shares*

In the second privatization program, because the new vouchers were not tradable and could be exchanged only at par for shares, there was no indication of the market value of vouchers and shares. The exchange of shares against vouchers and certificates at par value – rather than through bidding – may have been simple, but it failed to indicate the estimated worth of each enterprise. The rate of subscription of shares against vouchers and certificates was the only indicator of the worth of an enterprise in the eyes of the public, and it was communicated by the authorities only in March 1996. The bidding price of shares at the cash auctions was a better indicator. But these auctions took off at the end of the subscription process, and the public did not receive this information in time to make its choice. As a result, there were three different prices for the same shares: one is the par value of 25,000 lei at which shares were exchanged for vouchers and certificates, the second is the price at which those shares were sold for cash, and the third is the market price that was to be discovered when secondary trading of these shares starts. To avoid this confusion, the vouchers should have been tradable, and the shares should have been bid for vouchers as well as for cash. There should have been no limit on the number of shares exchangeable for vouchers and certificates (Tardy, 1997).

f) *Lack of transparency and information on the performance and financial health of each enterprise*

With no performance history and no evaluation of potential and development plan of enterprises, due to the managements lack of information, the public was so confused that the

subscription rate remained very low. The fairness and equity of the process were questionable because: first, it gave an undue advantage to insiders and second, most people only had access to the worst enterprises, and those who have entrusted their vouchers and certificates to the private ownership funds ended up owning leftovers from the subscriptions.

Due to the conditions mentioned above and contrary to expectations, the investment privatization funds have not developed into viable financial intermediaries; their development into portfolio managing investment funds appears to have been hampered by a lack of investor protection that has undermined the credibility of capital markets and restricted the funds' ability to raise new capital on the market.

The lack of development of efficient capital markets seems to be the result of the inadequate institutional framework. While the investment funds were created to become monitors of enterprises, no monitoring mechanism was developed to monitor the funds themselves: "who monitor the monitors?" (Stiglitz, 1994). If the privatization funds do not have adequate organization and control, and managements can and do deprive them of essential information, voucher privatization becomes merely ineffective absentee ownership. Mass privatization offered enormous possibilities for wealth creation which were disproportionately used by a few who exploited the opportunities of a non-transparent and unregulated market.

Political interference and vested interests

As a general rule, in the Anglo-Saxon model, the main role of the state is to maintain a stable environment where markets could operate free from any political or social interference. In Romania, especially during the 1990-1996 period, there was a reluctance of the state to evolve through the MPP towards a minimal role in the running of the economy. On the contrary, the highly controversial design of MPP has been charged with allegations of purposely aiming to maintain the state control, even after the conclusion of the program.

MPP in Romania did not ensure a quicker transition to the market economy: the financial institutions created by the state to handle the privatization process (SOF and POFs) were entirely captured by the industrial elites interested in delaying the process until the insiders were in a favourable position to take control as the new owners.

In the Romanian MPP, vouchers neither proscribed the capacity of the state to intervene nor guaranteed the protection of private property. What mattered to reformers was that vouchers *symbolized* both depoliticization and the transfer of ownership. The vouchers were used simply to offer something of recognized value to the public, rather as a social tool. This populist strain is not a feature of an Anglo-Saxon system. Reformers needed public support for privatization as well as for other reforms. It quickly became clear, however, that the public's expectations could never be fully met. Share distribution through vouchers was at best a small property inheritance following the years of communist propaganda, according to which the state's property belonged to the people.

The public sector formed the crux of a powerful coalition of vested interests with well-established claims to public resources and strong ties to the off-spring of the ex-communist party. Instead of a fully market-driven system, a hybrid system resulted, in which bureaucrats in state institutions had an important role in allocating economic resources and distorting competition in favour of their proteges (Dochia, 2000). Thus the whole reforming process was blocked:

"Romania got stuck in the first stage of the transition. A certain sector, formed either by people from the old *nomenklatura*, or by individuals who oriented themselves very rapidly in the interstices created and knew how to take advantage of the opportunities of the initial period, produced a zone of economic and social supremacy, acquired sufficient economic strength and has no interest in generating a second phase where competition may lead to losing its monopoly" (Tismaneanu, 1999).

The Romanian case confirms Hellman's (1998) insight, according to which the passing from "state socialism" to "state capitalism" results in a model of partial reforms in which "winners take all". The vouchers privatization created incentives for anti-reformists to block further reforms that would bring newly privatized firms into competition.

