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A DECADE OF PRIVATIZATION IN ROMANIA

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I. SCALE AND SCOPE OF PRIVATIZATION IN ROMANIA

I.1. Respective sizes of the state and private sectors

The scale of privatization in Romania can be gauged on the basis of two sets of data referring to: the contribution of the private sector to GDP formation and the percentage of original state property which has been transferred into private hands, respectively.

I.1.1. Contribution of the private sector in the Romanian economy

At the end of 1998, the contribution of the private sector to GDP formation had come to amount to 58.4 percent. This is a disappointing figure, which compares unfavorably with those of all other transition economies in Europe. [1]

Granted, Romania began its economic transition with a quasi-ubiquitous state sector: privately-produced GDP in 1989 accounted for a mere 12.8 percent (as opposed to “respectable” figures of around 30 percent in both Poland and Hungary). However, this low starting point was fully comparable to that of countries which managed to rapidly shrink the state-owned sector of their economies (such as, in particular, the Czech Republic).

The contribution of the private sector to GDP formation gives useful, but incomplete indications as to the actual scope of the privatization process. There are reasons to believe that this indicator overstates the success of privatization in the narrow sense of the term, i.e., understood as transfer under private ownership of assets formerly owned by the state. Three such reasons, in particular, appear compelling:

- the indicator also captures the contribution of “new-born” private enterprises, resulting largely from greenfield investments (although, in some cases, these have made use of formerly state-owned assets, the transfer of which into private hands was not recorded as “privatization”);
- the shift towards a higher contribution to GDP of sectors which are less capital-intensive (e.g., services), and where the presence of newly-created enterprises is larger than average, unmistakably leads to the conclusion that state-owned assets account for a higher proportion in the total of fixed assets used than in the share of GDP produced;
- because private companies typically face tighter budget constraints than state enterprises do, the latter are in a position to use fixed assets much less intensively than the former. Therefore, one could safely infer that, for an equal amount of fixed assets used, the money value of goods and services produced in the private sector is larger than that produced in the state sector. Moreover, many state-owned assets are leased out to private companies or represent in-kind contributions to the equity capital of joint ventures majority-owned by private operators, the production of which is recorded as fully private contribution to GDP formation.

On the other hand, one should note the results of the “land reform” undertaken on the basis of Law no.18/1991. Its implementation has rapidly increased the proportion of agricultural land privately possessed: from 25 percent in 1989 to 70 percent in 1993.

However, the issuance of valid land titles took much longer and has still not been completed. As of end-July 1999, only slightly more than 84 percent of the surface concerned had been properly accounted for by land deeds, and the pace of the process continues to be tantalizingly slow, as shown by the figures below. This is probably the only case where the contribution of the private sector to GDP formation understates the amount of “privatization” carried out. [3]

**Proportion of land restitution mandated by Law no.18/1991
properly accounted for by property titles issued**

<i>end- 1993</i>	<i>end- 1994</i>	<i>end- 1995</i>	<i>end- 1996</i>	<i>end- 1998</i>	<i>July 1999</i>
17.3%	37.1%	56.8%	67.0%	74.9%	84.3%

The above considerations point to many measurement problems inherent in assessing the aggregate relative size of privatized assets based solely on official GDP figures broken down as per forms of ownership. At the limit, one could even reach the conclusion that there is no obvious link between privatization of state-owned assets and the contribution of the private sector to GDP formation. Such a conclusion would be misleading, however. The existence of such a link is, at least empirically, proven by the evolution of official figures concerning the contribution of the private sector to GDP formation.

Contribution of private sector to GDP formation

<i>1989</i>	<i>1993</i>	<i>1994</i>	<i>1995</i>	<i>1996</i>	<i>1997</i>	<i>1998</i>
12.8%	34.8%	38.9%	42.6%	54.1%	58.1%	58.6%

Since the beginning of the reform process, these figures have consistently tended to show small increments of the private sector’s contribution to GDP (and, as such, were supported by anecdotal evidence concerning the evolution of the privatization process), except for two periods, namely:

- 1993 vs.1989, when an increase of 22 percentage points was recorded, which can only be accounted for by the land ownership transfer mandated by Law.18/1991;
- 1996 vs. 1995, when the 11.5 percentage points increase can only be reasonably attributed to the implementation of the so-called “Mass Privatization Program”.

At the very least, this shows there is not a total divorce between the pace at which the private sector increases its contribution to GDP formation, and the progress of the privatization process.

I.1.2. Original state property transferred into private hands

Such estimates have not been systematically carried out. Therefore, in order to arrive at a tentative figure for the percentage of state property which has reverted into private hands since 1990, some broad assumptions have to be made:

- The breakdown of state-owned assets between “commercial companies” (subject to privatization), on one hand, and “*regies autonomes*” (non-privatizable

entities), on the other hand, is deemed to have remained constant since the first (and, so far, the only) official estimate has been made, back in 1992: 53 percent versus 47 percent. It was assumed, for convenience purposes, that the “corporatizations” made until 1997 have been compensated by the inclusion of former commercial companies into “regies” (the most notable example being that of land reclamation companies);

- All the equity capital of state-owned companies which is held by the Private Ownership Funds (POFs) - and, subsequently, by their successors (the SIFs) - is deemed to represent privatized state property. Also, it is assumed that this makes up fully 30 percent of the share capital of commercial companies subject to privatization, thus disregarding the piecemeal adjustments on account of land introduced later on in the share capital, the equity product of which reverted solely to the SOF.

These two assumptions shift the burden of the computation onto the scope of privatizations carried out by the State Ownership Fund (SOF). This is not an easy task. First, because the companies featured in SOF’s portfolio have been mandated in several instances to “re-value” their assets, thus leading to an overstatement of the scope of privatizations carried out in the early stage of the process. Also, since SOF’s portfolio is in a state of flux, fool-proof provisions cannot be made in order to capture the dimensions of state property which has already been transferred and, on this basis, to gauge the property privatized later on as a percentage of property remaining in SOF’s hands.

Based on information given as part of successive annual reports of the SOF and on computations meant to bring these figures as close as possible to full comparability, we ended up with the following estimates of property privatized by SOF as a percentage of the original portfolio.

1993	1994	1995	1996	1997	1998	sem.I 1999
0.3%	2.8%	3.9%	3.0%	4.6%	8.8%	8.6%

It appears that since the beginning of its activity and until the end of June 1999, SOF has privatized 32 percent of its initial portfolio – that is, by applying the 70 percent share, 22.4 percent of the state assets included into commercial companies. Adding to this the 30 percent held by the SIFs, we end up with 52.4 percent of the state assets included into commercial companies; that is, around 27.8 percent of the total of assets originally held by the state. To this figure, we can add the percentage of ROMTELECOM’s share capital (35 percent of the total) already transferred into private hands, which roughly accounts for, at most, one percentage point of the total patrimony of the “regies,” i.e., 0.5 percent of the assets originally held by the state.

All in all, we end up with an estimate of 28.3 percent of the total assets initially owned by the state which have been privatized as of mid-1999. Even if we make allowance for the fact that close to nothing was privatized in the first three years of transition (1990-92), by extrapolating the performance recorded so far we could infer that another 15-16 years would be needed to conclude the whole process. This does not need to be the case, however. At least one important achievement has been obtained so far, by the considerable reduction of the number of privatizable entities. This means that

subsequent individual privatizations are bound to concern far higher amounts of assets, thus leading faster to important percentages of assets that the state will divest itself of.

Evolution of SOF's portfolio							
	1993	1994	1995	1996	- number of companies -		
	1997	1998	1999				
No. of companies at the beginning of the year	5937	6291	7602	9010	...	5554	4330
No. of companies privatized during the year	265	604	648	1388	1304	1267	1255 (end-Aug.)

The large variations recorded in SOF's portfolio, especially until 1996, are a reflection of very frequent break-ups of companies into smaller units. The most widely-encompassing of such exercises was carried out in 1995-96 with respect to agricultural service companies, which the "MPP Law" required to be divided into smaller companies, the shares of which were to be offered under preferential terms to the agricultural producers benefiting from those services. Since 1997, this "Danaides bucket" syndrome - consisting of a continuous increase of SOF's portfolio despite large numbers of companies being privatized - has, by and large, been arrested.

I.2. Shifting policies concerning the "non-privatizable sector"

At this still early point in the attempt to picture the status of one decade of privatization efforts in Romania, the need arises for following a three-pronged venue, which had been generated - maybe inadvertently, but which remain no less legally binding - by the first fundamental laws dealing with the issue of ownership in the economy, that is:

- Law no.15/1990 concerning the conversion of former "socialist enterprises", which enshrined the notion of non-privatizable entities, the so-called "*regies autonome*;"
- Law no.18/1991, subsequently dubbed the "Land Law";
- Law no.58/1991, the so-called "Privatization Law".

The coverage of the latter law had already been shrunk by the two laws mentioned above. It is only in 1997 that borderlines of the said three laws have been dented, and their provisions started to spill over from one to another. Thus, **for fully five years (1992-1996), the term "privatization" in Romania only meant whatever Law no.58/1991 had been allowed, almost by default, to cover.**

Crucial issues such as **land ownership** and **perpetual state ownership** managed to get practically obliterated from the public debate which, instead, came to be strongly concentrated on just a relatively small (and definitely a minority) "chunk" of public ownership, to the exclusion of all others. Since it is only in 1997 that the two above-mentioned "critical issues" were allowed to rejoin the mainstream of the privatization process in Romania (while in the meantime other topics - such as "MEBOs" and the

“Mass Privatization Program” - captured the headlines), they deserve a longer description.

I.2.1. The “*regies autonomes*” - non-privatizable form of state ownership

The term “*regie autonome*” originates in the first law going to the very heart of the economic reform process, which was issued in June 1990: Law no.15/1990. According to Art. 2 of the said law, such entities were to be set up in “strategic branches of the national economy - armament, energy, mining and natural gas, posts and railway transportation - as well as *in some areas belonging to other branches, as decided by the government*”. On this basis, until end-1992 around 950 “*regies autonomes*” have been set up by an impressive number of dedicated Government Decrees, as well as by decisions of the local authorities. Of these, around 80 were “*regies*” established at national level.

Such entities have been established in a very incoherent manner, in areas which were extremely different from the point of view of their characteristics, and without the use of a consistent set of criteria presiding over the option to have a particular activity carried out by a “*regie*,” rather than by a regular “commercial company”. Generally speaking, the reasons why “*regies*” had been set up in various fields were very different, encompassing the following:

- exploitation of goods constitutionally-designated as belonging to the public domain of the state, and, as such, non-privatizable (whereas a legal framework for concessions was very slow to emerge);
- public utilities, where - apart from the above-mentioned reason - the character of “natural monopoly” also played a role;
- performance of regulatory functions, sometimes in conjunction with acting directly as an economic operator in that same field;
- considerations pertaining to national security, public health, public order, etc (arms and ammunitions, medicinal vaccines and serums, enterprises operated by the Ministry of the Interior or the Intelligence Service, etc).

There were yet other cases, where none of the above considerations can reasonably have played a role, thus leaving as only possible explanation the prevalence of vested interests (e.g., tobacco, publishing, horse breeding, and the collection and processing of medicinal plants).

In formal terms, the main differences between a “*regie*” and a regular “commercial company” stem from the fact that the former does not have equity capital (but, simply, a “patrimony”) and has some sort of an entitlement to budget subsidies. The peculiar form of state enterprise represented by the “*regie*” also meant that it was non-privatizable for at least two reasons: it was not incorporated/corporatized (i.e., it did not issue shares) and, in some cases, it was “administering” goods constitutionally-designated as “inalienable”.

An additional difference emerged once a legal framework for bankruptcy had been belatedly enacted in June 1995 (Law no.64/1995). Art.129 of the said law specifically exempted the “*regies*” from the constraints of bankruptcy, pending the enactment of a dedicated law which subsequently was not even drafted, let alone approved. Interesting to note, none of the substantial subsequent amendments made to the Bankruptcy Law (by way of Emergency Government Ordinance no.58/3 October 1997 and Law no.99/27 May 1999, respectively) even attempted to clarify the colossal ambiguity stemming from the simultaneous presence on the market of the “*regies*” as full-fledged commercial operators and absolute, legally-enshrined, barriers to the exit from the market of such operators.

In short, for a very significant share of state ownership in the economy, its functioning according to market principles was denied absolutely, by ruling out not only the “first-best” option embodied by privatization, but also the “second-best” option entailed by the existence of at least the possibility to enforce hard budget constraints, since “normal” creditors (i.e., creditors other than the various public budgets) were deprived from any legal possibility to enforce any claims they may have on the “regies”.

In retrospect, this highly privileged status awarded to the “*regies autonomes*” helps explain the intense lobbying, and its relatively high success rate, as a result of which state entities were reorganized as “*regies*” rather than, as it would have made much more sense, as commercial companies or, indeed, public institutions. This form of organization entailed a double appeal:

- for commercial activities: no risk of bankruptcy, and an open-ended guarantee for insiders against tough measures eventually decided by profit-maximizing private owners;
- for regulatory activities: open-ended entitlement to budget resources, without the undesired counterpart of aligning the wages to the rigid and less generous grid applicable for public servants.

By and large, this state of play amounted to the conscious preservation of a fundamental ambiguity (being, *mutatis mutandis*, reminiscent of the “ni-ni” policy pursued by the Socialist Governments in France between 1988-1993). It prevailed until after the 1996 elections, when a Government reflecting the shift of parliamentary majority took over. [5] As mentioned above, starting with 1997, the issues pertaining to “*regies autonomes*” - which had previously been practically insulated from the privatization process - have been allowed to re-integrate the “mainstream” privatization. This was the result of different sets of legislation, first enacted in 1997, but copiously amended subsequently.

On one hand, one should note the undeniable progress made in the vein of **doing away with the hybrid construction embodied by the “*regies autonomes*”**. This occurred along the following lines:

(i) “*corporatization*” of the “*regies*,” that is, converting them into joint-stock companies having the state as sole shareholder, and which - unlike the “*regies*” - can be privatized. The actual exercise also entailed the conversion of some previous “*regies*” into public institutions, in cases where those “*regies*” exercised only regulatory functions.

(ii) *building up a horizontal legal framework for concession contracts*, allowing for the exploitation of goods designated by the Constitution as non-privatizable; [6]

(iii) *enactment of dedicated laws in the field of public utilities*, allowing for the “demonopolization” of these sectors, and for the separation of regulatory functions from the exercise of commercial activities (telecoms, railway transportation, electrical energy).

The above-mentioned measures have the undeniable merit of, at the very least, minimizing the *legal* (as opposed to any other) impediments to including a significant part of activities formerly exercised by “*regies autonomes*” under the realm of the privatization process. Problems, however, were not entirely eliminated.

The most directly relevant progress (i.e., the corporatization of “*regies*”) is proceeding slowly, in spite of the existence of legal acts that mandated its completion before the end of 1997. The pace of the process is also very uneven: proportionally, far more “*regies*” placed under the authority of the central administration were corporatized, than “*regies*” subject to the authority of local authorities.

On the other hand, since December 1997, the **legal framework dedicated to privatization started to make specific references to the issue of “*regies autonomes*.”** For the sake of simplifying the presentation, these references can be reduced to only two categories of issues:

- *The legal status of the successor entities to the “central regies.”*

The relevant legal act (Government Emergency Ordinance no.30/1997, as subsequently amended) distinguishes between “regular” commercial companies and “national companies”. Until the May 1999 amendments to the Privatization Law, the distinction had a practical importance, because special (and more constraining) rules used to be attached to the privatization of “national companies:” either a “golden share” reserved for the state, or privatization via sale of the majority share package to “portfolio investors” alone. In other words, *tertium non datur*. In far too many instances, the option was made in favor of the conversion of the previous “*central regie*” into a “national company”. No former “*central regie*” was wholly converted into “regular” commercial company(s). The most liberal stance, so far, consisted of breaking up the former “*regie*” into a “national company” and one or more “regular” companies.

The special privatization rules applicable to “national companies” appear to have been triggered by a blanket assumption that companies controlled by portfolio investors would have fewer incentives to engage in anti-competitive practices than companies controlled by a “strategic investor.” Implicitly, no regard was given to other qualifications, such as whether the portfolio investors have voting rights or not, how they can exercise them, and how long they keep their shareholdings before disposing of them.

Unwarranted (and, potentially, counterproductive) limitations to the privatization of “national companies” were thus instituted by law, out of the otherwise respectable desire to preserve a competitive environment. Yet, all other things being equal, there are strong reasons to believe that precisely a company controlled by portfolio investors (oriented, by definition, towards short-term gains) is more likely to abuse a dominant position it might enjoy than a company where a strategic investor is in control.

- *Legal provisions excluding specifically designated “central regies” from the blanket obligation of corporatization.*

Ever since mid-1997, the list of these “*perpetual regies*” has been in a continuous state of flux, as a result of the combination between successive dedicated Government Ordinances followed by amendments or outright rejections by Parliament, and provisions concerning the reorganization of “*regies*” contained in laws dedicated to privatization. The current legal regime, as a result of the recent (May 1999) modification of the Privatization Law, still provides for an impressive list of “*regies*” exempted from “corporatization”. [7]

The extreme diversity of “*regies*” deemed unfit for corporatization is a reflection of the fact that **still no coherent criterion is presiding over the decisions to keep certain activities under the realm of “*regies*.”** The appended list shows an even higher degree of inconsistency than before since, without obvious reasons *apart from lobbying by individual ministries*, activities of substantially the same nature are organized differently. For instance, under the Ministry of Defense are now placed both a “national company,” as well as two “*regies*” whose corporatization is legally prohibited. Similarly, the exploitation of goods constitutionally-designated as non-privatizable is entrusted both to “national companies” (in the mining area), as well as to entities which cannot be corporatized (e.g., the National *Regie* for Forests, in charge of managing the forests belonging to the public domain of the state).

The same lack of uniformity is apparent also with respect to the conversion of “*regies*” *exercising regulatory functions*. Very few of them were actually converted into public institutions, few others were transformed into “national companies” (e.g., the former “General Inspectorate for Radiocommunications”), but most were kept unchanged, as “*regies*” (e.g., the Romanian Naval Registry, the Romanian Auto Registry, the Romanian Civil Aeronautic Authority etc).

