



# ECONOMIC DIRECTIONS

A Publication of Saint Vincent College's Alex G. McKenna Economic Education Series

Saint Vincent College, Latrobe, Pennsylvania

Volume 1 Number 1 November 1990

## Western Experiences with Privatization: Are There Lessons for Eastern Europe?

*(The following is a transcript of a lecture delivered by Dr. Ryan C. Amacher, professor of economics and dean of the College of Commerce and Industry at Clemson University, at Saint Vincent College, Latrobe, Pennsylvania, on October 17, 1990. The lecture was part of The Alex G. McKenna Economic Education Series of lectures on privatization and government deregulation.)*

© 1990

When Gary Quinlivan asked me to participate in the Alex G. McKenna Economic Education Series I eagerly accepted. He shortly thereafter asked me for a title. He wanted me to speak on privatization and I wanted to address the exciting developments in Eastern Europe and the Soviet Union. I was so proud of myself when I switched the topic to my ground by sending him the title, "Western Experiences with Privatization: Are There Lessons for Eastern Europe?" Months passed and the date of the lecture got closer. I collected material and last week I sat down to prepare my remarks. I quickly came to the conclusion that the best answer to my question is NO.

Seriously, I did come to the conclusion that there were very few lessons, but that is not the end of my story.

I would like to begin with a slave tale. It is based on Nozick's analogy of the slave state and the modern welfare state as adapted by Geoffrey Brennan and expanded a bit by me.<sup>1</sup>

Once upon a time, there was a very rich King -- a brutal slave owner. He cared only about his wealth. He did not care what his slaves thought about him. Indeed, it



Dr. Ryan C. Amacher

*The primary motivation for privatization is that it reduces governmental expenditures...*

never crossed his mind. He whipped his slaves and made them work very hard. It was even rumored that he killed some of them when he moved them to collective farms. He heard that in the distant provinces there was an old wise slave. He called for this old wise slave and asked how he could get still richer. The wise old slave said he feared the King, but he would make him rich for one cent of every dollar his advice created. The King didn't understand incentives, but was curious. The wise old slave told the King: "You must assign rights to all people for what they do. You must sell the factories, the farms, the forests, and the mines - even the national parks! - AND you must create a constitution that protects these rights EVEN AGAINST YOU." The King was puzzled, "But what about my wealth?" The slave

replied, "You can take one-half of the wages and one-half of the profits." The wise old slave was obviously a Kennedy Democrat and the King had not yet met Art Laffer. But, the King agreed to try the experiment.

The rest of the story is well known. The economy boomed and the King became the wealthiest King in all the known world. It is told that his people became rich. People in another land honored him with a Nobel Prize, but the King did not care for such honor; he was only concerned with his wealth!

### The U.S. Experience

But enough about tales of privatization; let's look at the U.S. experience. The primary motivation for privatization is that it reduces governmental expenditures, yet is politically feasible because it does not eliminate the service. The expenditure reductions come from several sources.

Privatization introduces competition and the efficiencies that follow competition. Privatization permits smaller localities to join together into more efficiently sized units for purchasing services. Privatization removes government from labor negotiations and governmental retirement commitments. Finally, privatization transfers revenue-consuming activities to private firms that pay taxes and produce revenues.

In the U.S., most success is at the local level. Privatization has occurred in maintenance, golf course management, building security, water provision, parking, removal of abandoned cars, fire protection, and waste removal. Seventy percent of the waste removal in the U.S. is now done by private firms. The most important lesson from the U.S. experience is that private bidding for the government contracts is necessary to insure competition.

At the federal level in the U.S. there has been very little privatization, except for Amtrak. Experiments with the privatization of social security have been proposed, but they have fallen on deaf Congressional ears.

The size of government (all levels) grew in the 1980's indicating that privatization did not work to reduce the share of GNP

going through the government's sector. Indeed, small business leaders have suggested that the number two problem facing small business is competition from governmental or not-for-profit private firms. Small business leaders argue that these governmental firms have unfair advantage in the marketplace because they don't pay taxes, and they have other advantages, such as reduced mail costs. As one small cookie store owner stated in her Congressional testimony, "I don't object if the Girl Scouts sell cookies, but if they open a cookie store next to mine, I cry foul."

## Thatcherism

The Thatcher government in England has made much more dramatic progress with privatization. Thatcher privatized large, poorly run state enterprises. Over a seven

*Privatization introduces competition and the efficiencies that follow competition.*

year period forty-three state-owned monopolies were sold. In order to overcome the public distrust of private enterprise which runs deep in England, the Thatcher government gave part ownership in the new ventures to workers by giving them transferable shares. The other shares



## ECONOMIC DIRECTIONS

A Publication of Saint Vincent College's  
Alex G. McKenna Economic Education Series.