In Romania, state capture activities, as defined by Hellman *et al.* (2000), between industrial managers and politicians followed a paradigmatic situation, in which high-ranking politicians were members on the management boards of state owned enterprises engaged in privatization. The situation became problematic in 1996 after the adoption of a law making parliamentarians ineligible to sit on management boards. Despite its clear provisions, the Romanian legislators were the first to breach the law. Under the shelter of their parliamentary immunity, they continued to keep their position on the management boards. Since there was no instance of suspension of parliamentary immunity, there was no risk associated with breaching the law. A first report by the Government's Control Department (DCG) in 2000 found that 75 parliamentarians were members of 51 boards of directors, management boards or audit commissions. At lower levels, 3,100 civil servants from the Ministry of Finance were on audit commissions for various state owned enterprises (DCG 2000).

This situation demonstrates a constant politicization of the Romanian economy throughout the transition period. By taking part in management boards, top politicians and bureaucrats preserved a situation similar to the previous communist system when the ruling party was omnipresent in decision-making at enterprise level.

The institutional arrangements of the Romanian MPP did not place non performing managers under pressure from external threats of takeovers or bankruptcy, as happens in an Anglo-Saxon capitalist system and no internal surveillance mechanism (via shareholders) for managerial performance was produced. The only constraint mechanism was political, identical to that regulating the state owned enterprises.

A crucial feature of an Anglo-Saxon capitalist model is the efficient representation of equity rights for the shareholders. Instead, in Romania the POFs statute did not give any powers to the large number of shareholders. There was no annual meeting, and no mechanisms for providing accountability, as in the Anglo-Saxon capitalist system. POFs failed in their main task as agencies acting on behalf of the new individual owners and their interests, since the individual owners had virtually no say in the process. The Romanian citizens were *de jure* owners of the POFs, but *de facto* it was impossible to control them. As we have already mentioned, no institution was set up to provide information on their activity. The main task of POFs was to counteract the problems that diffuse ownership would create. Instead, the selection of POF board members became a highly politicized process. This is why the Romanian emerging capitalism is characterized by Cernat (2006) as a "state corporatism *cum* political clientelism" rather than a system closer to an Anglo-Saxon ideal type. Annex 2 compares the characteristics of the Anglo-Saxon capitalist model with the outcome of MPP in Romania.

As the POFs were claimed to be a strange mix of state and private factors, the Romanian capitalism could resemble as well to a distinct form of capitalism based on "recombinant property" (Stark, 1996). In a later version of this argument, Stark and Bruszt (1998, p. 7) explain that in post-socialism new property forms have appeared that blur the boundaries of public and private, blur the organizational boundaries of firms, and blur the boundaries of the legitimating principles through which they claim stewardship of economic resources.

The "political capitalism" thesis of Staniszkis (1991) matches also the Romanian case. According to Staniszkis, the "political capitalism" results when the former communist elite uses its political power to enact privatization laws that enable them to convert their former positions into new forms of post-communist privilege and thus private wealth.

King (2007) states that the type of privatization employed in Russia, Romania, Bulgaria and Serbia in the 1990's has laid the foundations for a "patrimonial capitalism". The main feature of this system is the nomenklatura's retain of power and ability to acquire private

property, high levels of non-market horizontal coordination, low ability of the state to provide public goods combined with a multiparty authoritarianism.

The development of the Anglo-Saxon neutral patterns of regulation which do not privilege particular social actors was impeded by some inherited institutional elements. The communist regime imposed relations of a *clientele* type, an environment of personalized rapports, replacing the impersonal and neutral mechanisms and laws of a market system. The social relations, including the privatization schemes, acquired the features of an illicit tie "master-client", along with all associated complicity.

A brief comparison with the Czech Republic and Poland

Unlike the Romanian MPP, it seems that the Czech and the Polish respective programs (see Annex 3 and 4) were not so politicized[8] and led to the introduction of a balanced package of Anglo-Saxon capitalist institutions: both diffuse ownership, but also an increased role of private investment funds and a well-functioning stock market that enabled individual shareholders to exert some degree of control. Despite differences in the motivations of mass privatization, both in the Czech Republic and Poland rapid privatization was recognized as a fundamental element of transformation. Especially in the Czech Republic (and before that in Czechoslovakia) privatization was understood as the precondition for the emergence of a market environment. It was viewed as the key element of the process of radical institutional change and was supposed to generate important spill over effects (Grosfeld and Hashi, 2003). Consequently, a main concern was the speed of the process.

Even if not so spectacular as in the Czech Republic, the Polish privatization started in the summer of 1990 with the Privatization Bill. From the very beginning, "there was considerable interest in classical privatization (which means British-style privatization)" (Thieme, 1993). Within the Carnegie Council Privatization Project, Thieme (1993) recognized that:

> "There are logistical challenges, and there are also external challenges, such as the availability of foreign capital for restructuring worldwide. Who knows whether this capital will be available for Poland or for this region? The last challenge is a systemic one. The solution (…) is based on capital market costs; specifically, on Anglo-Saxon capital markets."