I.2.2. Land ownership - perennial source of blockage for the privatization process

What distinguishes the land ownership issue from other ownership issues directly impacting on the privatization process is the fact that this is, so far, the only case where the principle of restitution of formerly expropriated properties was not only accepted, but also applied. Moreover, this has occurred in a very early stage of transition. In retrospect, the merit of this early attempt at solving a particularly delicate problem must be relativized in view of the very dubious solutions devised. Briefly sketched, the relevant Law (no.18/1991) provided for:

(a) placing a cap on the maximum surface of land which can be returned to its former owners (10 hectares);

(b) not allowing the in-kind restitution of land expropriated by the communist regime whenever it happened to be placed under the administration of agricultural state enterprises (IAS), as opposed to agricultural co-operatives;

(c) free granting of land to rural inhabitants who never owned land (up to 1 ha per family);

(d) prohibition on selling the land received for 3 or 10 years, depending on whether ownership rights had been reconstituted or created *ex novo*.

At the time of its legal enshrinement, this approach to the land ownership issue received an extremely wide backing in Parliament, despite the considerable range of extremely questionable features it entailed. Precisely because of these features, the issue of land ownership was doomed to haunt the privatization process for years to come: even as recently as end-September 1999, it was still fraught with considerable controversies. It should be noted, however, that **most of the subsequent problems would have been avoided, had an approach respectful of ownership rights and of market mechanisms prevailed from the very beginning.**

The provisions of the 1991 Law were far from satisfying these requirements. In the first place, they enshrined the principle that land placed under the management of state farms (as opposed to that of co-operatives) cannot be returned in kind to its former owners. Instead, the latter were given shares into artificially constructed agricultural “commercial companies.” This deliberate limitation of the right to restitution, and the discrimination it entailed (former owners of land used by co-operatives being entitled to in-kind restitution) has been justified on grounds of economic rationality: i.e., dismantling large state farms would negatively affect agricultural productivity. *This reasoning shows that, at least in what concerns agriculture, state ownership used to be deemed preferable to private ownership. It should not come as a surprise, then, that privatization made so limited progress in this area.*

Secondly, the 1991 legislators have attempted to “play God:” they set a low cap on the maximum surface of land which can be returned to former owners, and they instituted new ownership rights. Granted, the maximum amount of restitution allowable is a political option, and the proponents of the solution devised in 1991 enjoyed a very wide support in Parliament. *Yet, an “original sin,” transcending temporary political majorities, was built into the solution chosen: granting land to persons who never enjoyed a legal entitlement to it, without first addressing the rights of former owners. The land previously used by agricultural co-operatives has been treated as a disposable asset, while that used by state farms was rendered intangible. A moral aberration was thus allowed to emerge: former owners whose land happened to be used by state farms did not get it back (even within the restrictive limits for restitution established by Law no.18/1991), while people without any previous entitlement could receive land, insofar as this used to be held by co-operatives.*

Thirdly, the prohibition on the free disposal of land received on the basis of Law

no.18/1991 was another deliberately-built stumbling block to privatization. From an economic standpoint, it should have been anathema. From a political perspective, it (barely) might have been defended, but only relative to property created *ex novo*. Submitting former owners to constraints on the disposal of restituted property, after having discretionarily limited the size of this restitution, is proof of a paternalistic attitude pushed to extremes that is not widely experienced outside the former communist bloc. As if these impediments to the emergence of a land market were not enough, a “Land Lease” law was passed in 1994, which instituted wide rights of first refusal in connection with land transactioning in favor of a “Rural Development Agency,” which, subsequently, never came to exist. *Yet, its sheer spectre has haunted the land market, effectively preventing or rendering illegal many transactions. In the process, the limit of 3 years arbitrarily imposed on the transactioning of restituted land has de facto been extended sine die.*

The above considerations offer abundant arguments in support of the hypothesis that **land privatization has been** - for a long period (1991-1996) - **deliberately shunned, at both Parliament and Government levels.** [8]

The approach to the issue of land ownership has recorded dramatic changes following the new configuration of the parliamentary majority elicited by the 1996 elections. Yet, the extreme sensitivity of the issue is still preventing the emergence of sufficiently wide-shared solutions.

From the standpoint of privatization considerations, the ideal option would have consisted of devising solutions which, while correcting abuses of the recent past, would not induce undue delays in the implementation of privatization, nor would result in outcomes so politically controversial as to make them primary targets for modification by another parliamentary majority. This test - admittedly, very demanding - has not been passed by the current parliamentary majority. Correcting past abuses could have been simply confined to the in-kind restitution to former owners of land used by state farms. Apart from converting shady rights (shareholders of endemic loss-making companies) into real ones, such an approach would have had the merit of allowing the beginning of the privatization of these companies in earnest, since it would have clarified the legal status of the land used by them.

The goal of fast privatization has definitely not been served by the emergence - as early as the beginning of 1997 - of legal initiatives aiming at enlarging (from 10 hectares, to 50 hectares) the maximum size of land properties which should be returned to their former owners. This is a factual statement, which does not attempt to challenge the moral justification of this initiative. Nevertheless, one should recognize that, given the historical record of land ownership in Romania, there cannot be any such thing as an absolute entitlement to a given amount of land ownership. *Mutatis mutandis*, the 10 hectares limit imposed - for restitution - by the Land Law of 1991 is not less arbitrary than the maximum limits of surfaces left to expropriated owners by previous landmark agricultural reform laws: 100-250 hectares in 1921, and 50 hectares in 1945.

Ensuing from these initiatives was a long “saga” of political controversies, going into the very core of the ruling coalition, the outcome of which remains uncertain as of end-September 1999. Sadly, in view of the radical progress promised, the only tangible result derived from the change of approach towards the land ownership issue so far pertains to the elimination of previous legally-mandated limitations of the capacity to transact land (Law no.54/4 March 1998).

Having already designated the issues pertaining, respectively, to **land ownership** and “*regies autonomes*” as sources of important limitations to the scope of the privatization process in Romania, one can identify a basic contradiction even in the way these two different issues are approached by the authorities.

On one hand, the corporatization of the *regies* and the circumscription of the so-called “public domain of the State” are measures meant to pave the way for the privatization of these entities: whatever does not belong to the “public domain” is clearly targeted for privatization.

On the other hand, the draft laws - currently in the legal pipe-line - which are dedicated to the privatization and restructuring of the agricultural sector, share a common sensitive feature: the non-tangibility, for privatization purposes, of even the “private domain” of the State. Instead, this is destined - once it will be properly delineated, i.e., after former owners will receive back their properties within the limits which the chosen version of the law will allow - to be the object of concession contracts only.

II. INSTITUTIONAL FRAMEWORK

II.1. The “original sin”

The first comprehensive regulation of the privatization process, embodied in Law no.58/1991, has devised an institutional framework resting on three pillars:

- a Government body, the National Agency for Privatization (hereafter, NAP), entrusted with a supervisory and regulatory role, which included, *inter alia*, methodological guidance and drafting of implementing norms;
- the State Ownership Fund (hereafter, SOF), defined as a “public institution with an economic and financial character”, which - in fact - was a trustee in charge of managing the 70 percent stake of the state in the privatizable commercial companies; and
- five Private Ownership Funds (hereafter, POFs), having the status of joint-stock companies, which were meant to be a *sui generis* kind of mutual fund, to which was attributed 30 percent of the equity of all commercial companies subject to the privatization process, the counterpart of which were “certificates of ownership” (COs) distributed freely to the population. The COs were supposed to have a double nature: “special money” usable for buying 30 percent of the originally state-owned equity, and shares into the POFs.

This summary description of the main elements of the institutional framework for privatization shows, at the very least, a very significant originality. This is apparent from the mandated establishment of two “brand-new” categories of institutions, the SOF and the POFs, respectively. However tempting it may be to criticize the institutional setting of the Privatization Law with the benefit of a long (eight year) observation of the performance of these institutions, it would be unfair to put too hard a blame on the architecture of the law. Granted, with the benefit of hindsight, one can now identify much too strong illusions about the pace and, indeed, the feasibility of ample and complicated institutional constructions, but this was far from being the prevalent perception in 1991, when the law had been enacted. Besides, since the whole concept of “privatization” was an absolute novelty, it did not appear excessive to entrust its operationalization to institutions similarly untested before, the more so since the “track record” of existing institutions was far from conferring on them even a shred of credibility relative to the tasks that needed to be performed in the privatization area. Finally, the institutional design of the initial draft bill has suffered alterations, some of them absolutely crucial, in the process of parliamentary approval, as a result of political determinants.

Thus, the Privatization Law came to be debated at a time when the first signs of the future “schism” within the then ruling party (FSN, which enjoyed a two-thirds majority in Parliament) had appeared, along pretty well-defined lines: the pro-reform wing strongly in control of the Government and the free market allergics in charge of the Parliament’s main levers. The latter were strongly objecting to the SOF being answerable to the Government, and favored its control by Parliament instead. This option came to be supported by the main opposition parties as well, which were guided by a surprisingly

rudimentary reasoning: while the opposition had no influence on Government, it could have some sort of say in Parliament. This is how the seeds were sown for some of the most serious stumbling blocks of the privatization process for years to come: a “mega-institution” with sweeping powers (at least on paper), but no proper accountability or guidance; and the implicit consecration, from the very outset, of the prevalence of politics in matters pertaining to the “tactics” of privatization (over and above the “strategy” of the process, which only elected politicians are entitled to determine).

Summing up, the shortcomings of the initial institutional framework (which soon came to be exposed abundantly) stemmed from:

- *Its early “pollution” by politicianist power games.*
- *A much too complicated setting, relying on entities to be created from “scratch”.* This was in itself a delaying factor, as a result of which it was only in the second half of 1993 that the new institutions could start operating according to the mandate entrusted to them.
- *Loose wording regarding the distribution of responsibilities,* especially between NAP and SOF. In retrospect, this seems to reflect a naive belief that inter-institutional co-operation can be generated endogenously. Ensuing were countless disputes between SOF and NAP, but also between SOF and various economic ministries, where emotional reactions played a large part, and where each party came to palliate to its inability to impose its own point of view by actively (or passively) blocking the initiatives of the others.

Finally, and very importantly, **the executive branch of government had been deprived from the outset of any decisive tool enabling it to steer and control a crucial component of the economic reform process - privatization.** Some observers may find a merit in this “de-coupling”, either because it rimes particularly well with the fashionable philosophy of “grass-roots” and “decentralization”, or simply out of lack of trust in the reality of the reform commitment of the Executive. Apart from the subjectivity inherent in assessing the degree of commitment to reform at the level of the executive branch as opposed to other bodies, the fact remains that **it is the Government which is vested with the ultimate responsibility for the conduct of economic policy and, as such, should not be deprived of one of the most important tools needed in this respect.** Otherwise, an extraordinary opportunity for “shifting the blame” is generated. [10]

One should also bear in mind that the “original” institutions created by Law no.58/1991 have sparked sentiments of frustration and envy within the public administration in the narrow sense of the word (ministries and other Government agencies).

Initially, these sentiments were fueled by the well-documented instincts of bureaucrats to preserve (and even increase) their own “turf” (and, obviously, the influence that goes with it). Subsequently, especially since 1997, this jealousy was strengthened by the abundance of anecdotal evidence (extensively relayed by the mass-

media) showing that wages and fringe benefits available to SOF staff significantly outweigh those accessible to civil servants.

Although more research is needed, which goes beyond the scope of this paper, this author feels confident enough to formulate the hypothesis that **a non-trivial proportion of unnecessary regulatory measures devised in the last 6-7 years by various economic ministries has originated in the desire of the bureaucrats to substitute their formerly direct influence over state-owned companies (devolved to SOF) with other instruments.** [11]

In a way, the capacity (surrendered to SOF) to bear an influence on the activity of individual state enterprises by “command” tools was partly replaced by “bribery” tools. Of course, the whole picture is more complicated than that. On one hand, because the “commanding role” of the SOF was neither very strong (particularly in the case of very significant state enterprises, such as state-owned banks or industrial mammoths like SIDEX, where groups with political connections have actually “run the show”), nor direct (a high proportion of SOF-appointed representatives in the general meetings of shareholders or in the boards of administration have been selected either from the pool of civil servants within line ministries, or thanks to political “clientelism”). On the other hand, before 1997, SOF itself had recourse to “bribery,” via discretionary direct financing of some of the enterprises from its own portfolio.

II.2. *Ad hoc* attempts at “re-balancing” the institutional framework

The history of institutional developments pertaining to privatization cannot be better explained by any consistent set of motivations other than the **desire of the Executive to re-assert full control over the privatization process.** A retrospective assessment of the successive legal acts issued in the privatization area allows the identification of three stages conducive to the progressive “reclaiming” by the Government of the meaningful levers of the privatization process.

- *Law no.55/1995, by which the “Mass Privatization Program” was set in motion.*

In this case, the “*reconquista*” attempted by the Government was implicit in the “tactical setting” of the law. While the “strategic elements” of the MPP Law have, as will be shown below, reflected broader political considerations, the implementation mechanisms unveiled a strong propensity to put Government bodies in control. NAP has thus been given sweeping responsibilities, the fulfillment of which was critical for the effectiveness of the ample transfer of ownership envisioned by the MPP Law. Conversely, their non-fulfillment would have created serious difficulties for the continuation of the privatization process, past the MPP stage (which, sadly, is what actually happened). [12]

- *Government Emergency Ordinance no.88/29 December 1997, as approved by Law no. 44/25 February 1998*

The law entailed the complete reshuffle of earlier laws related to privatization and had the merit of consolidating within a single act all legal provisions pertaining to privatization, which had been previously been scattered among several bills. One of the legal acts so melted into a single law had been Government Emergency Ordinance no.15/5 May 1997, by which piecemeal adjustments were made to the 1991 Privatization Law. One of these amendments concerned the status of SOF, which had explicitly been “subordinated to the Government.” [13] In a way, GOE 88/1997 has cut this “Gordian knot” by explicitly placing the SOF under the authority of a newly-created Ministry of Privatization, successor of the “lame-duck” NAP. At the same time, the new legal provisions have implicitly upheld the function of the SOF as “sole privatizer” of all the state ownership in the economy.

This was probably the worst combination of institutional changes that a law could have brought. And there are strong reasons to believe that personal motivations have prevailed over general and pragmatic considerations. Upholding the subordination of SOF to the Government and clarifying the co-ordinates of this subordination were, undoubtedly, useful initiatives. Having the SOF explicitly subordinated to the Government has, indeed, been a must. Also crucially needed was the endowment of the institution entrusted with carrying out the privatization process with a hierarchical status corresponding to the importance of this task. In other words, it was desirable both to have a Government body formally in charge of privatization, as well as to give a Cabinet-rank to this body.

The need for a Cabinet-level representation of the institution in charge of privatization did not derive solely from considerations of political “clout.” By end-1997, enough “trial and error” episodes had occurred, allowing for the identification of unwarranted legal impediments to the smooth implementation of privatization. Many such impediments originated in the “secondary legislation,” that is, in unduly rigid stipulations of implementing norms. Because the right to initiate legal norms (including, simply, Government Decrees) is reserved, in the overall Romanian institutional framework, to “ministries” (i.e., public institutions headed by Cabinet-rank officials), it would have been useful for the specialized Government agency in charge of privatization to enjoy this right of legislative initiative. In other words, there was a clearly felt need for the “champion” of privatization to be represented at Cabinet level. Unfortunately, these institutional improvements were rendered operational in a very clumsy manner.

Thus, instead of the Ministry of Privatization being a “light” structure, consisting of the Cabinet-rank minister and a limited number of personal advisers, while the operational apparatus would have been the SOF itself, the option was made for duplicating the SOF with a heavy institutional structure (a full-fledged Ministry) whose responsibilities, at the end of the day, simply overlapped those of the SOF, while also creating disputes in the process. Due to far superior wage incentives, SOF’s staff in 1997 was far better qualified for the privatization job than NAP’s, which formed the backbone of the personnel of the Ministry of Privatization. Moreover, the latter had practically no clearly-defined tasks to fulfill apart from second-guessing and censoring the decisions and initiatives of their (better-paid) counterparts in the SOF.

Finally, the sheer logic deriving from the placement of SOF under the Government's authority would have required that the Minister for Privatization be *ex officio* chairing the SOF. EGO 88/1997 stopped short of mandating this, and such a combination of prerogatives occurred almost by accident - as a "personal union" *sui generis* - and for a very short period (April-October 1998), when the chairman in office of SOF's Board also served as Privatization Minister.

The institutional framework established in December 1997 also entailed the *extension of SOF's privatization prerogatives*, so as to encompass the actual selling of companies resulting from the conversion of "*regies autonomes*." At first glance, such a choice would seem to contradict the above-mentioned assumption of a continuous effort by line ministries to "reclaim" from SOF the control over state-owned enterprises. Yet, at a closer look, this episode is not inconsistent with the overriding drive towards having the privatization process firmly under the control of the Executive. Since SOF had been placed under the authority of a Government ministry, any disputes concerning the identity of the ministry in charge could only reflect intra-Government disputes. And, indeed, given the moment when the legislative amendments were made, there are strong reasons to believe that the senior member of the governing coalition (PNTCD), which controlled the Ministry of Privatization, found it appealing to limit the room for maneuver of its political allies in charge of other ministries, which managed, on behalf of the state, 100 percent percent of the share capital of companies resulting from the conversion of former "*regies autonomes*."