### CO-EDITORS

Dr. Gary M. Quinlivan  
Associate Professor of Economics

Mr. Lee J. Weissert  
Instructor in Economics

### ASSISTANT TO THE EDITORS

Mr. David K. Roger, C '91

### STAFF

Mr. Frank A. Gamrat, C '91  
Ms. Wen-Tong (Wendy) Li, C '91  
Mr. Jay R. Jackson, C '91

### PRODUCTION COORDINATOR

Mr. Don Orlando  
Director of Public Relations



Dr. Amacher (center) is welcomed by Mr. C. Philip Weigel, (left), president of Latrobe Steel Company, who introduced the lecture, and Dr. Gary M. Quinlivan, Director of the Series.

were sold in small lots to broaden the ownership base. The prices were underpriced and the stock price rose shortly after transfer to private owners. Many of these initial offerings were quickly resold and the gain from going private was broadly distributed.<sup>2</sup>

Are there lessons to be learned that can be applied in Eastern Europe and the Soviet Union? Recently a member of the Leningrad Communist Party argued, "We must hurry away from Marxism-Leninism, through Socialism, to Reaganism." This isn't quite right. He should have said, "We must hurry away from Marxism-Leninism, through Socialism, to Thatcherism." And even here the lessons are not going to be easily applied.

## Privatization

It should be very apparent that privatization in Eastern Europe and the Soviet Union has to be much more difficult than privatization in the West. To begin, almost all the privatization in the West was privatization of well-funded programs or the turning of certain aspects of them over to the private sector and the sale of inefficient, but well capitalized government firms in England. Secondly, in the West there is a market and a legal system that easily absorbs the privatized agencies. In Eastern Europe and the Soviet Union, no market exists and the legal system has been antagonistic toward private property. Indeed, Party officials avoid even the use of the term, choosing instead, "social property." Finally, the countries of Eastern Europe and the Soviet Union are attempting to privatize virtually worthless factories, with a work force that is not well

trained or accustomed to working hard. It reminds one of the old Russian worker joke: "They make believe that they pay us and we make believe that we work."

In looking at privatization in the formerly communist countries, we should separate Eastern Europe from the Soviet Union. Once it became apparent to the countries of Eastern Europe that the Soviets would not (or perhaps could not) intervene militarily as they had in Hungary in 1956 and Czechoslovakia in 1968, reform movements accelerated with breathtaking speed. A joke circulating in Eastern Europe perhaps says best what the goals of the reforms are: "Socialism is the longest path from Capitalism to Capitalism."





Dr. Amacher (center) meets distinguished Saint Vincent College Alumni Charles J. Flavin, L.H.D., P '47, C '51, H '87 (left) and Martin E. May, C '85.

reform package, loosely based on a Thatcher-inspired gradual sell-off of governmental enterprises. The ability to attract foreign capital will determine Hungary's success.

The Czech reform is proceeding more slowly. Czech reformers do not want to sell government assets directly to foreigners or to Czech citizens. They favor a gradual approach where "vouchers" will be given to citizens and these vouchers would be used to buy equity in state-owned enterprises.

Finally, the Soviet Union faces the most staggering problems in its movement to privatize its economy. To begin, in the Soviet Union, the Party is not an alien imposition as it is in Eastern Europe. The Party is a national institution with deep roots in the success of WWII. In addition, the Party is not a political party in the sense we think of political parties. It is not a party for the contesting of elec-

*Experiments with the privatization of social security have been proposed, but they have fallen on deaf Congressional ears.*

Early success in Eastern Europe is based on many factors. To begin, most have escaped the ethnic unrest that has been so devastating in the Soviet Union. In addition, their economies were not in as bad shape as the Soviet economy when the reforms began.

East Germany was the most developed of the Soviet Bloc countries. Its reform movement will be greatly helped by its reunification with West Germany. The financial aid of the West German economy is so profound that East Germany is a special case by itself.