The comparison with these countries reflects that both in terms of scale and timing, Romania was a later starter, little privatization occurring during the period 1990-1995. The Czech MPP voucher program in the early 1990s was successful not only for its speed but also for the scale of privatization. In the Czech Republic up to 97 percent of state owned enterprises (SOEs)' assets were privatized via vouchers distribution, while in Poland the figure was 55 percent (OECD 1993). As shown in Table 3, as early as 1992, in the Czech Republic, almost 60 percent of the privatization process was completed. By contrast, although the first privatization laws were adopted in 1990 and 1991, at the end of 1992 Romania was lagging far behind other countries in terms of privatization, with less than 0.22 percent of the total number of state owned enterprises.

[8] In fact, political interference affected the Polish MPP, delaying the program until 1995. The Poland's mass privatization was conceived as a heavily engineered program, rigidly organized by the state. The privatization investment funds were "top down" created funds, instead of private, spontaneously created funds, as in the Czech Republic.

Table 3
Results of privatization in 1992-1995

Country	Firms (% of total number of SOEs)		Industrial firms (1995)	
	1992	1995	% of total industrial output firms	Weighted by industrial (%)
Czech Republic	60	87	89	93
Poland	20	55	61	60
Romania	0.22	20	15	12

Sources: OECD (1993); World Bank (1997b).

According to Table 4, by 1995 the Czech Republic had privatized more than 80 percent of the total number of SOEs, while Romania had only privatized 20 percent. Similarly, the percentage of privatized firms in Romania's manufacturing sector was lower than in the other two countries. When weighted by output, the percentage of privatized firms is even lower, suggesting that MPP privatization was largely confined to small and medium-sized firms rather than larger SOEs. The Czech Republic and Poland were front-runners, while Romania lagged far behind.

Conclusions

Examining property transformation in a post-communist country leads to the investigation of creation of capitalism. The manner in which the privatization agenda has been pursued creates a particular institutional configuration.

The overview of Romania's experience reflects that the mass privatization program did not put in motion the expected advantages of an Anglo-Saxon market-oriented system. Large-scale ownership generated in the course of mass privatization may be less than ideal[9].

Voucher privatization is part of early transition, reflecting the need for a systemic and rapid shift in the structure of property ownership. Instead of creating a truly independent and self-reliant private sector, the early stage of Romanian transition produced a state-compliant and state-dependent private sector. The main drawback of the MPP was the tendency of the state to over-control the whole process using mainly administrative, not competitive measures to privatize the economy.

The investment privatization funds were specifically developed for gathering and disseminating information about privatized firms and monitoring the property rights of the new shareholders. However, they did not evolve into sound financial intermediaries which provide these market-building services due to a series of problems such as: institutional conflict, lack of confidence in financial markets, unwillingness of government to abdicate economic control.

Given the high interplay of interests between the economic and political factors associated with privatization, the emerging capitalism in Romania never managed to emulate the efficient mechanisms of the Anglo-Saxon model of capitalism. It is a special form of post-socialist capitalism, in which political clientelism plays a major role.

Of course, the mass privatization developed in the early years of transition, confronted the constraints of the initial choices and did not represent the single determinant of the emerging

[9] This is also the conclusion of the study realized by Estrin, Nuti and Uvalic (2000), with respect to the Czech Republic, Poland and Slovenia, but as Romania is obviously a laggard in comparison with these countries, the idea is valid all the more.

type of capitalism. We have not analyzed in this paper, for instance, the subsequent external influences, like foreign direct investment, which increased more than seven times after 2000. Nevertheless, the privatization decisions made in the initial stages of transition laid the foundations of the new economic system. The timing of reforms (MPP being associated with rapid privatization) proved to have a strong influence on the type of capitalism developed in post-communist countries. Thus, the more delayed the MPP, the lower the chances that either a liberal market economy or a coordinated market economy could have developed, but the greater the chance that an intermediate type with a strong state component would develop.

Even if ideal solutions or instant financial markets were not available at the beginning of transition, a better institutional and legal framework and a diminished political interference would probably have spared precious time and social costs.