Had the issue of privatizing former "*regies autonomes*" been approached in a pragmatic manner, several considerations should have pleaded in favor of leaving the privatization process under the responsibility of line ministries:

- the knowledge of crucial aspects pertaining to the entity subject to privatization is vested in the line ministries, which used to exercise the corporate governance prerogatives;
- SOF's staff resources are inadequate (both quantitatively, as well as qualitatively) for taking over privatization responsibilities concerning enterprises operating in sectors displaying significant peculiarities; [14]
- the privatization of meaningful entities would, anyway, be carried out with the assistance of hired consultants; [15]

The limited anecdotal evidence available so far similarly pleads in favor of leaving the line ministries in charge of carrying out and completing the privatization of former "*regies*." The sad ROMTELECOM experience, derived from the transfer to SOF - half-way into the privatization process - of the shareholder prerogatives previously exercised by the Ministry of Communications, should provide enough anecdotal experience in this respect. [16]

- Law no.99/27 May 1999

Although it upholds the principle of SOF's subordination to the Government, the

new legal framework put in place clearly marks a step backwards. No obvious explanations can be found for this regress, apart from petty politicianist considerations. Thus, the stipulations concerning the subordination of SOF were watered down, by reverting to the ambiguous provision (which replicates the one enshrined by Government Emergency Ordinance no.15/1997) according to which “SOF is subordinated to the Government” *at large*. [17] The “remake” of former legal provisions concerning the institutional setting has been further pushed forward by the “invention” of yet another Government agency, not represented at Cabinet level, but entrusted with specific responsibilities in the area of privatization. This institution inherited the name of “Romanian Development Agency” from a Government Agency established in 1992, but in fact was entrusted with responsibilities very similar to the ones (very ambiguously formulated) which the defunct NAP had been empowered with.

Last, but not least, the May 1999 Law entailed a **full reversal in what concerns the privatization prerogatives of line ministries**. Previously, these ministries had been mandated to surrender to SOF the control exercised over “national companies” resulting from the conversion of *regies autonome*, once these were entering the privatization process. The 1999 Law, on the contrary, not only implicitly vests the privatization of these entities with the line ministries, but renders possible the transfer of privatization prerogatives from the SOF to line ministries also for companies which had been featured in SOF’s portfolio ever since its inception.

As mentioned above, compelling reasons exist for not transferring the task of privatizing “national companies” from line ministries to SOF. In many cases, these reasons are associated with the superior knowledge of these companies vested in the line ministries, and the limited “value-added” that SOF could have brought to the process, given that the recourse to specialized intermediaries (investment banks and the like) had been foreseen. The conversion of the “*regies*” had given birth to companies where line ministries exercise, on behalf of the state, full ownership rights. Yet, not for all these companies do the line ministries enjoy, in privatization matters, a “comparative advantage” relative to SOF. Upholding the privatization prerogatives of line ministries, even in such cases, appears justified in order to avoid the delays generated within the privatization process by the turbulence inherent in the change of ownership prerogatives. Such a consideration (namely, the avoidance of unduly turbulence) would plead against the reversal from SOF to line ministries of privatization prerogatives. Moreover, entrusting to line ministries the privatization of companies previously controlled by SOF can definitely not be justified in terms of the “superior knowledge” vested in the line ministries (actually, the reverse is true).

In a way, this cancellation of SOF’s privatization prerogatives can be regarded as the fulfillment of a perennial goal of the public administration which was already mentioned above: regaining commanding positions vis-a-vis state-owned enterprises. Unfortunately, this is being achieved to the detriment of the privatization process itself. Apart from the fact that the long separation of line ministries from companies entrusted to SOF-exercised corporate governance dwarfs any claim of “expertise” made by these ministries, another pragmatic consideration is being neglected.

At the end of the day, as long as none of the two contenders can convincingly assert a comparative advantage, preference should be given to stability. Therefore, **SOF should not be mandated to surrender its privatization prerogatives relative to companies already featuring in its portfolio, nor should have been line ministries obliged to do the reverse.** Instead of simply correcting the excesses of EGO no.88/1997, Law no.99/1999 wipes them off by erring on the opposite side.

II.3. Successful “discrete attacks” against SOF’s privatization prerogatives

More disturbing is the fact that some line ministries have been successful in lobbying not only for legal norms which would open the possibility of SOF surrendering its privatization prerogatives in specific cases (such is the thrust of Law no.99/1999), but even for legal norms which render SOF’s demise in particular areas a “*fait accompli*.” One would have expected that, if SOF was to be stripped of its privatization responsibilities, at least this transfer of prerogatives would concern those few industrial sectors where strategic considerations are important (e.g., steel or oil processing). [18]

In such cases, the direct involvement of the line ministry could, theoretically at least, produce value-added. That is, provided it vests within itself the knowledge about the sector, it is prepared to make harsh decisions concerning the future shape of the sector (e.g., by mandating the closure of excess production capacities), and enjoys the political “clout” needed for materializing its initiatives. Nevertheless, these prerequisites are hardly compatible with the current capabilities and agendas of the line ministries.

Yet, very surprisingly, the **sectors where SOF is currently being forced to relinquish its privatization responsibilities to line ministries are precisely those where one would have expected that privatizing state property is the easiest: *tourism and agriculture*.** These are also the sectors where SOF’s efforts to privatize have been most severely hampered by problems exogenous to SOF’s own activity, such as:

- uncertain ownership rights, magnified by continuous political disputes concerning restitution versus enshrining the outcome of past nationalization exercises (or, more subtle even, between in-kind restitution versus financial compensation); and
- *ex post* granting of first-refusal rights to tenants of assets previously rented out precisely because the uncertainties surrounding the ownership issue had made their sale impracticable in the first place.

The first episode of the drive towards an across-the-board substitution of SOF’s privatization prerogatives has occurred on 17 November 1998, when a Government Emergency Ordinance (no.32/1998) was passed with the purpose of instituting special privatization rules for **tourism companies**. Institutional-wise, the Ordinance did not entirely cancel SOF’s responsibilities, however. Rather, it sought to make SOF a simple executioner of instructions issued by ministerial civil servants, while shielding the latter from any material responsibility, since SOF continued to assume all the formal

obligations (though not all the rights) entailed by the capacity of shareholder of behalf of the state. The Ordinance also introduced some special rules for privatization in the area. [19]

Within exactly one month from the enactment of the above-mentioned Ordinance, the Ministry of Tourism was downgraded into a non-Cabinet-ranked National Authority for Tourism. This notwithstanding, the reshuffle in May 1999 of the whole legal framework for privatization has upheld the special rules dedicated to the privatization of tourism companies, although it contains several specific provisions directly opposite to EGO 32/1998.

An even stronger intention to “expel” the SOF from the privatization process is being displayed by the currently competing draft laws concerning the **state-owned farms**. There is, on one hand, a legislative initiative promoted by the Democratic Party (PD) which has already been passed by the Senate in February 1999. According to its terms, a newly-created National Agency for State Farms (NASF) would take over from SOF all prerogatives of beneficial ownership on behalf of the state of the state-owned equity in an impressive number - 784 - of companies operating in the agricultural sector. The land used by these companies which will not be restituted to former owners becomes “public property,” and cannot be sold out, but only leased out (on the basis of concession or rental contracts). Subsequently, NASF should take “effective measures for restructuring and privatizing” the companies within its portfolio so as this “action to be completed within 6 months for units with high debts ... and within 12 months for the other units”.

On the other hand, there is an initiative launched in January 1999 by the Ministry of Agriculture, which has been passed by the House of Deputies in June 1999. This draft provides for the establishment of another agency (the Agency of State Domains - ASD), subordinated to the Ministry of Agriculture, which would exercise the ownership rights on behalf of the state on the land used - without valid ownership title - by agricultural companies. The privatization of these companies would be carried out in tandem by SOF and the ASD, the former being in charge of selling the equity while the latter would conclude concession contracts for the land. Moreover, the draft law contains provisions similar to those of the Government Ordinance relative to the privatization of tourism companies in that it prescribes specific privatization methods (not fully in line with those provided for by the horizontal regime - Law no.99/1999), specific preferential rights for some categories of potential buyers, as well as a special distribution of privatization proceeds, 80 percent percent of which would be destined to a special fund managed by the Ministry of Agriculture.

While the two draft laws are very different, they nonetheless share the common provision that the land of the state should not be sold out, while foreseeing - very optimistically - that it should be possible to sell the state-owned equity in companies whose main production tool is precisely the land without also relinquishing state ownership over it.

This special privatization regime foreseen by pieces of legislation dedicated to the tourism and agriculture sector, respectively, does not only have in common the partial “eviction” of SOF from its current role. It **also provides for specific destinations of proceeds derived from selling or renting state property.**

The existing Ordinance on tourism privatization mandates that fully 80 percent percent of both privatization proceeds (as well as proceeds derived from the sale of assets by companies which owe them) be transferred to the “Special Fund for Tourism” directly managed by the National Authority. Similarly, the draft law concerning the Agency of State Domains provides that 80 percent percent of the revenues from privatization (but only 70 percent percent of those derived from concession contracts) be destined to a special fund - to be created - managed by the Ministry of Agriculture. This fascination exerted on all Government agencies having access to “special funds,” which they can manage without the “interference” of the Ministry of Finance, is a general characteristic (though not a less preoccupying one) of the Romanian public finances. Less understandable is the blatantly self-serving way in which the resources for these funds are sought. [20]

For the sake of exhaustiveness, it is noteworthy to identify **other contenders** for taking away from SOF the control-cum-privatization responsibilities in specific areas, which have become rather vocal in the recent period under consideration.

- the “National Agency for Science, Technology, and Innovation”, which feels compelled to see, in the words of its President, that a system be created for protecting “the research infrastructure” so as to make sure that “the infrastructure of the research activity will not be modified” together with the change of ownership. [21]

- the Ministry of Industry and Trade, which wants to assert control over the two oil refineries remaining in SOF’s portfolio (PETROMIDIA and RAFO, which collectively account for 30 percent percent of the country’s oil refining capacity). [22]

Finally, one should mention another episode of other institutions of the public administration pushing the SOF aside and taking over the task of privatizing particular companies. This is the thrust of a Government Emergency Ordinance (no.15/1998) enacted in September 1998, which empowers the **Ministry of Finance to take over the state-owned equity in selected commercial companies and attempt to sell it out in order to cover from these proceeds the debts accumulated by those companies towards various components of the public consolidated budget (State Budget, Social Security Budget etc.).**

The mechanism for “extinguishing budgetary claims” devised by the Ministry of Finance, while pompously called “debt-equity swap”, is nothing of the sort; it does not entail the payment by the debtor of its obligations by surrendering equity, nor the taking over by a third party of equity owned by the debtor in exchange for paying its obligations towards the creditor. The difference between the “traditional” path and the new mechanism only pertains to the identity of the seller on behalf of the state, nothing more. Thus, the only meaningful change it introduces in the process consists of creating yet

another institution effectively exercising privatization responsibilities. And, as such, this risks creating undue additional difficulties, because a whole new set of logistical and personnel resources, and of internal procedures, which exist ready-made within SOF, will need to be established in another institution that does not yet have the kind of expertise and resources needed for successfully carrying out such operations.

II.4. The “dark face” of SOF

The “wholesale attack” on SOF’s privatization responsibilities, which had started already in 1998, but which has been much strengthened in 1999, is - as already mentioned - a direct reflection of the perennial attempt by the public administration to extract more power. Its increased assertiveness over the last couple of years has been illustrated by open frictions between top decision-makers, made very visible by direct disputes carried out in public, via the mass-media, between the successive heads of SOF and various ministers. In conventional terms, one could thus see the executive layer of the public administration throwing its weight behind the long-existing (yet, partly suppressed) aspirations of the bureaucratic apparatus.

But, on the other hand, **this increased pressure on the SOF could not have been so successful if significant weaknesses were not obvious at its receiving end.** In other words, SOF’s own activity was far from being beyond reproach. Nor was the setting in which SOF was operating particularly conducive to fast privatization. And this, not only for legal reasons, but also for cultural ones.

From a legal standpoint, SOF was entrusted with a complex mandate: to privatize state ownership, being responsible for undertaking restructuring measures at company level so as to render them more attractive for privatization, while also exercising corporate governance prerogatives over companies within its portfolio during the interim period ending with their privatization. Thus, from the very beginning, the giant task of administrator of roughly half the state-owned assets fell on a colossus with clay feet. SOF’s organizational chart, staffing, and equipment had to occur on a greenfield because no ready-made structures (such as the privatization departments which ministries had established themselves in 1990-92) were transplanted to it.

Yet, although this background should have triggered adaptation measures consisting in broad delegation of tasks and strong reliance on privatization intermediaries (thus, effectively, “contracting out” the process), SOF moved - very rapidly after its creation - in exactly the opposite direction: the Board of Administrators became heavily involved in the day-to-day activities of the institution and substituted - for almost all decisions with practical relevance - the executive management. A tremendous contradiction has thus been induced between the very large number of decisions in need of being made, on one hand, and the extremely narrow bottleneck of the decision-making mechanism, on the other hand. So strong was this unfortunate tradition built up in the early days of SOF, that it is even now taking its toll. [23] It should be acknowledged that the taking over by the Board of executive responsibilities was not necessarily a move

resented by SOF's executive managers, whose decision-making powers had thus been limited. The existence of a legislative framework prone to interpretations, but mostly the fact that it came to be interpreted in the most restrictive way possible by a plethora of bodies claiming control prerogatives (Court of Audit, police, Government Control Corps etc.), has made these managers exceedingly cautious and willing to dilute as much as possible the responsibility for decision-taking, when not outright passing this "hot potato" on to higher levels.

The extensive corporate governance prerogatives of the SOF meant, in the first place, that far too many resources had to be diverted from what should have been the main goal of the institution: fast privatization (although, admittedly, the pre-eminence of this task had never been clearly spelled out in any of the privatization laws). It also had extremely damaging side-implications as well:

- the reliance on thousands of outsiders appointed as representatives of the state in the Boards of Administration or general meetings of shareholders of companies with state-held share capital. [24]
- the availability, until 1997, of relatively large amounts of money derived from dividends and privatization proceeds (which it was not legally mandated to surrender to the State Budget) allowed the SOF to step into the shoes of a big "financing body," dispensing direct subsidies to companies within its portfolio under non-transparent mechanisms (heavily tainted by suspicions of favoritism), and placing large deposits with various banks (some of which went subsequently bankrupt: e.g., COLUMNA Bank).

Apart from the diversion of resources from the privatization goal and the other negative side-effects (some of which have been corrected since) which SOF's quasi-ubiquitous administrator role entailed, there are other, subtler, consequences of this dualism, which continue to take their toll also in the current period. First and foremost, it determines the assumption by SOF of **initiatives meant to "ensure the future" of companies privatized**. In its crudest form, these are translated into exceedingly complicated stipulations of share sale-purchase contracts relative to future investments to be undertaken by the new owners, keeping in place a certain level of employment for a given period etc. This adds undue strains on the already difficult-to-strike privatization deals, while keeping SOF staff resources entangled, even after privatization, into contract monitoring tasks which, in most of the cases, should have been redundant. [25]

This leads us to another facet of SOF's activity, one which has been abundantly labeled - especially by foreign observers of the Romanian privatization process - as the **fundamental original flaw of SOF's mandate**: the fact that it is counterintuitive to expect that an institution can genuinely and forcefully push forward with activities which would eventually deprive it of its "*raison d'être*." Indeed, speedy privatization is the mirror image of rapid disappearance of the SOF. [26] Yet, this hypothesis (which has slowly assumed the value of axiomatic explanation for SOF's ineffectiveness) disregards important considerations.

- Privatization is, by definition, a “one-off” activity. As such, it needs dedicated staff resources, over and above those needed for current activities had this activity been left under the responsibility of ministries. Therefore, any other public institutions which would have been entrusted with this task would have faced the same problem. Granted, the problem could have been avoided by devising other overall approaches to privatization (genuine “mass privatization,” as in the Czech Republic, or genuine “privatization of the privatization,” as in Poland), but - in the given framework - there is no reason to believe that the “built-in opposition” of SOF has been more damaging than that of any other public body(ies) with the same mandate.

- The “incentives” and “constraints” of the SOF should be considered in their entirety. Whomever accepts the hypothesis that SOF’s staff has consciously delayed privatization in order to preserve its workplace and the advantages going with it, should also accept that - given the extreme pressures put since the beginning of 1998 on the organization to speed up privatization - the “workplace preservation” goal would have been best served by quickly showing results. The fact that these did not occur is a *prima facie* evidence of the limited role that SOF’s staff’s personal commitment could play in accelerating the pace of privatization (and, conversely, for slowing it down),

- The cultural environment. SOF cannot be an institution “de-coupled” from the mainstream of ideas, beliefs, and representations of the virtues and threats of the privatization process which circulate in the Romanian society. It could have been the “white knight” of privatization only to the extent that society at large felt the need for such a champion.

Yet, an inventory of criticisms commonly formulated against SOF’s activity, not only by press commentators, but also by MPs and even prominent members of Government, show the SOF as culprit:

- when *actually selling* (too low price, identity of the buyer etc.), as well as when *not selling* (not putting a share package up for sale immediately after a - non-binding - expression of interest has been formulated, canceling a share sale procedure, terminating a share sale-purchase contract);

- when *not financially supporting companies from its portfolio* (recent example: the debt-ridden shipping companies), as well as when *giving direct financial support to some companies* (widespread until 1997, discrete in 1999: e.g., SIDEX, COMTIM, TRACTORUL, ROMAN);

- for “*meddling with the internal activity*” of some companies, as well as for “*not caring about the internal problems*” of other companies;

- for “*disregarding the rights of small shareholders,*” as well as for *not massively using the capital market for disposing of control packages held by SOF* (which means that existing small shareholders cannot benefit from preferential terms for the sale of these shares).

This amalgam of public perceptions about the functions which SOF should assume is a reflection of the fact that there is **no consensus**, even at the highest political

levels, **about what makes privatization desirable in the first place.**

A priori, the crucial benefit to be derived from privatization in a transition economy like Romania's stems from the inducement of a dramatic change in corporate governance. This should determine formerly state-owned companies to begin pursuing profit maximization as their main goal, eventually creating a "critical mass" of economic operators led by market principles. It is only against such circumstances that conventional tools of economic policy tested in market economies can yield the expected results.

When other goals (such as: enhancement of budget revenues; securing fresh investments and working capital for the privatized companies; keeping in place as much as possible of the original workforce etc) *are simultaneously assigned to the privatization process, without even trying to define priorities among them, the whole picture gets blurred, and no objective criteria can apply any longer.*

There might well be some very exceptional cases where privatization could satisfactorily respond to all above-mentioned requirements. Yet, even in such circumstances, a trade-off between the various objectives mentioned above is unavoidable. In other words, it is impossible to end up with a situation where *all* the expectations build up in conjunction with the privatization process are fulfilled *simultaneously*. One might, conceivably, end up with a "Pareto optimum" situation, but this would still not be sufficient in the public's eyes, as long as privatization is treated as a panacea.