Poland, where the most recent reform movement began, moved toward Capitalism in a bold step. Poland's Finance Minister, Leszek Balcerowicz, is a former economics professor with an MBA degree from St. John's University in New York and is an admirer of Milton Friedman. With the help of Harvard University Professor Jeffrey Sachs, Balcerowicz drafted a plan for Poland's economic reform. In 1990, inflation dropped to an annual rate



Saint Vincent College Economics majors David K. Roger (left) and Jay R. Jackson (right) discuss privatization with Dr. Amacher.

of around 30%, compared to 3000% in 1989. The stores are well stocked with agricultural products from local farms and high tech consumer goods from West Germany and Hong Kong. All restrictions on new enterprises were lifted in the fall of 1989, and 80,000 new companies sprang up in the first year. Problems remain. Unemployment is high and consumers spend most of their income on food and shelter. The main obstacle to continued success in Poland is political. Lech Walesa and Prime Minister Tadeusz Mazowiecki are fighting for control of the ruling Solidarity movement. Walesa's critics fear he will try to curry political favor with labor and undermine the reforms.

Hungary is pursuing a very sophisticated

## About the Series

*The Alex G. McKenna Economic Education Series is presented by the Saint Vincent College Departments of Economics and Business Administration. These periodic lectures are open to the general public and their purpose is to explore free markets in solving many of the social problems confronting the United States and the world today. Dr. Gary M. Quinlivan, associate professor of economics at Saint Vincent, directs the series.*

*The Alex G. McKenna Economic Education Series is made possible by a grant from the Philip M. McKenna Foundation Inc. of Latrobe.*



Dr. Amacher addresses audience in the Saint Vincent College Science Center Amphitheatre.

tions, but rather a self-appointed society for the exercise of monopoly power. It is not clear if the Party apparatus can undermine the reform or if the Party has disintegrated. If there were political turmoil, Gorbachev would be hard to replace because his international status is about all on which they have to build.

The plan is to privatize the Soviet economy over a 500 day period. In the first 100 days the collective farms and state run farms are to be broken up and the sell-off of state companies is to begin. In days 150-200, privatization is to speed up. By June 1991, half of all shops and restaurants are to be in private hands and the privatization of big industry begins. In days 250-400, 40% of industry is to be in shareholder, worker, or private hands. In days 400-500, 70% of industry and 90% of retail trade and construction will be privatized.

The next few years will determine whether reforms succeed in the Soviet Union or if a conservative backlash ends the reforms. The twin forces of *Perestroika* and *Glasnost* can cause opposing forces. In China, the democracy movement created a setback for the reform movement. In the Soviet Union, the same result could occur. The Russians have long been fond of ironic

jokes to relieve their political anxiety. In 1990, a chilling joke that the Russians found funny was being told in Moscow. "A Russian is asked by a visitor - and how are things in Russia these days? The Russian replies, Well there is *Perestroika*. It means higher prices and no job security. We are told things will get better - but we've been told that for seventy years. Then there is *Glasnost*. Its job is to wreck *Perestroika*."<sup>3</sup>

A major problem that market reform faces is the attitude of consumers. Consumers want the standard of living that capitalism produces, but they like the safety of governmental regulation. A study by Professor Robert Shiller of Yale University and two Soviet economists, Maxim Boycko and Vladimir Korobov, dramatically highlights the political difficulty. The economists asked a series of questions to randomly selected consumers in Moscow and New York. One question asked if it was fair that the price of flowers rose on holidays when demand increased. Sixty-six percent of the Russians said it was unfair and 68% of the New Yorkers thought it was unfair! Twenty-five percent of the Americans and 54% of the Russians thought the government should intervene to hold the flower prices down.<sup>4</sup> If those attitudes prevail it

will be very difficult to institute market reforms in a democratic setting. The joke is indeed chilling! *Glasnost* could wreck *Perestroika*.

<sup>1</sup> Robert Nozick, *Anarchy, State, and Utopia*. New York: Basic Books, 1974. Geoffrey Brennan, *The Tale of the Slave owner: Reflections on the Political Economy of Communist Reform*, Virginia Political Economy Lecture Series, George Mason University, March 14, 1990.

<sup>2</sup> John Vickers and George Yarrow, *Privatization: An Economic Analysis*, Cambridge, Mass, MIT Press, 1988.

<sup>3</sup> Brennan, p.14.

<sup>4</sup> Alan S. Blinder, "Land of the Free, But Not of the Free Market," *Business Week*, September 10, 1990, p.22.

## On Our Mailing List?

If you would like your name to be added to the mailing list for either the Alex G. McKenna Economic Education Series Lecture or the Economic Directions newsletter, please indicate your preference and send your name and address to:  
**Dr. Gary M. Quinlivan, Economics Department, Saint Vincent College, Latrobe, Pennsylvania 15650-2690.**



**ECONOMIC  
DIRECTIONS**

Saint Vincent College  
 Latrobe, Pennsylvania 15650-2690

Non Profit Organization  
 U.S. POSTAGE PAID  
 Latrobe, PA 15650-2690  
 Permit No. 110