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Annex 1

Features of Anglo-Saxon Capitalism

The Anglo-Saxon capitalism is generally described as a system with extensive market coordination by economic actors and relatively neutral patterns of governmental market regulation aimed at maintaining property right institutions without privileging particular social actors. The term Anglo-Saxon capitalism was popularized by Michel Albert (1993) in his book *Capitalism vs. Capitalism* (called there "Atlantic capitalism" and contrasted with the "Rhenish" coordinated type) and is central to recent research on "varieties of capitalism". Anglo-Saxon capitalism is associated with the United Kingdom and the United States, but also characterizes Canada, Australia, New Zealand, and Ireland. Non-market or associational patterns of economic coordination are weak within this system. Markets or relatively short-term pacts between firms are used to coordinate most patterns of economic activity. Unions, employers groups, or other social actors have few statutory bargaining rights within the economy or the governance of firms. The Anglo-Saxon system has a low and declining rate of unionization (Pryor 1996). It is also associated with generally deregulated labour markets, primarily firm-level patterns of wage bargaining, a system of corporate governance dominated by the financial owners of the firm, and a system of finance depending on capital market based financing rather than long-term bank debt. The main policy instruments are in accordance with neoclassical economics and political neoliberalism. Therefore, in the Anglo-Saxon model the main actions that the state is willing to take are those enforcing the rule of law and macroeconomic stabilization policies with regard to inflation, unemployment, exchange rates and public deficits.

The structure of corporate ownership is the most distinguishing feature of the Anglo-Saxon model. For example, in the USA, the main exponent of this system, individual shareholders account for a majority of total outstanding shares. This differs substantially from Germany and Japan, the representatives of respectively, continental and developmental capitalism, where individual shareholders own a small fraction of the existing shares traded on stock market. Because of this ownership structure, the Anglo-Saxon corporate governance system is one where ownership is more widely dispersed. In this system, a well-functioning stock market is vital so that unsatisfied shareholders can sell their shares. In addition, the individual shareholder is protected by strict regulations on information disclosure, and against insider trading.

Individual liberty and the sense of competition are fundamental values. Dynamism, innovation, flexibility and adaptation are the strong points of this model.

The ideal type characteristics of the Anglo-Saxon capitalist system are presented by Rhodes and van Apeldoorn (1997); the advantages of this system can also be found in Moerland (1995) and Kristensen (1997).

The main characteristics of this variety of capitalism, as presented by Rhodes and van Apeldoorn (1997, pp. 174-175), can be summarized as follows:

Macroeconomic factors:

Role of the state – minimal state

Cooperation between social partners – Conflictual or minimal contact

Labour organizations – Fragmented and weak

Labour market flexibility – Poor internal flexibility; high external flexibility

Microeconomic factors

Shareholder sovereignty – Widely dispersed ownership; dividends prioritized

Employee influence – Limited

Market for corporate control – Hostile takeovers are the "correction mechanism" for management failure

Role of stock exchange – Strong role in corporate finance

Role of banks – Banks play a minimal role in corporate ownership.

Annex 2

Comparing Anglo-Saxon capitalism and Romanian MPP-induced capitalism

Factors	**Anglo-Saxon Capitalism**	**Romanian MPP induced capitalism**
Role of the state	Minimal state	Regulatory state
Shareholder sovereignty	Widely dispersed ownership Dividends prioritized Liquid stock markets allow an easy "exit" option for individual shareholders	Widely dispersed ownership Dividends not prioritized Low sovereignty since financial intermediaries are not accountable
Employee influence	Limited	Extensive, when Romanian MPP was combined with MEBO
Unionization rate	Low	High[10]
Corporate governance	General separation of equity holding and management	Managers remained political clients in the case of incomplete privatization
Management boards	One-tier board	Two-tier boards; political involvement in both levels
Managerial labour market	Strong incentives for managers (stock options)	Limited incentives for economic performance Strong incentives for asset stripping[11]
Market for corporate control	Hostile takeovers is the "correction mechanism" for management failure	Takeovers forbidden Foreign investors discouraged
Role of stock exchange	Strong role in corporate finance	No stock market or very low performance of stock market
Role of banks	Banks play a minimal role in corporate ownership	State-created financial intermediaries play a key role
Availability of finance	Explosion of venture capital companies	Lack of venture capital Credits easily available only for the initial purchase of the company

Adapted from Cernat (2006).

[10] One of the highest in post-communist countries: 50 in 2000, as compared with: Bulgaria - 30; Estonia – 15; Hungary – 20; Latvia – 30, Lithuania – 15; Slovakia – 40 (EBRD 2001).

[11] Asset stripping by insiders was a phenomenon manifested before privatization with MEBO method. Both labour and management, as future buyers of the company, had an incentive to depreciate the value of the SOE as much as possible, by reducing its profitability in the period prior to the privatization process.