In most cases, however, Jan Tinbergen's "*policy assignment*" theory should apply to privatization: i.e., there can only be one outcome pursued by the recourse to one policy tool (in this case, privatization). Insofar as the thesis of privatization being good *per se* (thanks to its consequences in terms of corporate governance) is deemed not acceptable, because too dogmatic, one could accept that the privatization of enterprises with high stakes attached to them is subordinated to a particular aim.

Yet, such relaxed conditions do not seem palatable to Romanian decision-makers. Based on their stated expectations, as well as on their reactions to privatization deals concluded in the past, it seems that their gauging mechanism is blocked in the position "all or nothing." Against such a background, it would be excessive to fault the mass media for its inconsistency in approaching the privatization issue. At the end of the day, it does nothing more than reflect a state of mind that is shared at all levels of the society.

III. SHIFTING APPROACH TO PRIVATIZATION

III.1. Stage one (until 1994): “spontaneous” and “pilot” privatizations, MEBOs

During fully four years after the enactment of the first comprehensive Privatization Law, the privatization process was basically confined to a very limited range of options.

III.1.1. “Spontaneous privatizations”

The least explored among these, also because of its non-transparent nature, can be regarded as the Romanian breed of “spontaneous privatization” (which used to play a very important role in the Hungarian privatization, for instance). Two main venues have been used for this kind of privatization:

- “joint ventures”, i.e., newly-established commercial companies to the share capital of which state-owned enterprises contributed a significant part (sometimes, all) of its assets;
- outright share capital increases of the SOE, fully subscribed by private investors (usually, insiders). [27]

As early as 1993 (that is, even before privatization began in earnest), there were already 209 joint ventures between state-owned companies and foreign investors, as well as 512 joint ventures formed by state-owned companies with Romanian private investors. A non-trivial number of these joint ventures have been set up under terms and conditions which, later on, came to be challenged by various control bodies, usually on grounds that the capital contribution of the Romanian founding SOE had been undervalued, while that of the private partner was, conversely, overvalued. Interesting to note, these challenges appear to have been more frequent when foreign investors were involved than when Romanian private entities took part in such exercises. Yet, this venue has been quite extensively used by the management and employees of state-owned companies from selected sectors (such as foreign trade, research & design, tourism), where the low level of social capital favored the quick dilution in percentage terms of the stakes held by the state.

The “spontaneous privatization” has been favored by the ambiguous legal framework and the much-too-long institutional vacuum prevailing between the moment when the creation of SOF was legally mandated (thus reducing the responsibility perceived by line ministries, when not outright inducing last-minute “sweetheart deals”), and the moment when the SOF became functional. This is apparent also from statistical data concerning the creation of joint ventures with state-owned companies as partners:

1990-93	1995	1996	1997	1998
721	76	86	17	16

The above figures also show a much less pronounced propensity of the SOF to approve such operations, following the 1996 elections. Insofar as the principles of transparency and competition are much better served by other privatization methods, this finding should qualify current politically-motivated statements, to the effect that privatizations carried out before 1997 are much less prone to suspicions than the ones conducted subsequently.

III.1.2. “Pilot privatizations”

A stipulation of the 1991 Privatization Law mandated the National Agency for Privatization (NAP) to carry out, prior to the establishment of SOF and POFs, the privatization of commercial companies, provided that their number does not exceed 0.5 percent percent of the total number of companies covered by the law. On this basis, a list of 32 companies has been drawn up. While, on the face of it, this “pilot” failed in terms of achievements (only 22 companies could be privatized, most of which through sales to their employees), it helped bring to light two important conclusions:

- cash sales are an extremely inappropriate method for quick privatization and, in order to succeed, should be accompanied by very generous payment terms (which is tantamount to saying that the seller should be prepared to reduce its “call price”, but - at that time (in 1993) - this was still too revolutionary a proposal to be made openly);
- the case-by-case approach embraced by the Law was flawed and should be corrected - as a “second-best” option - by “standardizing” (or “industrializing”) at least part of the process).

The immediate practical result of NAP’s pilot was the devising of a standard methodology for the sale of “small” companies to their management and employees, under preferential terms. Thus, provided they were prepared to buy a majority stake in their company, these insiders were entitled to acquire the POF-held 30 percent percent stake by using certificates of ownership issued by any of the five POFs (irrespective of which of these were the legal holders of those shares) and SOF was mandated to grant concessional payment terms: long-term scheduled installments and very low (and fixed) annual interest rates: 10-15 percent percent *per annum*, against three-digit annual inflation in 1993, and two-digit subsequently.

In retrospect, it appears fairly obvious that this decision opened the “Pandora’s box” of MEBOs, which came to dominate the privatization process for several years in a row and is haunting it even nowadays. Yet, the decision had its merits: it introduced a quick way of selling state ownership in companies where stakes were not very important, and where a trade-off between a sub-optimal transaction price and the saving of important logistical resources of the seller was probably warranted. Very importantly, this decision did not directly entail the two major shortcomings of the MEBO privatization, which its subsequent generalization has led to:

- a *de facto* veto right enjoyed by the employees, leading to the eviction of any other potential buyers (and, moreover, to the reversal of privatization contracts

because employees refused to accept the outcome of the procedure leading to their award);

➤ the severe reduction of the privatized company's viability prospects, once MEBOs spilled over into companies of larger size and with much more significant needs of working capital.

III.1.3. "Management and Employees Buy-Outs" (MEBOs)

The panorama of privatizations carried out, especially until end-1994, shows a disappointing lack of diversification of the methods used.

	1993	1994	1995	1996	1993-96
Total no. of companies privatized,	265	604	648	1388	2905
<i>of which:</i>					
No. of companies sold by MEBOs	261	519	43	14	837
MEBOs as % of total privatizations	98.5%	85.9%	6.6%	1.0%	28.8%

After 1996, as result of legislative changes, no privatization transactions were formally recorded as MEBOs anymore. Also, the figures for 1995 and 1996 should be qualified in view of the fact that, according to some sources, a large part of privatization contracts attributed through open auctions have been awarded to insiders (management and employees) as well. [28] However, insofar as in these cases the "MEBO-type" buyers were not favored over other competitors, nor did they benefit from concessional payment terms not available to other categories of buyers, these cannot be qualified as genuine MEBOs and - as such - do not share the characteristics described below.

MEBOs could conceivably be praised for being, for a period, the only effective engine of the privatization process. There are several *objective factors* that gave the "MEBO method" a large extension in the first years of the privatization process:

➤ it entailed a bottom-up approach, which to some extent allowed the overcoming of the immobility engendered by the optional character of the privatization process (i.e., its reliance on the initiative of institutional shareholders: SOF and POFs);

➤ it benefited from the existence of a standardized methodology, which minimized the inherent aleas (I am unsure of the word intended by the author) of the negotiations entailed by striking a privatization deal, and provided a useful protective tool to the decision-makers involved in the privatization process: they could easier discharge their responsibilities by simply showing that they followed *ad litteram* the procedures prescribed by the standard methodology.

These factors would have allowed MEBOs to play an important part in the privatization process and to palliate to some of its early shortcomings, even without features which led to its excessive favorization. MEBOs benefited from a dedicated law (Law no.77/1994) enshrining significant privileges for MEBO buyers both in what concerns the conditions of acquiring the shares from SOF (down-payment of "*maximum*"

20 percent, remaining payments scheduled over “*minimum*” 5 years, with an interest rate of “*maximum*” 10 percent), as well as relative to the subsequent tax treatment of the company concerned (50 percent profit tax reduction for the share of taxable profit corresponding to the percentage of total shares acquired by MEBO, and non-application of the withholding tax to dividends paid on behalf of these shares). Moreover, MEBOs came to be regarded as an unconditional entitlement by the employees and, sometimes, tribunals have upheld this excessive request by ordering SOF not to sell to anyone else if the employees had asked to buy its stake (e.g., the case of the hotel AMBASADOR).

This is probably **the worst feature of MEBOs** in the picture of Romanian privatization. **Instead of being a “fallback” solution, used for covering the drawbacks of other methods, it eventually became an instrument by which other methods were deliberately shunned.**

It is from this angle that the shortcomings inherent to the MEBO method should be looked at. No privatization method is perfect, so there would be nothing wrong in the sub-optimal nature of MEBOs. But it is quite another thing to “cast in stone” its shortcomings by instituting “entry barriers” to the use of other privatization methods on any significant scale. These were mainly “*de facto*” barriers (the privileges offered to MEBO buyers were not available to other would-be investors, nor did the latter enjoy for a long while the virtues of standardized methodologies, let alone the tax concessions), but sometimes they amounted to “*de jure*” barriers (e.g., court rulings ordering SOF to sell to MEBO buyers).

This background magnifies the shortcomings of the MEBO method, which are not trivial:

- the underlying inequity arising from the fact that only insiders could benefit, to the exclusion of any other citizen;
- tying up together one’s workforce with personal wealth, leading to a built-in contradiction between the functions which a company is supposed to maximize (profit versus insider utility: high wages, preservation of employment); [29]
- access to fresh working capital, not to mention investments, know-how and market outlets is practically non-existent in the case of MEBOs. [30]

The meaningfulness of these shortcomings could be (and, indeed, currently is) disputed on grounds that not many privatization contracts resulting from MEBO procedures had to be cancelled subsequently. Data in this respect are scant and not very up to date. As of end-1997, it appears that only 3 percent of MEBO contracts were cancelled as a result of non-fulfillment of payment obligations. Even assuming that the figure has not changed significantly in the meantime (which is most likely the case), it still does not warrant the inference that this is proof of the success of MEBOs. As time goes by, the real value of payments due is eroded, and there could well have been cases of re-arranging the original schedule of payments. [31]

Much more significant for gauging the success of this method are data concerning

the performance of the “MEBO-ized” companies. A study based on 645 companies privatized through MEBO in 1993-94 (that is, on over 80 percent of the relevant individual cases) shows a significant decline of their performance in 1996 and 1997: profitability declining from 7.3 percent in 1994, to 2.2 percent in 1997, and the degree of indebtedness going up - between the same years - from 29.3 percent, to 48.5 percent. While this worsening cannot separate general considerations (such as the deterioration of the overall economic climate) from determinants pertaining to the privatization method followed, it definitely cannot be regarded as an argument in favor of “MEBO’s success”. *Ceteris paribus*, there are few chances that privatization methods could not have yielded worse results.

III.2. Stage two (1995-96): the “Mass Privatization Program”

III.2.1. Genesis of the “Mass Privatization Programme”

The impetus for a Mass Privatization Program (hereafter, MPP) appeared against the background of a very disappointing performance of the privatization process. In hindsight, one cannot fail to notice, though, that - in fact - very few opportunities had actually been given to SOF for making its proofs: high-profile official statements about the imminence of a reshuffling of the legal framework started to be made only about one year after SOF had become operational.

Yet, there are reasons to believe that the main shortcoming which the MPP was ostensibly meant to address could not have been corrected by the SOF itself at that point in time: the “voluntary” nature of privatization, relying heavily on the - scant - privatization offers made by the SOF and by the POFs alike. **There was, indeed, a real need to instill a new dynamics into the privatization process.**

This renewed interest of the Government in privatization matters was not, however, entirely endogenous. To a significant extent, it had been linked to the terms under which continued access to official external financing was to be granted. A long-protracted adjustment loan from the World Bank had been negotiated for more than one year, one of the main stumbling blocks to its conclusion being the unsatisfactory pace of the privatization process.

III.2.2. Questionable features leading to questionable outcomes

If the need for a new impetus to privatization can hardly be disputed, the way this was eventually done is extremely questionable. Two broad aspects, in particular, deserve special consideration:

- the use of the MPP as a pretext for achieving political goals;
- the actual small impact of the changes made, coupled with numerous conceptual flaws.

- *“Political hijacking”*

As already mentioned earlier, one of the implicit institutional side-effects of the MPP was to bring back into the mainstream of privatization Government institutions which had been side-lined by the SOF. This was achieved by providing for convoluted procedures, requiring the direct involvement of the NAP (and, later on, almost by default, the General Secretariat of the Government and the Ministry of Industry). Much more questionable was the deliberate attempt at undoing the concentration of COs that had occurred spontaneously since the issuance of these privatization vouchers. [32]

Because restricting the number of COs used by a single person in an individual privatization deal was deemed impractical, but also in order to derive more “gratitude” from the population at large, the Government opted for a more convoluted formula. The decision was made to issue and distribute freely to all citizens a new type of privatization voucher (called a “privatization coupon”), in nominative form, and with a determined par value. These coupons, together with the existing COs, were to be the counterpart of the same 30 percent of the aggregate equity of state-owned companies. In order to allow for this “trick,” an upwards adjustment of the book value of all state-owned enterprises was mandated by a Government Decree issued on 10 August 1994. Then, COs were assigned by fiat a final par value of only ROL 25,000, so as to allow the coupons to bear a face value of ROL 975,000. As a result, what had been designated by the 1991 Law as being the equivalent of 30 percent of the aggregate equity of state-owned companies was finally diluted to less than 1 percent.

This “solution”, whose political motivations cannot reasonably be disputed, entailed at least two very negative implications.

At a philosophical level, it bore proof of very strong egalitarian instincts. The pretended “equality of opportunities” ostensibly restored in this way was, in fact, nothing more than an “equality of outcomes.” In the second place, the exercise had at least a flavor of expropriation and retroactive application (COs had been originally designated as representing the counterpart of 30 percent - not 1 percent - of the state-owned companies’ aggregate equity), but in strict legal terms this was probably not the case: deference is due to the ruling of the Constitutional Court on this issue, following the challenge introduced in May 1995 by over 100 MPs belonging to the opposition. But, even more preoccupying, a serious credibility problem has been engendered: by blowing the whistle and ordering a restart every time that some segments get better off, the irreversibility of privatization can be called into question. [33]

Also noteworthy, given the elaborate defense of the MPP Law on grounds of its “more equitable thrust,” is the fact that, through its sheer design, it offered incredible rent opportunities to selected categories of employees. This was done through the provisions allowing employees from companies not featuring on the “MPP list” to nonetheless use their privatization vouchers for acquiring shares in their own companies. Had those companies been included in the MPP, their employees would have been confronted with the competition of other voucher holders, potentially leading to over-subscription, and

thus to fewer shares allocated to each subscriber, in the cases of attractive companies. Yet, these employees have been deliberately shielded from any competition and, in some cases, at least, the “rents” they have thus extracted are important. [34]

At a pragmatic level, the convoluted maneuvers needed for diluting the value of the COs had a very negative impact on the pace of privatization deals. The monthly number of privatization transactions has plummeted after the artificial increase of the companies’ book value, the more so that no explicit provision was made to the effect of discharging the SOF from any responsibility should it sell at less than the book value.

**Evolution of monthly privatization transactions before and after Government Decree
no.500/10 August 1994**

<i>April</i>	<i>May</i>	<i>June</i>	<i>July</i>	<i>August</i>	<i>Sep</i>	<i>October</i>	<i>Nov</i>	<i>Dec.</i>
40	45	65	114	90	12	8	11	41

Thus, among its many paradoxical features, **the path towards the “Law for the Acceleration of the Privatization Process”** (as the MPP Law has been officially designated) **began with a slow-down of large proportions.**

- *“Timidity” of the program and conceptual flaws*

As designed, the MPP entailed only one undisputed progress over the prevailing state of play: doing away with the optional character of privatizations, by forcing the “putting on the block” of a large number of companies, and making possible the acquisition with privatization vouchers of more than 30 percent (i.e., up to 60 percent) of any listed company’s share capital.

It still remains impossible to understand, from the perspective of economic rationale, why the percentage of shares freely exchangeable against privatization vouchers was limited at maximum 60 percent (and, in many cases, only 49 percent) of the equity capital of any MPP company. Of the 4803 companies eventually included in the “MPP list,” 17 percent had only a minority stake available for public subscription, but these accounted for 62 percent of the aggregate share capital of MPP companies. [35] There is no compelling reason for not having allowed that up to 100 percent of the share capital of some companies be distributed freely, apart from paternalistic considerations. Since, immediately after the public subscription, private share ownership could only be very dispersed, actual control would have rested with the SOF. Subsequently, assuming that concentration of private share ownership would have occurred, the sale by SOF of its minority stake could be hampered by the decisions of the majority private owners. [36] Similarly not understandable is the reason why, in many cases, only minority stakes were offered for free distribution. Had these companies been deemed “strategic” or particularly important (let alone the merits of such designations), a decision not to include them in the MPP list would have saved everybody a lot of trouble.

Thus, mainly as a result of the way it was designed, the **MPP had the incredible double drawback of:**

- *not only* failing to realize the main (if not the only) advantage of “mass privatization” as opposed to “case-by-case” privatization: speed;
- *but also* complicating the realization of “case-by-case” privatization subsequently.

SOF still has to carry out case-by-case share sales for each and every company included in the MPP. It had to postpone the sale of large number of companies while negotiations were on-going with the ex-POFs for the reciprocal “regularization” of portfolios. And, last but not least, it frequently faces problems in disposing of the shares it holds because of opposite interests of the other shareholders resulting from the MPP. [37]

Against this background, the conclusion of Earle and Telegdy, according to whom “the so-called mass privatization has managed to privatize only 5.5 percent of the capital existing in state hands,” is probably of lesser significance. The MPP has not even attempted to go beyond the “magic” 30 percent figure of state-owned equity destined to free distribution and, eventually, it led to only a small proportion of this already low percentage being owned by other parties than the five POFs (subsequently converted into investment funds).

III.2.3. POFs and their conversion into full-fledged investment funds

While the property of the ex-POFs is - for all practical purposes - regarded as private, its relatively large size warrants a more thorough exploration of the nature and goals of these peculiar institutions. While the SOF has not been an absolute innovation (comparisons with *Treuhand* being, up to a point, justified), the POFs were brand-new theoretical creations. As briefly sketched previously, the five POFs had been established as a peculiar type of joint-stock companies, having as shareholders all existing owners of COs and holding - between them - 30 percent of the share capital of all SOEs slated for privatization.

The *mandate* of these institutions entailed conflicting objectives: on one hand, **portfolio maximization** (which amounted to a built-in incentive to stick to the stakes held in the most profitable commercial companies) and, on the other hand, **rapid divestiture** (which would have meant offering for exchange against COs as many shares as possible).

Their *status* was equally fraught with ambiguity. They were not investment funds proper, because their equity (the COs) were at the same time “special money” that could buy shares in individual companies. And they were not mutual funds either, because the securities they issued were not redeemable.

Another contradiction has arisen from the fact that, while designed to represent private interests (the mass of CO holders), POFs were established in a top-down manner and their control was exercised by politically-appointed (by Parliament) Boards. [38]

In retrospect, one cannot fail to notice that the establishment of POFs was yet another reflection of paternalistic attitudes. Citizens were not deemed “mature” enough to make their own decisions concerning the companies where they wanted to lodge their certificates of ownership, and they also needed to be protected against their own errors through the cushion of shareholdings within POFs, deemed to have the virtue of spreading the risk.

The conflicting objectives of the POFs, coupled with the political appointment of their leadership, resulted in their excessive concentration on portfolio management, at the expense of privatization proper, and in a price maximizing approach to privatization, so as to cancel as many COs as possible without having to give up too much of their initial share portfolio. It is true that the 1991 Privatization Law also comprised a feature meant to counteract a too conservative behavior of the POFs: the requirement that they be converted, within 5 years, into full-fledged investment funds. Yet, as will be shown below, means have eventually been devised to ensure that, even after this conversion, the insiders will keep a firm grip on the control of ex-POFs, meaning that the “sunset provision” was not as effective as one would have hoped in curbing the drive towards portfolio maximization, and retention of as much as possible of the initial portfolio of shares allocated to each POF.

The innovation brought by the MPP by allowing that more than 30 percent of an individual company’s equity be purchased with privatization vouchers (COs and coupons) has created huge complications for the definition of POFs’ portfolios. Whereas previously SOF-held shares could only be bought with cash, it became possible to buy with vouchers a portion of SOF’s stake (i.e., the one exceeding 30 percent of a company’s equity capital, up to 49 percent or 60 percent). [39]

Hence, the solution found: to organize, at the end of the free exchange of shares for vouchers, a **gigantic “regularization” exercise**, whereby POFs were surrendering to SOF shares in non-MPP companies (or, as the case may be, in under-subscribed MPP companies), so as to compensate the latter for its shares which had been given away against privatization vouchers.

This unnecessary complication bears witness to the gross underestimation, by the MPP scheme, of practical implementation problems. There seems to have been a blanket assumption that things would proceed smoothly, totally disregarding the fact that both types of institutions (SOF and POFs, respectively) had their own functions to maximize and, as a result, divergent interests. It should, however, have been expected that - among entities with a commercial character - considerations pertaining to the “market value” of shares exchanged would prevail over simple arithmetic computations based on par value. Moreover, the ex-POFs sought to use the opportunity of this “regularization” as a means to obtain compensation for companies (or parts of companies) which had been taken out of their portfolios in previous years, via dedicated Government Decrees aiming at creating or extending “*regies autonomes*” or, simply, at endowing public institutions with hotels, villas and the like. As a result of these complications, the regularization process has still not been fully completed as of end-September 1999, in spite of

successive legal acts mandating its conclusion at various deadlines, successively postponed. [40]

Another set of extremely complicated matters pertains to the **identification of the ex-POFs shareholders**. Once converted, by virtue of a law (no.133) passed in the dying days of the former Parliament (28 October 1996) into “investment companies” (hereafter, SIFs), the ex-POFs were to draw up the list of their shareholders. Had perfectionist temptations not prevailed over the law-making process (just as they did when the MPP has been designed), this would have been a straightforward exercise: SIFs’ shareholders are those citizens who have chosen to lodge their privatization vouchers with one of the POFs of their choice, rather than directly into one of the 4800 MPP companies generously offered for subscription. Yet, the legislators balked at this simple solution. Instead, they required that SIF shares be issued also to those citizens who, while finally subscribing their vouchers into individual companies, had nonetheless been POF shareholders between 1992 and 1996 and, therefore, eligible to receive the dividends cashed in by POFs for the corresponding financial exercises. Since POFs had used these dividends to make financial placements rather than distributing them, eligible citizens were to be compensated in-kind for this “lost revenue,” by receiving newly-issued SIF shares.

It would be difficult to imagine a measure whose cost-benefit implications are worse. More than two years and a half have passed since SIFs finally received the list of these “additional shareholders.” Over the same period, the possibility of SIFs’ “original shareholders” (i.e., the citizens who have lodged their privatization vouchers with one of the POFs) to dispose of their shares was blocked. All this, for additional shares to be issued on behalf of dividends whose value barely covers the transaction costs entailed by distributing them! It has to be mentioned that the number of citizens having subscribed directly into POFs is around 2.2 million, while that of citizens entitled to receive “in-kind” past dividends is around 10 million. In other words, *the right of disposal by 2.2 million persons of their entire benefit from the mass privatization has been deliberately rendered hostage of the acquirement by 10 million persons of extra benefits from the mass privatization, on which they did not count, and which are anyway negligible.*

To make matters worse still, the above-mentioned Government Emergency Ordinance no.54/28 December 1998 has introduced an additional difficulty, by effectively inventing new shareholder claims on the equity capital of the SIFs. Such rights were to be granted to: citizens who could not subscribe during the MPP because of having received privatization coupons with erroneous indications; citizens who did not receive shares because the companies of their choice had been effectively withdrawn from the MPP list for various reasons (mergers, break-ups, non-validation of their equity capital); and, most importantly, citizens who - due to over-subscription in the companies of their choice - only received shares the aggregate par value of which was lower than the par value of the privatization vouchers they had subscribed with. Whereas meeting the former two newly-created entitlements would not entail more than a 2-3 percent increase of SIFs equity capital, the latter provision is explosive. According to the estimates of the POFs, it should lead to at least the doubling of shares issued by SIFs, obviously without

any asset counterpart. Consequently, the market value of the holdings of the citizens who subscribed their privatization vouchers directly into SIFs would be severely diluted.

Summing up, **significant problems** - which could have been avoided had a more pragmatic approach presided over the design of the MPP Law and of the POF Conversion Law - **have seriously hampered the determination of both the assets of SIFs** (due to the “regularization” exercise), **as well as of the liabilities of the SIFs** (identification of the number of shareholders and of the size of their shareholdings). Among these two problems, the former is by and large sorted out (as of March 1999, the regularization had been completed for 98.2 percent of the assets under contention), but the former cannot be resolved in a satisfactory manner as long as the new share entitlements decided by the end-December 1998 Ordinance are not formally rescinded. [41]

The above-mentioned problems have a direct impact on the **reality of the privatization entailed by SIFs’ shareholdings**. It is already difficult to imagine how the most useful virtue of private ownership (proper corporate governance, oriented towards profit maximization) can be genuinely realized through the existence of five “mega-funds”, each owning significant stakes in hundreds of individual companies. But, moreover, as long as SIF shares are not publicly traded, genuinely private owners are deprived of an essential attribute of ownership: the possibility of free disposal. By the same token, the concentration of shares issued by the SIFs is blocked, thus leaving control safely in the hands of current leaders, who owe their positions - first and foremost - to “right” political affinities. [42]

Brief outline of SIFs’ portfolios

	- as of mid-1999 -				
	<i>Banat</i>	<i>Moldova</i>	<i>Transilvan ia</i>	<i>Muntenia</i>	<i>Oltenia</i>
Equity stakes (no. of companies)	838	601	516	446	360
Equity capital (ROL billion)	574.4	519.3	546.1	564.6	580.2
“Original” shareholders (th.)	491.3	475.6	476.6	294.0	479.6
Total shareholders (mil.)	9.30	9.32	9.28	9.19	9.29
1998 profit (ROL bn.)	97.8	83.7	91.3	100.7	115.2

More preoccupying is the fact that - under the current circumstances - even if SIF shares get listed on the capital market, the emergence of proper corporate governance at the level of SIFs (which would enhance the corporate governance of the hundreds of companies featuring in the portfolios of SIFs) will be delayed *sine die*. This is because, ostensibly in order to protect the small shareholders, each and every SIF has - in the meantime - included in their by-laws provisions which forbid any individual shareholder from exercising voting rights in excess of a weight of 0.1 percent of the total share capital. Even assuming that the interests of small shareholders would indeed be served by such a provision, sheer common sense indicates that the intensity of this putative “gain” spread over hundreds of thousands of individuals is copiously dwarfed by the rent opportunities so offered to the insiders managing, without proper accountability, the SIFs. But, in fact, such restrictions can only render SIF shares non-attractive once listed

at the Stock Exchange, meaning that the small shareholders who are supposedly “shielded” by this incredibly self-serving stipulation will get a very poor price for their shares, when not faced with the impossibility to exit from those shares, due to lack of demand.

III.3. Stage three (after 1996): full recourse to case-by-case privatization

The third (and current) stage of the privatization process mainly consists of a continuous drive towards divesting state ownership by individual transactions. Relative to the previous two stages, the current one displays several new features.

a. Undoubtedly, the most important feature pertains to the *first successful privatization transactions concerning state-owned banks and public utilities*. Much more important than the budget revenue-enhancing consequences of these transactions is **the unequivocal signal they entailed**, by breaking deeply-embedded “taboos”, **with respect to the irreversibility of the reform process in Romania**.

b. A second important feature stems from the *much wider recourse to capital market-mediated transactions as a method for disposing of state-owned shares*.

c. Thirdly, one should note *the emergence of a genuine effort to “outsource” privatization tasks, by having recourse to services offered by specialized consultants and/or investment banks*.

Unlike the former above-mentioned feature, which entailed an absolute novelty for the brief “history” of Romanian privatization, the latter two had precedents in the previous period. However, those precedents consisted of extremely sparse episodes, not really allowing for relevant conclusions to be derived from such a limited experience.

There can be no doubt that the record of the privatization process since 1997 shows a performance that is significantly superior to the previous achievements. This can be illustrated by several quantitative indicators, such as:

- *Percentage of SOF-controlled equity divested*. As shown above (see point I.1.2), some 22 percent of the state equity originally held by the SOF has been divested in only 2.5 years (between 1 January 1997 - 30 June 1999), as opposed to only 10 percent in the 4 previous years.

- *Number of “large” enterprises privatized*. Due regard being given to the fact that the definition of the “large” enterprises rests on book value (whose significance in relative terms shrinks due to high and persistent domestic inflation), the fact remains that only 83 companies defined as “large” had been privatized between 1993-1996, as opposed to 183 in the subsequent 2.5 years.

- *Number of privatization transactions carried out with the involvement of foreign investors*. The corresponding figures for the periods 1993-1996 and 1997 - sem.I 1999, respectively, are: 11 versus 201!

The above figures are prone to qualifications, as there is some auto-correlation among them: more “large” enterprises privatized necessarily entails a larger proportion of

equity capital divested. And the number of privatization contracts concluded with foreign investors is probably a qualitative indicator to at least the same extent as being a quantitative one. But, even after these words of caution are sounded, there can be few doubts that **privatization has moved to a superior dimension after 1996**, and that this cannot be divorced from the **existence of a higher political will to privatize**.

This is not to say that the performances recorded since the beginning of 1997 could not have been significantly better. Too often, the Romanian explanations offered for the under-performance are confined to the lack of interest by foreign investors, because not sufficiently enticed by their home-country authorities, and/or to the declining attractiveness of emerging markets, in the wake of the Asian and (even more) the Russian crises. [43]

But, more importantly, such explanations are too self-serving, as they implicitly disregard **self-built impediments**. For practical purposes, these can be grouped into 3 categories:

- *Problems which can be ascribed, to a large extent, to the SOF itself*; they will be discussed below (see chapter IV.), in conjunction with the description of the privatization methods used.

- *Problems derived from non-addressing very significant externalities negatively impacting on the privatization process*; they played a negative part also in the previous conventional stages of Romanian privatization, but their blocking potential has increased with time (see chapter V.).

- *Problems exogenous to SOF's activity, which are "new" in the sense that they started to manifest themselves after 1996.*

A first such problem can be defined as being the **unfortunate legacy of the Mass Privatization Program**. Concretely, as shown above, the architecture of the MPP raised three unnecessary difficulties for SOF's subsequent privatization activity:

- the need to carry out a gigantic "regularization" negotiation with the SIFs, with the corollary that a non-trivial number of SOF-held stakes in individual companies have been deliberately held back from being "put on the block" pending the final sorting out of the shareholdings of SOF and SIFs, respectively;
- the reduction of SOF-held stakes in many individual companies to minority positions, resulting in undue difficulties for SOF in disposing of its shares;
- the over-burdening of the SOF by the need to sell-out minority stakes (which could very well have been privatized, had they been fully open to the free subscription exercise).

As a result, SOF had to engage in a significant number of "residual" transactions, which undoubtedly diverted scarce resources from the more productive goal of selling out majority stakes. The scope of this unwarranted duplication can be illustrated by the number of transactions entered into SOF's data base as referring to companies where share sale-purchase contracts had already been formerly concluded by the SOF (albeit,

not for the entire stake initially or, as the case may be, the entire stake finally reverting under SOF's control).

Available data shows that, in 1998, 383 such transactions had to be carried out, while another 321 similar transactions occurred in the first eight months of 1999. The 704 "residual" transactions mentioned above are equivalent to 28 percent of the number of "genuine" privatization deals carried out by the SOF in the same period. This indication is illustrative for the significant extent to which resources theoretically dedicated to privatization had to be used, instead, for "cleaning up" the portfolio of the SOF. [44]

Another factor which has significantly slowed down the pace of the privatizations carried out after 1996 can unmistakably be traced back to **the excessive volatility of the legal framework**. A brief factual description of the developments which occurred successively shows that:

- the three "core" privatization laws in force as of end-1996 (the 1991 "Privatization Law", the 1994 "MEBO Law", and the 1995 "MPP Law") were all substantially amended in *May and July 1997*;
- important additional changes were brought in *August and September 1997*, with respect to the protection of the employees of privatized companies and the destination of privatization proceeds, respectively;
- a full consolidation of the privatization legal framework, entailing many important modifications of the former, was carried out in *December 1997*;
- comprehensive implementing norms for the new consolidated legal framework were issued, successively, in *August 1997, February 1998, and July 1998*;
- another comprehensive modification of the "horizontal" privatization legislation occurred in *May 1999*, and implementing norms to this effect were issued in *June 1999*.

To these, one should add the similarly frequent changes made to the "omnibus" legislation dedicated to "investments," which has an immediate relevance for the decision-making process of most potential buyers of state-owned equity: *June 1997, December 1997, December 1998, March 1999, May 1999*.

It thus clearly appears that, **over a period of only 25 months** (May 1997 - June 1999), **no less than 15 substantial reshuffles of the legal framework directly concerning privatization had been carried out**, of which at least 7 entailed "wholesale" changes to all the privatization methods, applicable to all privatizable companies.

The amendments made to the "investments" legislation have been exceedingly capricious, as a result of disputes within the Cabinet itself, as well as of significant differences of view between the executive and the legislative branches, respectively. Lately, they have moreover been polluted by the attempt to give "blanket coverage" to very specific incentives negotiated as part of individual privatization transactions (e.g., the take-over of the domestic car manufacturer DACIA by RENAULT).

However, when looking at the successive pieces of legislation dedicated to privatization, a clear trend is apparent - with the exception of institutional provisions - towards making privatization transactions simpler and easier to conclude. Against such a background, one can legitimately ask **why were legislative changes undertaken after 1997 detrimental to SOF's efforts to privatize.** In order to answer this question, a distinction should be made from the outset between the *sheer recourse to frequent legislative changes*, on one hand, and the *content of the legislative changes*. Generally speaking, the blame put on the legislative changes undertaken since the beginning of 1997 has been associated much more with the latter aspect than with the former. [45]

It is the strong opinion of this author, however, that this is not the case. On the aggregate, although there are discrete episodes where new legal provisions were less "privatization-friendly" than the ones they replaced, each and every comprehensive piece of privatization legislation has been superior to the one it superseded. Nevertheless, this continuous state of flux had important negative consequences, the most important of them being the need felt by SOF to "re-adjust" transactions already started in such a way as to properly fulfill the exigencies of the new legal framework. A large venue has thus been created for a tremendous waste of resources on configuring deals, only to have them "re-configured" subsequently. This led to a negative cost-benefit balance of the legislative changes, the occurrence of which had not been foreseen, because it was counter-intuitive: *the potential for accelerating privatization via relaxing legal provisions previously constraining it ended up being over-compensated by the slow-down triggered by the need to adjust to the new legal framework.* Had these adjustments been less frequent, the former effect would have prevailed over the latter.

IV. PRIVATIZATION IN ACTION: METHODS, PRICING, PROBLEMS

IV.1. Privatization methods used: figures and reasons

The picture of the privatization transactions carried out between 1 January 1996 and 31 August 1999, broken down as per privatization methods used, is captured by the table below.

	Auctions		Direct negotiations		Sales on capital market	
	<i>Number</i>	<i>% of total</i>	<i>Number</i>	<i>% of total</i>	<i>Number</i>	<i>% of total</i>
1996	455	31.3%	1006	68.7%	-	-
1997	231	17.7%	1064	81.6%	9	0.7%
1998	991	78.2%	244	19.3%	32	2.5%
I-VIII/1999	1000	79.6%	204	16.2%	53	4.2%

The figures presented show a very non-uniform recourse to the various privatization methods available. It is only in the latter part of the interval that a pattern seems to become discernible: absolute prevalence of auctions, and increasing recourse to sales made directly on the capital market. A caveat should also be made in what concerns the statistical significance of conclusions derived from the observation of privatization developments expressed in terms of number of deals carried out, rather than in terms of capital divested. Broadly speaking, the share of direct negotiations in the overall capital divested is larger than that of any other method, while that of sales on the capital market is also larger than the percentage recorded by the same method in terms of number of companies sold off.