Annex 3

Mass privatization in the Czech Republic[12]

The Czech MPP was, from the very beginning, intended to create an Anglo-Saxon type of capitalism (Gould 1999). The privatization program was implemented through a combination of different methods, but voucher privatization was quantitatively the most important. About 1700 companies were privatized in two waves in 1991-1992 and 1992-1994. The investment funds emerged in the Czech Republic as *spontaneous* and *decentralized* institutions.

The privatization investment funds set up by manufacturing companies, private individuals and institutions as well as state-owned banks and insurance companies, actively participated in the process as financial intermediaries.

Adult citizens received vouchers which they could exchange for the shares of companies in the scheme either directly by themselves or indirectly through the privatization investment funds. Vouchers had a nominal value of 1000 investment points. The price of shares of companies in the scheme were also expressed in investment points. In the indirect case, citizens could entrust their vouchers to investment funds and become shareholders of these funds (which were joint stock companies) or unit holders in unit trusts. The funds, in turn, could use vouchers collected from their members to bid for shares of their preferred companies. In the first wave, 72% of investment points available were used by funds and 28% by individuals directly. In the second wave, the percentages were 64% and 36% respectively. The bulk of investment points controlled by funds were concentrated in the hands of a small number of funds set up by banks and financial institutions. In the first wave, these funds were all close-end funds but in the second wave many of them took the form of unit trusts. Later on, as part of the reform of the financial system, close-end funds were required to convert themselves to open funds by 2002. Initially, the funds were allowed to hold up to 20% of the shares of each company in the scheme, though they quickly found ways of bypassing this constraint. The funds' maximum holding in each company was later reduced to 11%.

The shares of mass privatized companies and privatization investment funds were immediately listed on the stock market without the need for prior approval and the publication of a prospectus. The process of buying and selling of shares, and the reorganization of funds' portfolios, quickly followed the two waves – a process generally referred to as the "third wave" of privatization. Investment funds, despite their large overall stakes, were generally not in a controlling position in their portfolio companies. Many funds had ended up with shares of too many companies and wanted to reduce the size of their portfolios. Many individual shareholders, preferring cash to risky shares, also entered the secondary market, selling their shares, thus further pushing down share prices. A major feature of the so-called third wave of privatization was the takeover of investment funds. Given that the privatization investment funds (especially those set up in the first wave) were joint stock companies with a large number of shareholders, they were easy targets for aggressive bidders.

[12] The information in this Annex is based on: Grosfeld and Hashi (2003); Mladek and Hashi (1993) and Brom and Orenstein (1994).

Annex 4

Mass privatization in Poland[13]

The Polish mass privatization included 512 companies and 15 National Investment Funds (NIF), which were set up by the Government. The management of these funds was initially entrusted to special consortia of western and Polish partners (commercial banks, investment banks, consulting firms) selected through an international tender offer. The implementation of the program was delayed by at least four years (1991-1995) due to the absence of a consensus in the government and the parliament about the final list of companies in the scheme, the precise share of different beneficiaries and the specific arrangements concerning corporate governance of the NIFs. The equity of the 512 companies was transferred from the state to new owners according to a common scheme: the majority of shares of each company (60%) were given to the 15 NIFs, with the remaining 40% going to employees (15%) and the Treasury (25%). For each company, one of the 15 NIFs received 33% of shares and thus became the "lead fund" for that company. The remaining 27% were divided between the other 14 funds (each holding just under 2% of shares). This uniform scheme sharply contrasted with the Czech program where the outcome of the biding process was completely unforeseeable and any number of funds, individuals and other beneficiaries could end up as new owners of the companies.

Foreign financial institutions were invited to participate in the program and bid for the management of NIFs. The foreign institutions were expected to follow the same practice as in their own countries, and not to engage in opportunistic behavior, insider dealing and shareholder expropriation which their inexperienced Polish counterparts may have been tempted to embark on. Many foreign institutions took part in the program and most NIFs started to be managed by consortia of foreign and Polish institutions.

The citizens did not become direct shareholders of companies in the scheme but received vouchers (or certificates) which entitled them to one share in each of the 15 Funds, thus becoming indirect shareholders of privatized companies. The stated aim of the program was for NIFs to restructure their portfolio companies, turn them into market oriented firms and sell them to either strategic owners or on the stock exchange. The Funds themselves were floated on the Warsaw Stock Exchange in June 1997 and the citizens' certificates had to be converted to Funds' shares by the end of 1998. Following a buoyant initial market, and the large-scale sale purchase of shares, the role of the government began to decline. Members of the supervisory boards initially appointed by the government were replaced by members elected by new private shareholders. The direct role of the state came to an end.

[13] Information based on Hashi (2000).