There can be several sets of explanations for the actual distribution of privatization transactions among the different methods used.

- From a legal standpoint, the preference for direct negotiations had been explicitly enshrined by a Government Decree (no.887/1999) dating from 1 November 1995. This had grouped the companies whose state-owned shares were to be offered for sale against cash in parallel with the implementation of the MPP in several categories, while also prescribing the methods to be used for each category. [46] It is counter-intuitive to note that, although the Decree has been putting more emphasis on auctions than on direct negotiations (minimum 2296 companies versus a maximum of 1559 companies), the results recorded in 1996 have been strongly tilted in favor of the latter method.

Subsequent legal provisions have been much more “open” from the point of view of privatization methods. The only explicit instruction pertains to the deals attempted via direct negotiations, in that it mandates that this method should be used whenever “the sale is addressed to strategic investors” (or when an auction organized previously has only yielded a single offer to buy). This leads to a second set of explanations for the distribution of privatization methods actually implemented.

- The condition relative to “addressing the sale to strategic investors” is linked to the percentage of shares still held by SOF. The prevailing assumption of this explanation is that majority stakes trigger almost automatically the appeal to “strategic investors.”

The relative weight between companies in SOF’s portfolio where majority stakes are held, as opposed to companies where only minority stakes were left under SOF’s control, has been severely affected by the architecture of the MPP. Since the content of the “MPP list” was such that 83 percent of enterprises were open for the free distribution of up to 60 percent of their share capital (as opposed to just 17 percent of companies where SOF was to retain majority stakes), and since the degree of under-subscription was broadly similar in both cases, it would appear that that SOF should have been left with more companies *a priori* destined for auctions than for direct negotiation. This, however, seems not to have been the case, because of the large number of companies left out of MPP’s coverage as well as of the subsequent “regularization” with SIFs, as a result of which SOF ended up with majority stakes even in companies offered for 60 percent subscription in the MPP, but not actually subscribed to that degree.

The other legal condition, relative to the lack of competition in the auctions attempted, is effectively a “fall-back” one. Normally, all other things being equal, it should increase the share of privatization deals carried out by direct negotiation, to the detriment of auctions.

- A third possible explanation, based on the size of companies slated for privatization, would presume that the percentage of direct negotiations should be positively correlated with the size of the companies privatized. The actual data, however, lead to counter-intuitive conclusions. Since - in the recent period - the average state-owned share capital divested is increasing, one would have expected to see an increase of the share of deals carried out by direct negotiation relative to the proportion held by auctions. Probably, such a situation will prevail in the subsequent period, because the number of small companies left for privatization is declining much faster than that of large companies.

- A final explanation for the observed state of play with respect to the privatization methods used, one which is favored by most Romanian-originating comments about this issue, assumes that direct negotiations had been privileged over auctions because of the higher discretion they gave to the seller in terms of attributing the privatization contract. The same explanation has been offered, moreover, for the scant recourse to capital market-mediated privatization transactions, the reasoning being the same: the more transparent a privatization method is, the more likely it was that the “privatizer” will deliberately shun it.

Such line of reasoning cannot be confirmed by the developments recorded in the last two years. It could, perhaps, explain why the recourse to direct negotiations has been so widespread in 1996, although the legal framework was pointing in the opposite direction. Yet, such a thesis is invalidated by the subsequent developments: there was

still a strong propensity for direct negotiations in 1997, that is, after a wholesale change of SOF's management has been operated and, moreover, with the very same management team at the level of the SOF, a dramatic "U-turn" occurred since 1998.

It thus appears that none of the conventional reasons which can be offered for the break-down of privatization methods carried out by SOF yields satisfactory explanations.

This may be attributed to several factors, in particular to the inherent "learning curve" which SOF has followed since the cash sales have been generalized. This, coupled with the evolution of the legal framework (not in terms of prescriptions of methods used, but rather with respect to issues such as pricing and the procedural requirements attached to the recourse to each privatization method available), has helped crystallize in practice (by a "trial and error" process) a certain pattern for the recourse to various privatization methods, which is not necessarily identical to what theoretical assumptions would predict. Extremely important for explaining this relative "hiatus" between practice and theory is the fact that, as already mentioned above, *SOF is operating under the pressure of different goals, which it is supposed to achieve although some of them are mutually contradicting themselves.*

Under such circumstances, the extensive recourse to auctions is the reflection of the desire to conclude a large number of privatization deals without mobilizing too large resources to this end. According to the same logic, the appeal to direct negotiations occurs in cases where the nature and state of the companies offered for sale anticipates the need (legally stipulated or not) for other aspects to be addressed as part of the privatization deal (investment commitments, assumption of past debts, protection of workforce employed).

There are also spill-overs from one method to another. Broadly speaking, because rather stringent pricing provisions apply to sales through auctions (partly because of legal requirements, partly as a result of over-cautious attitudes by SOF's staff), some of the companies which could be privatized via this method - if more flexibility would be accepted concerning the issue of the price - end up by being offered for sale via direct negotiation, because the simultaneous application of the element "investment commitments" helps reduce the pressure on the element "price per share."

And, ultimately, whatever could not have been privatized by any of the two methods mentioned above ends up as earmarked for sales on the capital market, where neither the price conditions, nor the side-elements of the privatization transaction are deemed to be as stringent. This is probably the aspect of SOF's strategy for the use of the privatization methods that is most open to criticism. Instead of using the capital market for the privatization of companies whose characteristics are appropriate for this kind of sales (and whose number is, at the end of the day, very limited), this venue, to a growing extent, has started to be used as a "dustbin," collecting the failures recorded by the recourse to other methods, which could have been far less numerous if all the possibilities of those other methods had been thoroughly explored.

IV.2. Sales through auctions; issue of pricing

Apart from various formal procedural requirements, **the price offered is the main element of a privatization transaction carried out by auctions.**

The issue of pricing has been one of the most problematic ones that has hampered the privatization process, although its relative importance tended to decline as time went by. To a large extent, this was a “self-inflicted” problem, generated by SOF itself. Thus, although no formal legal restrictions existed for a long while with respect to a “minimum price,” ever since the beginning of the privatization process SOF had taken the view that shares could not be sold under their par value. This implicitly *favoured the MEBO method, where the very generous payment terms offered effectively amounted to an implicit price discount.*

The very rigid stance initially taken by SOF can also be attributed to an over-cautious stance triggered by the “fault-hunting” approach taken by the controls of the numerous bodies ostensibly entitled to carry them out: police, Court of Audit, Prime Minister’s Control Corps, etc. This approach effectively amounts to reversing the normal logic prevailing in a free society: anything not specifically allowed by the law is deemed prohibited.

A first timid attempt to correct this shortcoming was made in the framework of the 1995 MPP Law, which included a stipulation to the effect that “the sales price *may* be reduced, based on a valuation report, under the nominal value”. However, reductions of more than 30 percent triggered the obligation to include special clauses in the share sale-purchase contracts. Originally hailed as a genuine breakthrough, this provision entailed some perverse consequences. In particular, since a legal stipulation went into effect, specifically allowing a reduction of the price under the nominal value, this could be interpreted as meaning that, previously, no sales under par value had been lawful. [47]

Subsequent legal developments have, to a large extent, relaxed the “straitjackets” concerning pricing, but have done so in an inconsistent manner, and through repeated modifications.

- In July 1997, a Government Emergency Ordinance (no.37/1997) was enacted, which implicitly acknowledged that there should not be any minimum price as part of privatization transactions. The formulation, however, was clumsy: “shares offered for sale... at the best price offered”. This disregarded the distinction that should be made between the price asked for by the seller and the price at which the transaction can be concluded.

- Clarifications were made as part of the end-1997 consolidation of the legal framework for privatization, which specifically provided that “*no minimum price exists.*” Subsequently, the implementing norms of the law (issued in February 1998 and amended

in July 1998) made clear that there should be a “call price”, determined on the basis of a full-fledged valuation report, or of a “simplified valuation report” - essentially, a computation formula based on the net asset value. No limits were prescribed for the level at which this price could be reduced. *Such limits were nonetheless introduced by the SOF itself, by narrowly interpreting an admittedly ambiguous provision of an Order issued by the Privatization Minister in March 1998. [48] A de facto minimum price has thus been devised.*

- Government Decree no.450/24 June 1999 has significantly relaxed the previous limitations. [49] While the situation has been improved, the complexity of the legal provisions means that there is still going to be an undue waste of resources by organizing successive auction sessions. *Conceptually, even the relaxed pricing limitations do not make much sense. If there is competition for the acquisition of a particular share package, the price will anyway be set at the best level that the seller can get. Nothing prevents the prospective buyers from waiting until the price declines to the maximum level they are willing to pay. Yet, time and resources will be wasted in the process.*

IV.3. Sales through direct negotiations; issue of investment commitments

The history of these kinds of sales shows that they have been triggered by various considerations. Initially, in 1995, they have been indicated by legal acts as being the venue for selling companies “for which potential investors had expressed interest or have drafted and submitted to SOF a realistic business plan, or for which SOF has drafted a business plan which could attract such investors”. Subsequently, the legal requirements were made less explicit, via the mention that direct negotiations are to apply whenever “the sale is addressed to a strategic investor” (or when, after having attempted an auction, only one offer has been received).

It nonetheless appears that the 1995 formulation was still orienting the choice by SOF of this particular method. This is because the existence of expressions of interest received at SOF had been used as a criterion for opting for the recourse to direct negotiation (in spite of those expressions of interest not being, in any way, binding) and, also, because the contract award criteria consist of a combination between price and investment commitments (which, in turn, presupposes that the potential buyers have a business plan).

The central element of the direct negotiation as a privatization method is the accent it puts on investment commitments made by the new owner. *A priori*, this can be regarded as a good thing. On one hand, it defuses the pressure put on the “price element” and, thus, allows transactions to be carried out at prices that are very low relative to the expectations, often irrational, formed by public opinion. On the other hand, this helps - theoretically, at least - to “ensure the future” of the privatized companies, and thus gives additional respectability to privatization.

Upon a closer look, however, both these advantages only exist because too high

expectations were built with respect to the virtues of privatization, and too many objectives are hoped to be simultaneously attained by the recourse to privatization. This is, at the end of the day, a cultural problem that cannot be corrected overnight. [50]

The experience of contracts awarded by direct negotiation by SOF shows that, apart from the two advantages mentioned above (which, moreover, are immaterial and, as such, impossible to ascertain), **the issue of the investment commitments is a constant source of troubles.**

A first category of problems derives from the questionable conceptual merits of the idea to “ensure the future of the company” by binding the new owner into a schedule of pre-determined investments which it has to make.

- there is an *implicit assumption* in this idea *that the new owner will lack the motivation needed for doing what is best for the company* it took over, despite having paid something for acquiring it and having everything to gain from an improvement of the company’s performance;

- the investment commitments have, as an automatic counterpart, a lower price paid directly to the seller for the acquisition of the company; this has a good side, because over-optimistic price expectations can be overcome by pointing to the “aggregate value of the transaction”. However, experience shows not only that criticisms against the low price obtained have seldom been silenced by this “computation trick”, but also that - in many cases - the trade-off between the price and the investment commitments led to foregoing real money for the hope of future investments which eventually did not materialise;

- since both elements (price and investment commitments) have to be taken into account for the purpose of awarding the contract, problems have arisen whenever more than a single contender existed for the acquisition of the share package put on sale. Aggregating a score from the two elements necessarily entails subjective judgments of the respective weights attributed to each of the two elements, and also complex computations to ensure comparability (net present value of commitments spread over several years, further complicated by the need to make exchange rate forecasts; comparability of in-kind investments with cash investments etc.). This makes the deal far more vulnerable to challenges by the rejected bidders, which *cannot increase acceptability of privatization by the society at large, although this is precisely what the recourse to investment commitments is supposed to achieve.*

- finally, there is an interesting, though overlooked, issue of principle: it would appear that *a bidder which is successful thanks to its investment commitments gains twice*: on one hand, because it pays less for the shares acquired than otherwise; and on the other hand, because its own subsequent investments are, first and foremost, beneficial to itself (insofar as they increase the financial performance of the company it owes).

A second set of problems stemming from the recourse to investment commitments pertains to the extreme difficulty of securing that they are actually done.

To begin with, there is a *need to “tie up” considerable resources for monitoring*

the implementation of the contractual obligations and less resources for carrying up the main function, which is privatization. Conversely, if monitoring is not adequate, the very objective of the investment commitments is lost, not to mention the legitimate frustration of those potential buyers who have been evicted for not having matched a winning bid which turns out to be a fake.

Secondly, there is a *big risk for privatization to be reversed*, the size of which should not be under-estimated. [51] Apart from rendering necessary new attempts at privatizing companies already sold out in the past, considerable legal problems are foreseeable: there are many chances that lengthy legal disputes will be engendered at the initiative of control bodies claiming that the “temporary owner” had financially frustrated the company.

Thirdly, there is *no fool-proof method of guaranteeing that investments committed will actually be done*. All methods so far attempted by SOF are either ineffective or prone to abuse. The issuance by the buyer of a bank guarantee (or any other form of security) which can be executed if the investments promised are not made is toothless, because the guarantee is issued to the beneficiary of the investments (the company itself) and one cannot reasonably expect that the company will execute its owner. Guaranteeing the investments by not transferring the full ownership of shares until these are done leads either to the non-materialization of the corporate governance improvements which privatization is supposed to bring, or can be abused. [52]

Fourthly, *the non-fulfillment of investment commitments may well be justifiable and in the best interest of the company itself* if, for instance, the conjuncture of the market changes to such an extent as to render the initial business plan unrealistic. Only central planners entertain the illusion that a program spread over 3-5 years can be immutable or only revisable upwards. In centrally-planned economies, under-fulfillment of plan targets is anathema, while over-fulfillment is always commendable, when not outright “planned”: Romanians should still be familiar with the early-70s general mobilization for fulfilling the 5-year plan within only 4.5 years.

All above considerations plead in favor of a much more parsimonious recourse to the element “investment commitments” as part of privatization deals than used to be the case until now. Ideally, these should be used only for the purpose of privatization of public utilities, where natural monopoly aspects (and/or the supply of “public goods”) would justify this approach in the interest of the consumer/user.

Having recourse to investment commitments for motives pertaining to the interest of the producer (i.e., the privatized company) is dubious from the point of view of its economic rationality and, certainly, overly complicated in its implementation. While fully appreciating the “cultural pressure” leading to this option, it is certainly possible to limit it to only a handful of very large industrial companies, where political sensitivity is really insuperable.

IV.4 Sales directly on the capital market: the big illusion

The recourse to this privatization method is “older” than many now remember. In fact, already in the fall 1994, SOF has carried out - in tandem with the POFs - a “public offering program.” [53] Privatization on the capital market proper only began in earnest in 1997: September for a sale at the Bucharest Stock Exchange (BSE), October for five sales on the RASDAQ. The subsequent year (1998) was a “trial and error” period, and it appears that this method has only reached its “cruising speed” starting with 1999. The outcomes in terms of number of companies privatized, however, are very different from the expectations built by the main proponents of this method: annual numbers can still be counted only in tens (and maybe, soon, in the low hundreds), while the initial expectations had assigned to this method the task of privatizing several hundreds of companies already in 1998.

The degree to which the expectations vested in this method have, so far, been defeated is a reflection of the unrealistic assumptions which have driven their proponents. Yet, depending on their position, the tasks assigned to capital market privatization were very different.

As already mentioned above, at the level of SOF, capital market privatization has been regarded as a convenient means for palliating to self-induced constraints relative to pricing within auctions (i.e., the fact that minimum prices had been devised), whenever the recourse to direct negotiation was also deemed inappropriate (for various reasons: no expressions of interest received, only minority stakes still held by SOF etc). In other words, with few exceptions, the company portfolio destined to capital market privatization mainly consisted of companies deemed “unfit” for other privatization methods. Therefore, **the size of the task entrusted to capital market privatization mainly reflected the extent of actual or expected failures of the other methods.**

Thus, instead of correcting the flaws of the two other methods, which should have been clearly discernible, an attempt was made to see whether capital market privatization cannot work even against the odds. A “trial and error” has been deemed necessary in order to ascertain problems, the existence of at least some of which could have been identified by theoretical reasoning. To be fair, not all the constraints inherent to the application of other privatizations method were of the SOF’s own making. Although the preparation of capital market sales is laborious and resource-consuming, at least it has the merit of leading to straightforward results whenever a deal can be closed: the price is paid immediately and no further monitoring of contractual stipulations is required.

This makes it possible to avoid the unwarranted problems stemming from:

- legally-mandated obligations to consent to “soft” payment terms in favour of buyers privileged by the legislation (i.e., the employees), while at the same time SOF is legally bound to ensure the equal treatment of all bidders; it is, nevertheless, obvious that two bids cannot be compared solely based on price if the price proposed

by one of them is “discountable” because of far more generous payment terms;
➤ the above-mentioned difficulties of monitoring and securing the implementation of investment commitments made as part of direct negotiations.

It is, thus, not entirely SOF’s fault that **capital market privatization has in many cases been chosen as the preferred venue “by default”, namely because of the flaws displayed by other methods, and not thanks to its own merits.**

At the end of the day, in spite of its own inherent problems (which are explored below), capital market privatization has indeed alleviated the problems raised by other methods. It allowed for “one-off” deals to be carried out, spared from the specter of possible reversals (because the price is not being paid, or because investments are not undertaken). Also, it allowed for the price issue to be treated in a more relaxed manner.
[54]

At the other end of the spectrum were the actors of the capital market (brokerage houses, regulatory bodies and self-regulating bodies, administrators of the logistics). While these would have preferred that SOF’s offer on the capital market is significant in both qualitative and quantitative terms, they eventually settled for quantity. This is a reflection of the serious decline of the Romanian capital market from the “peak” it recorded in 1997. Since the size of the capital market operators had been already dimensioned so as to accommodate the requirements of a “bull” period, the subsequent sluggishness has raised for many the specter of under-employment.

As a result, SOF came under violent attacks in the second half of 1998 for, ostensibly, being responsible for the severe drops of capital market indices because it did not sell, while less self-serving assessments would have pointed to the fact that a larger supply on behalf of SOF should normally have sent indices further down. In fact, this was probably not the case, given the characteristics of the company portfolio destined by SOF for the capital market.

In order to clarify this assertion, one should tackle the third side of the triangle, namely the prospective buyers. The nature of SOF’s company portfolio (and, *a fortiori*, that of the portfolio destined for capital market privatization) is such that it makes it a more suitable target for *direct investors* (interested in acquiring a controlling stake) than for *portfolio investors*. This, at its turn, is a reflection of the generally large stakes held by SOF (susceptible to give control to whomever buys them), as well as of the distribution of the other shares within a particular company, where either SIFs or third parties - to which SIFs had sold “wholesale” previously - have very large minority positions.

Consequently, the market for trading such shares is either very thin or particularly prone to distortions, features which cannot give comfort to a portfolio investor, interested first and foremost in capital gains which could be obtained. At the same time, the above-mentioned distribution of shares also makes it less likely that a portfolio investor would be interested in buying into a company before this is safely placed under private control –

that is, reputed to be managed in a logic of maximizing the profit (rather than the utility of insiders).

The above considerations indicate the existence of a **considerable “mismatch” between the utility functions of each of the three categories of actors playing in the episodes of capital market privatization.**

This is due, in the first place, to the disregard of the sheer essence of privatization transactions best suited for implementation through the capital market. Let us not forget that the main element normally distinguishing “genuine” capital market transactions from other privatization transactions is the fact that they address a very extensive “pool” of individual investors, which cannot be identified with utmost precision either before the deal, or after its conclusion.

Broadly speaking, the primary appeal of this venue is not that it helps fulfill the objective of speedy divestiture, but rather that it helps increasing the transaction value, providing larger amounts of cash (than would otherwise be the case) to the seller and/or to the company itself, when primary public offerings are carried out in conjunction with secondary ones. This also means that the appropriate “products” for this privatization method belong to a very limited range of sectors (typically, public utilities). Under normal conditions (that is, if not undue “straitjackets” are put on carrying out other privatization methods), there is nothing that these other methods cannot achieve, while the recourse to capital market can. Finally, there has to be enough comfort offered to the portfolio investors, and this normally cannot be achieved unless the company is controlled by trustworthy and accountable private shareholders (it is debatable whether SIFs meet this description), or a sale by the state to entities which fulfill this criterion is carried out in parallel.

Apart from the inadequacy of the “merchandise” so far destined to the capital market, there are ***problems at the receiving end of this supply as well***. These had been theoretically identified long before the debate on the pros and cons of capital market privatization in Romania has even started. A paper issued, already in 1993, under the aegis of OCDE’s “Center for Co-operation with European Economies in Transition” has sounded what appear to be, in retrospect, very wise words caution:

➤ “For the time being, in view of the poor economic condition of enterprises in the region, other mechanisms will be preferred in terms of enterprise privatization. Capital markets [...] will take on more prominence after the initial mass transfer of ownership to the private sector is accomplished”. *The “accomplishments” of the Romanian breed of mass privatization have been discussed, in some detail, in the second chapter of this paper.*

➤ “many observers feel that the IPO method cannot be the primary vehicle for privatization in Central and eastern Europe [because of] very narrow markets, with low liquidity and high volatility”; *One should point out, however futile this might be, that the current state of the Romanian capital market is not exactly*

characterized by a significant “depth,” and that its recent relative stability is the result of having hit the bottom, rather than that of having exhausted, for the time being, its growth potential.

Last, but not least, in order for the capital market privatization to yield better results, significant progress should be made in *ensuring the consistency of capital market regulations with privatization norms*. Also, capital market privatization would be greatly helped if the National Securities Commission would finally manage to make consistent rulings, instead of constantly seeking novelties, which yield questionable results from the standpoint of the purpose they are meant to serve (increasing transparency and improving the protection of small shareholders), while imposing extremely high adaptation costs to SOF. Not to mention that a highly-volatile regulatory framework is seldom conducive to the fulfillment of any of the two goals ostensibly sought. Although these problems could be regarded as mere technicalities, they take a high toll on the effectiveness of the seller’s efforts. [55]

V. EXTERNALITIES WITH IMPACT ON THE PRIVATIZATION PROCESS

There are four categories of problems, totally outside of SOF's purview, which are negatively affecting the privatization process. Moreover, they are bound to take an increasing toll on the pace of privatization because, as "problem-free" transactions are progressing, the pool of companies remaining to be privatized is affected to a larger extent by these problems.

V.1. The issue of land ownership

The problems arising from the decade-long stalemate in the resolution of this issue are twofold. On one hand, the privatization of several hundreds of state farms, with a cumulated surface of around 1.7 million hectares, is postponed *sine die*, while the financial performance of most of them has deteriorated dramatically. This, at its turn, has severe macroeconomic consequences, as explicit and implicit subsidies are constantly being thrown at these same farms, in an elusive attempt to keep them afloat.

On the other hand, non-resolution of land ownership issues hampers also the privatization of other companies. State enterprises privatized before obtaining valid titles for land are legally mandated to increase their share capital once they obtain such titles, and to surrender the shares issued as counterpart to the state. This raises the prospect of earlier privatization transactions being reversed or, at least, needing additional sales of state-held shares. Such a situation is not convenient for either the buyer, or the seller.

The former is faced with a considerable uncertainty, as a result of which he might even give up the intention to buy altogether, or a significant "discount" (reflecting the risk perceived) affects the price he is willing to pay for acquiring the state-owned shares.

As far as the seller is concerned, the fulfillment of legal requirements represents an undue addition to its post-privatization monitoring burden, and also entails carrying out additional negotiations and transactions further to the increase of the share capital with the value of the land.

The most recent legal changes concerning this aspect sought to reduce these negative implications, notably by giving the buyer a right of first refusal for the acquisition of newly-issued shares. This is still far from solving the problems. First, this right only applies for the percentage of newly-issued shares corresponding to the stake it holds in the company. Therefore, the rest of the newly-issued shares have to be put on sale separately. Secondly, the price at which the pre-emptive right can be exercised is the price paid for the initial shares acquired from the state. This stipulation, meant to avoid difficult negotiations, is sub-optimal because the parameters of the two types of deals are different, so the shares should not be identically priced.

The above problems are indicative for the perfectionism and over-regulation

*which still characterizes the privatization legal framework. Given the utmost importance of privatization, one can and should be much less preoccupied with such technical details. Moreover, if companies were not able to obtain legal land deeds before privatization, this is to a great extent the fault of the state (unclear legal provisions, unsatisfactory activity of the specialized bodies in charge of making the measurements and determining the boundaries between land plots, etc). In the light of the above considerations, it would not be excessive for land plots which had not been included in the equity capital of a company prior to its privatization to be **treated as “windfall profits” of the privatized companies** as and when land titles are obtained.*

V.2. The issue of restitution of state property originating in nationalizations

The restitution of nationalized property is an issue with very strong moral and political overtones. Irrespective of how it is handled, though, there is no reason for it to affect the privatization process, at least not to the extent it currently does.

Practically, ever since a legal framework dedicated to privatization was first put in place - back in 1991 - barely an “omnibus” piece of privatization legislation has been passed without containing some sort of ritual provision according to which the situation of goods which have been nationalized by the state will be dealt with by a special law. In some cases, deadlines were even set for the enactment of such a law. Yet, *the fact is that after fully a decade since the overthrow of the communist regime, **such a law does not exist**. This state of play borders on the irrational. One cannot continuously refrain from deciding whether privatization transactions are or not protected from restitution claims, because this task is explicitly assigned to another law, which has not been enacted in almost 10 years.*

The importance of the problems created for the conduct of privatization by the uncertainty surrounding the restitution issue can be gauged from figures computed by SOF at the end of 1998 concerning only two sectors: tourism and commerce. They show that the existence of legal disputes concerning ownership, and triggered by restitution claims, was affecting the privatization of 70 tourism companies and of 50 companies operating in the commerce area.

The most recent reshuffle of the legal framework for privatization makes a commendable attempt to reduce the uncertainty faced by the new buyers, notably by guaranteeing the new owners the right to compensation for any fixed assets (generally, buildings) which their companies could be obliged to surrender following successful restitution claims.

However, in a way, this very same Law (no.99/1999) somehow increases uncertainty by implicitly upholding the principle of in-kind restitution. Compensating the new owners, even if guaranteed by the state, is a sub-optimal solution not only because the amount of the compensation will most likely trigger disputes, but mainly because the operations of some companies would be severely disrupted by applying the principle of

in-kind restitution. The law palliates only to a small extent this latter problem, by stipulating that buildings cannot be restituted in kind, if this would trigger “the dissolution and liquidation” of the company.

This is yet another illustration of perfectionism and over-regulation. After all, the above-mentioned law implicitly recognizes that restitution in-kind to former owners is not the only way of solving their justified claims. And, indeed, from a constitutional standpoint, this is admissible: Art.41 of the Romanian Constitution allows expropriation, provided it is in the public interest and proper compensation is given to the owner. One could hardly see what general interest could be more important than furthering privatization. If so, it should be possible to legislate that any nationalized assets which are included in the capital of enterprises slated for privatization cannot be returned in kind to their former owners, who would instead be compensated by the state.

Between the option of compensating former owners for their property nationalized by the state and that of compensating new owners for property they might need to retribute in kind to previous owners, the former option makes much more economic sense. First, it would eliminate a non-trivial stumbling block to privatization transactions: by removing the uncertainty perceived by would-be investors, more deals could be concluded than otherwise and at higher prices. Secondly, it would also avoid unnecessary disruptions to the activity of a private company, the costs to which - arising from restitution to previous owners - would clearly exceed the benefits to the latter from in-kind restitution (as opposed to compensation).

V.3. Issue of debts accumulated by privatizable companies

The problems to privatization generated by this issue have already engendered a very pernicious “*vicious circle.*” On one hand, the *large debts* accumulated by privatizable companies have come to *block an increasing number of privatization transactions.* On the other hand, *the longer privatization is postponed, the higher the level of accumulated debts will be.*

The circumstance that, in all cases, a large part of debts have been incurred towards various budgets included in the public consolidated budget should offer the means to break this vicious circle. This would require, however, the breaking of some mental “taboos” of the authorities in charge, by acknowledging the existence of some simple truths, which have been consistently been shunned until now.

Any privatization transaction takes into consideration both the assets and the liabilities of the company put on the block. The idea according to which a company can have, in abstract, a sort of “intrinsic value” is not only theoretically flawed, but has also been constantly repudiated by the practice of privatization deals attempted in the past period. [56] There are numerous, and ever growing, cases where the sheer assumption by the new owner of the obligation to pay back the debts previously incurred by the company (or, only a part of them) is the maximum financial result of a privatization

transaction which can reasonably be hoped for. It is, thus, **crucial that both facets of privatization transactions be integrated and dealt with simultaneously: the price paid for the purchase of state-owned shares, and the assumption of debts previously incurred by the company.**

So far, neither SOF nor other public institutions acting as sellers of state-owned shares have been given the levers allowing them to integrate, within a privatization transaction, the two above-mentioned aspects. This, despite the fact that the existence of very serious problems entailed by the “debts issue” has finally been formally acknowledged by the authorities, over the course of 1998.

*Apart from the extreme delay by which a response was attempted, this is still woefully inadequate, because it is **minimalist in substance and overly complicated in form.*** The relevant recent episodes which substantiate this assertion are described below.

- In the first place, one should mention the legal provisions made - by way of a Government Emergency Ordinance (no.15) issued in September 1998 - to the effect of empowering the Ministry of Finance to take over, in selected cases, the responsibility of beneficial shareholder on behalf of the state. This mechanism, inadvertently described as “debt-equity swaps,” has already been mentioned above, in conjunction with its institutional implications. From the point of view of its usefulness for solving the problem entailed by the large liabilities accrued to privatizable companies, this mechanism appears plagued by serious conceptual shortcomings:

- while implicitly recognizing the simple truth that a heavily indebted company cannot be privatized without a work-out of its debts, it stops short of providing for the most obvious solution, which consists of accepting a discount of the budgetary claims; instead, it envisions complicated contractual stipulations regarding the rescheduling of debts;

- it devises mechanisms lacking sound business justification (such as the conversion of debts into additional shares) which have already been attempted with resounding failures: e.g., the aborted sale of TRACTORUL Brasov in the fall of 1998, because the buyer asked for a discount of the debts towards the budget, but was offered instead a complicated combination of rescheduling and equity capital increase on behalf of part of the debt, with the buyer only being granted the right of first refusal for the acquisition of the new shares for a specified period.

- budgetary claims cannot be genuinely recovered by selling equity of debtor companies which is already state-owned: revenues would simply be collected by the budgets under a different heading.

The ineffectiveness of the mechanism for sorting out the problems entailed by selling large companies with high outstanding debts is not only presumed on the basis of its conceptual flaws. It is also confirmed by the first implementation attempts. By end-September 1999, only 10 companies of no particular relevance had been included in the exercise. Even assuming that the mechanism will work in these cases, this will have negligible positive effects, because the biggest problems are encountered by the

privatization of large and very large companies.

- A positive development has been entailed by the issuance - on 25 November 1998 - of a common Order of the Ministry of Finance and SOF, according to which officials of the Finance Ministry will participate in privatization negotiations carried out by the SOF, with the mandate to negotiate various debt-restructuring clauses: rescheduling of the principal, reduction or cancellation of penalties accrued for non-timely payment, and grace periods for the repayment of the obligations.

Relative to the previous lack of any formal co-ordination, this can be regarded as a step in the right direction. Its significance, however, is limited by:

- the fact that it only concerns debts accrued towards the State Budget (thus, leaving aside the debts towards other important components of the consolidated public budget);
- the discretionary character still left to the debt work-out exercise;
- and
- the imposition of useless procedural “straitjackets,” such as the difference in treating the principal of debts (which can only be rescheduled), as opposed to the penalties (which can be reduced or even cancelled).

The simple truth that money is fungible, and that there is no reason for treating debts as a whole, has been disregarded for the sake of abiding by bureaucratic rules: the extent of the “concessions” which can be granted by the Ministry of Finance only replicates the content of an older Ministerial Order dealing with the procedure for alleviating the debt obligations of any corporate taxpayer. In other words, relative to the way the Ministry of Finance handles any application for debt alleviation, all that it accepted to do for the sake of facilitating privatization was to negotiate (as opposed to just rule on a request) and to do so at the same time that privatization negotiations are conducted.

- Some progress can also be discerned from several stipulations of the latest version of the Privatization Law, as amended in May 1999.

- first, among the “principles” of the privatization process, the law explicitly mentions, for the first time ever, “the *reconsideration* of the debts of the companies, with a view to increase the attractiveness of the privatization offer.” This is a welcome acknowledgement, albeit too sibylline, of the crucial need to treat the former debts of the companies put on the block as part and parcel of the privatization deal, on the same footing with the price paid for the shares sold and the investment commitments. It would have been even better if an explicit acknowledgement had been made of the fact that budgetary claims towards those companies can be discounted.

- secondly, from a procedural standpoint, the law introduced the novel concept of “certificate of fiscal obligations” which potential buyers are

entitled to request, and which the Ministry of Finance is obliged to deliver. The certificate is meant to include all budgetary claims on the company offered for sale, with the corollary that the company is exonerated from any other budgetary claims whose existence is unveiled subsequently. This should avoid problems of the kind that plagued earlier privatization attempts, because the Ministry of Finance disavowed the amount of fiscal obligations mentioned in tender dossiers prepared by the SOF. Nevertheless, it only serves the purpose of “freezing” for a certain period the obligations towards the budgets. In other words, it helps preventing the underlying problem from growing, but does not reduce its size.

➤ finally, explicit reference is made to the fact that the debts towards the budgets of the company put on sale can be renegotiated. Also, budgetary creditors are now obliged to enter into such negotiations, upon the buyer’s request, and any divergences would be submitted to the Cabinet for arbitration. Unfortunately, this still stops short of providing for an automatic mechanism for debt alleviation: the “arbitrage” by the Cabinet, besides being time-consuming, can only be applied to a limited number of cases; and precedents (such as the TRACTORUL case) show that the Cabinet is not poised to take a very flexible approach on such matters.

However counter-intuitive this may sound, this author would dare to say that **the progress recorded in the last year with respect to the treatment of debts incurred by privatizable companies does not augur well for the future**. This is because, although the authorities have clearly become aware of the existence of this problem and several practical demonstrations were made of its pernicious impact (i.e., several deals aborted because of it), the response has been extremely cautious. A lack of any reaction would have suggested a corresponding lack of awareness, but the minimalist stance taken suggests the existence of deeply-embedded mental “taboos.”

Yet, there are compelling reasons for putting in place an automatic mechanism for discounting existing debts towards the budgets, by integrating them with the issue of the price paid for the shares sold by the state. The benefit from such an approach, in terms of allowing the privatization of many large companies, should be obvious.

And the corresponding costs are non-existent, in spite of fears being expressed to the contrary. In strictly formal terms, one should bear in mind that the possibility of discounting state claims is explicitly accepted in the case of official loans made by Romania to several developing countries during the Communist period. Given the importance of privatization, there is a strong case for having a bolder (instead of a more cautious) approach with respect to the state’s claims on domestic enterprises subject to privatization.

It is also high time that debts incurred by state enterprises towards the budgets be treated as what they actually are: implicit subsidies, granted over time, via the non-enforcement of hard budget constraints. From this perspective, giving up the elusive goal

of full recovery of budgetary claims amounts to no more than accepting the legacy of a past period characterized by an extreme laxity of state creditors.

On the other hand, the costs associated with such an automatic approach can safely be minimized. No significant problems can be engendered for the execution of the creditor budgets because, anyway, the debt service obligations of the debtor enterprises are already heavily discounted in the projection of the budgets' revenues. In other words, the "sunk costs" character of these debts is already acknowledged. This leaves the moral hazard problem as the most important negative consequence to be derived from an automatic debt alleviation exercise. Yet, unlike in any other cases of debt alleviation (which are, anyway, carried out on a large scale by budget creditors), this risk is far less likely to occur in the case of debt reductions directly linked to privatization, because this can only be a one-off exercise.

V.4. The protection of the workforce employed in privatized companies

This consideration has affected the privatization process to varying degrees and in different ways over time. Thus, in the first years of the process, the objective of keeping in place the initial level of employment (or, at least, to avoid significant layoffs) has been indirectly achieved, by the absolute prevalence of MEBO transactions. As already shown above, one of the main reasons behind the insistence with which the employees sought to secure the privatization of "their" company by MEBO, to the exclusion of other methods, has been the enhanced job security perceived as arising from the double status of employee and owner.

After the MEBO transactions started to fade away, the preoccupation for avoiding the fact that privatized companies generate significant unemployment has begun to be reflected in legal provisions introduced to this effect in the privatization legislation. A first implicit reference to the preservation of jobs can be found in a Government Decree (no.887/1995) issued already in November 1995, according to which special clauses relative to employees are to be included in share sale-purchase contracts whenever the acquisition price represented less than 70 percent of the par value of the shares acquired. [57]

The issue of protecting the employees of privatizable companies received explicit legal consecration in August 1997, when a dedicated Government Ordinance (no.48/1997) has been enacted. The Ordinance imposed undue straitjackets on new owners, by a set of requirements with a very dubious justification:

- it became mandatory for any privatization contract to contain clauses "referring to the situation of the personnel, to its maintenance or its dismissal";
- if SOF was negotiating with the potential buyer the subsequent implementation of a restructuring program entailing layoff measures, the representatives of the employees were to be informed about this;
- should the privatization contract include clauses relative to collective

dismissals, adequate provisions were to be made concerning the compensations awarded to the employees laid off.

It appears that the content of the Ordinance reflected to a significant extent the trade union leader background of the Prime Minister then in office. Little, if any, regard was given to the actual possibility of implementing such tough provisions. Thus, not all privatization contracts can reasonably include stipulations about the fate of the employees: e.g., the share sales carried out directly on the capital market. Secondly, informing the employees about the prospects of collective dismissals already when these are being only negotiated is the perfect recipe for making sure that the trade unions will do anything in their power to block the privatization deal. And, finally, making mandatory the granting of compensation for the personnel made redundant, without clearly stipulating whose obligation is it to offer this compensation (the seller's or the buyer's?) is an obvious blunder.

Some of these imperfections were corrected by the Law no.99/27 May 1999, which at least made clear that the severance payments for employees laid off are to be covered out of the Unemployment Fund. Subsequently, amendments made in June 1999 to the general regime for severance payments introduced a number of new conditions directly linked to redundancies created further to a privatization transaction. [58]

The issue of the protection of employees within the negotiation and conclusion of privatization contracts is a tricky one. On one hand, it can conceivably be contended that this helps minimizing the subsequent opposition by the employees to the rationalization measures that the new owner intends to take. In a way, it is better for the potential buyer to be confronted with the opposition of trade unions before entering a contract, than to be prevented from running the company after acquiring it, because labor unrest becomes endemic. On the other hand, it "freezes" the new owner into a pattern of restructuring measures, agreed with the seller, but which reality would not necessarily validate: either because the actual state of the company taken over is different from the one known to the buyer before the conclusion of the contract, or simply because subsequent developments of the market render the implementation of the initial program inadequate.

Of course, the problems entailed by the preservation of the workforce are not similar for all privatized companies. Their manifestation crucially depends on the performance of the company itself. Yet, as the pool of companies "easy to sell" shrinks continuously, the marginal impact of employment factors becomes more important, the more so that it comes on top of other objective constraints to privatization of the kind described above in this same chapter. The stumbling blocks to privatization engendered by the preservation of employment display elements of a vicious circle, the breaking of which is not obvious.

A first such element stems from the moral hazard generated by state ownership. The collusion between insiders (managers and employees) which has been forged over the last decade in practically all state-owned enterprises, coupled with the excessive involvement of politicians whenever labor unrest erupts in state enterprises, has led to a

situation whereby *jobs in the state sector have come to be regarded as more secure than in the private sector*. Therefore, nearly any transfer of ownership from the state into private hands, regardless how many cushions are offered to employees, is bound to generate the opposition of the employees, the more so that these are still mesmerized by the pretended employee-friendly merits of MEBOs. This greatly reduces the virtues of special provisions regarding employment included in privatization contracts in terms of sparing the new owner from the problems derived from the opposition of trade unions. *The only way to overcome this problem consists in hardening budget constraints in the state sector. This is, however, extremely difficult, precisely because very inferior means exist for making state enterprises to act in a profit-maximization manner. At the end of the day, privatization is the main instrument for ensuring the tightening of budget constraints.* Ergo, the vicious circle mentioned above.

The inter-linkage between privatization and employment preservation can also be looked at from the perspective of the “policy-assignment theory”. In fact, what recent developments concerning the treatment of the workforce within privatization deals show is an **increasing tendency for using privatization as an employment policy tool**. It is true that the emergence of a dominant private sector (including, by transferring state property to private owners) is a pre-condition for unleashing an economic growth potential which state ownership suppresses. And, because a “rising wave lifts all boats”, more opportunities for job creation would thus be created. Yet, this is a *mediated effect of privatization* on employment. Instead, what is currently sought is a *direct and immediate effect*. By over-burdening privatization with employment objectives, the process is fatally slowed down, which means that its potential to eventually contribute to job creation is similarly held back.

REFERENCES

[1] The qualitative appraisal undertaken by the EBRD in its 1997 Transition Report shows Romania having the lowest score among all European economies in transition in what concerns “small-scale privatization” (on a par with Bulgaria) and the second-worst score in what concerns “large-scale privatization” (only bettering the performance of Albania).

[2] To give but one example, the tire-manufacturing venture started in Timisoara, at the beginning of 1999, by CONTINENTAL rests on the land and premises sold to the German-based multinational by the majority state-owned company UMT, whose own privatization was delayed as a result.

[3] A very low average size of land exploitations, coupled with scarce working capital and a relative lack of equipment, is bound to have led to lower-than-average yields in the privately-held segment of the agricultural sector. Besides, official GDP figures are likely to fail to capture a sizeable proportion of privately-produced agricultural output, given the important share of its use as self-consumption. Finally, the domestic relative prices of raw agricultural products have been declining ever since the beginning of the decade.

[4] Official statistics only kept track of the overall number of “regies” until end-1993 and - for national “regies” only - until end-1995.

[5] Some progress was nonetheless occurring during the tenure in office of the Vacaroiu Cabinet, between 1992-1996. Unfortunately, the developments were not consistent. On one hand, based on a Government Ordinance (no.15) issued in August 1993, some limited progress was made towards “corporatizing” whole “regies” or parts thereof. Such is, notably, the case of:

- the conversion into commercial companies of the wood processing “regies” ESTREL, VESTREL, and SUDREL;
- the partial restructuring of the monopsonistic grain storage “regie” ROMCEREAL into a smaller “regie” (ANPA) and 41 county-based companies called ROMCEREAL;
- spinning off some ancillary activities carried out by the mining “regies” and RENEL, and their reorganization as commercial companies.

On the other hand, commercial companies operating in the land improvement sector (irrigation, land reclamation etc.) were merged, as mandated by Law no.50/1994, into a large “regie”: RAIF.

[6] Very important, and long-delayed, legislation was enacted in December 1998. This is the case of:

- the “Law on Public Property and its Legal Regime” (no.213/1998), which enshrines the principle that public property rights belong to the state or the “local administrative units” for all goods which “by law or by their nature” are of public use or public interest. Goods belonging to the “private domain” of the state can be transferred into the “public domain” by way of Government Decrees or decisions of the local authorities, as the case may be. Goods belonging to the “public domain” cannot be used to constitute guarantees and cannot be seized by creditors. The use of goods belonging to the “public domain” can be entrusted, free of charge, to “regies,” public institutions or public authorities. In all other cases, they can only be exploited on the basis of rental or concession contracts.

- the Law on the Regime of Concessions (no.219/1998), which covers a very wide range of activities: *inter alia*, public transportation; transport infrastructure; construction and exploitation of hydro power plants; postal services; telecommunications; transport and distribution of electricity, oil, gas, and water; mining etc. Concession licenses cannot be granted for the exploitation of those “public goods, activities and services” where no regulatory bodies exist. Any concession can only be granted for no more than 49 years and entails both the right and obligation to “exploit the good, activity or public service”.

[7]

<i>Name</i>	<i>Field of activity</i>	<i>Authority</i>
National Regie of Forests	Forests	Ministry of Environment
Official Journal	Printing and publishing	Chamber of Deputies
National Printing Office	Printing	Ministry of Finance
State Mint	Coins and bank-notes	National Bank
Arsenal of the Army	Arms, ammunition	Ministry of Defense
“Romtehnica”	Military equipment	Ministry of Defense
“Multiproduct”	Products manuf. by detainees	Ministry of Justice
Adm. of State Protocol	Miscellaneous (incl. real estate)	General Secretariat of the Gov’t
National Adm. of Roads	Road construction/maintenance	Ministry of Transports
“Rasirom”	Miscellaneous	SRI (intelligence service)
RAMI-Dacia	Miscellaneous	Ministry of Interior

[8] There is, nonetheless, a caveat to be made in this respect. None of the successive privatization laws attempted to prejudge on the ultimate ownership of land used by state farms. Instead, both before and after the 1996 elections, they have consistently and explicitly upheld the principle that the legal status of that land is “in the process of clarification.”

[9] Relevant in this respect are the following two episodes:

- concerning the SOF: in a recent paper by the former Deputy Prime Minister who steered the 1991 Privatization Law from its drafting until its enactment, Mr. SEVERIN, it is contended that “some of the main critics and opponents of the privatization Law” were appointed, in 1992, to head the SOF;
- concerning the POFs: although supposedly private entities, organized as joint-stock companies, the first Boards of the POFs had been appointed by a Government Ordinance in August 1992, and their composition was changed so as to reflect the new parliamentary majority in March 1994, when the said Ordinance came to be considered for approval by Parliament.

[10] And, indeed, whomever had the patience and interest to run through the statements of top economic decision-makers within the successive VACAROIU, CIORBEA Cabinets cannot fail to notice the compulsive tendency to explain all economic evils by the poor performance of the SOF. And, what’s more, such statements cannot be dismissed entirely because, indeed (albeit to varying degrees), none of these Governments was in a position to implement directly its “own” privatization policy.

[11] E.g., trade policy measures such as “temporary,” yet dedicated, departures from the statutory levels of import duties or lists of goods which can only be exported under particular payment terms; measures ostensibly destined to “curbing financial indiscipline” by requesting companies to submit detailed financial statements to the informatics department of the Ministry of Industry; award of various non-transparent forms of subsidies, etc.

[12] The hypothesis that, in designating NAP as a “hub” of the system, special considerations have prevailed over pragmatic ones, is supported by the total lack of preparedness of this institution in all respects: staffing, territorial network, logistics etc. A frantic drive ensued to palliate to these shortcomings which included, *inter alia*, the takeover from the Romanian Development Agency of local (county-level) branches, as well as the purchase of adequate IT equipment with the support of international donors. This patent non-preparedness, coupled with the “turf-enlargement” motivations of any bureaucracy, has eventually led to the bypassing of NAP by other Government bodies - the General Secretariat of the Government, the Informatics Department of the Ministry of Industry - which have eventually come to *de*

facto assume tasks initially entrusted to NAP. The end-result is that, for almost three years after the supposed completion of the MPP, problems regarding the share subscription-cum-allocation process have remained unsolved, whereas no single Government body had all the means and information required for their resolution.

[13] Subsequently, this provision became the crux of personal rows between the then Minister for Reform and the Chairman of SOF's Board. While the former kept contending that that SOF's chairman should report directly to him, the latter acknowledged only the authority of the Prime Minister.

[14] This thesis may be regarded as inconsistent with the earlier assertion to the effect that "*regies*" have abundantly been set up also in sectors with no special characteristics justifying the direct involvement of the State. Granted, in such cases nothing would prevent SOF from doing as good a privatization job as the line ministries formerly in charge of those entities, or even a better job, given that SOF's staff has far superior experience and knowledge of privatization-related matters. However, if the "pros" and "cons" of this approach are cast against one another, the turbulence entailed by the abrupt change of the identity of the shareholder on behalf of the state risks outweighing the merits of a more "professional" approach (backed by experience) towards the strictly transactional aspects of the privatization deal.

[15] Their contribution to the privatization transaction, in terms of past experience and knowledge of relevant "best practice," is almost certain to dwarf the corresponding "value-added" which SOF could bring to the process.

[16] Following the takeover, in June 1998, of the sole shareholder prerogatives by the SOF, new terms and deadlines had been announced to the investors which had already expressed interest in the transaction. The change of the "rules of the game", justified by SOF as a way to increase competition, has finally lead to the withdrawal of the only putative competitor of the eventual buyer. Press reports were eager to blame either of the two Romanian parties successively entrusted with the task of privatization process. A more balanced perspective would have shown that, since they were subject to different sets of legal procedures, the two entities had actually been forced to act differently.

[17] The reversal to the imprecise formulation which, for several months in 1997, soured the relations between SOF's chairman and the Deputy Prime Minister in charge of economic reform, may well have been deliberate. This is because it implicitly entails the direct authority of the Prime Minister. This is tantamount to the assumption by the Prime Minister of the function of *de facto* Minister of Privatization. A legal consecration was thus given to the prevailing state of play, since it was Prime Minister VASILE who assumed the function of Minister of Privatization *ad interim* following the resignation, in October 1998, of Mr. DIMITRIU.

[18] The term "strategic" is used here strictly in the meaning it has in the theory of games. A sector-wide approach would be useful wherever there is chronic over-capacity, a relatively narrow (mostly substitutable) range of goods produced, and high concentration on a limited number of companies of very large size, which moreover tend to be the largest single employers in regions with a non-diversified economic profile. In such circumstances, and because of high legal exit barriers, leaving downsizing decisions in the hands of individual enterprises could tie them in a "prisoner's dilemma" of sorts, leading to sub-optimal capacity adjustment and extensive rent-seeking of the "beggar thy neighbor" kind.

[19] These entailed, in particular:

➤ remolding the assets of existing companies so as to separate the equity held by SOF from that owned by SIFs and to single out assets on which claims can be made either by existing tenants or by former owners (had the Ordinance explicitly attributed all these assets to companies controlled by SOF, some progress in clarifying long-pending issues would have been achieved but, unfortunately,

this was done by a lower-ranked legal act, i.e., Government Decree no.464/4 December 1999);

- special privatization procedures (sale methods, specific payment terms etc.);
- obligation for SIFs to divest within a given deadline (long since past);
- a peculiar distribution of proceeds from privatization: denying SOF any share of privatization revenues (i.e., not even allowing it to cover its transaction costs), and mandating companies to surrender proceeds derived from the sale of assets they themselves used to own. All this, in order to feed a “Special Fund” directly managed by the Ministry of Tourism!

[20] The National Authority for Tourism, which has justified its direct involvement in privatization by the need to protect the interest of companies operating in the area, sees no contradiction in effectively confiscating the largest part of the revenues derived by state-owned companies from the sale of assets belonging to itself. And the Ministry of Agriculture seems to find it normal that SOF be allowed to retain only maximum 20 percent of the revenues obtained from privatization, while the Agency placed under its own authority would be allowed to retain up to 30 percent of the proceeds obtained from concession royalties.

[21] Apart from the sibylline nature of such statements and the inherent contradiction they entail (a new owner should normally be allowed to run his business as he sees fit), they point to a fundamentally ambivalent attitude towards privatization which is discernible in many other cases as well. Privatization is deemed desirable, but only to the extent that the state can still patronize the private entities.

[22] This attempt revives an older, yet very heated, controversy sparked by the creation, in 1996, of a wide-encompassing holding-type structure in the oil sector (the “Romanian Company for Oil”), which had included all Romanian oil refineries alongside the oil extracting *regie* and several companies with *de facto* monopolistic positions in the port handling and transportation of crude oil. Ostensibly in order to restore a competitive framework (but also because this was a condition for the continuation of an important project loan granted by the World Bank), that structure was dismantled in 1997. It gave way to a much lighter structure (the “national company” PETROM), which surrendered all infrastructure companies and retained only two refineries. Since PETROM is placed under the authority of the Ministry of Industry and Trade, the assertion of the latter’s control over PETROMIDIA and RAFO would be tantamount to the partial reconstitution of the defunct “Romanian Company for Oil”.

[23] An Executive Committee, made up of executive managers, has supplanted the Board for most of day-to-day decisions, but the tradition of having the Chairman (or, in his absence, the Vice-Chairman) of the Board directly in charge of running the institution (in spite of it now having one Executive Director, as well as a Deputy Executive Director!) has been maintained.

[24] Political clientelism was ripe in making these appointments. Moreover, SOF’s appointees tended to be a very easy target for “regulatory capture” by the insiders (management and trade unions) of the companies they were supposed to supervise, also as a result of lavish benefits bestowed on them. Yet, since most of them owed their quality to political affiliation, their link and direct accountability to SOF was diluted, meaning that - ultimately - SOF bore the blame for many decisions taken by these persons, which it had neither triggered, not explicitly condoned.

[25] Yet, there are reasons to believe that the concern for the “future” of privatized companies is not peculiar to the role of large administrator of the State’s wealth, but is rather a generic cultural feature. It is worth noting how quickly this mental stereotype related to privatization has come to be internalized by the Ministry of Finance even before actually carrying out its first self-conducted privatization transaction (under the misleading label of “debt-equity swap”): witness the condition according to which any alleviation of the privatized company’s debts towards the budget should be “paid” by the new owner, with the commitment that it will keep alive the company acquired for at least five years.

[26] To this, the author would add that the above-mentioned excessive preoccupation with “the future of privatized companies” (investment commitments of the buyer, commitments to keep the

workforce), which entails long and laborious monitoring of privatization contracts already concluded, can be read from the same angle: prolonging the existence of the SOF.

[27] This was a particularly effective way of “privatizing” the biggest, formerly monopolistic and sectorally-specialized, foreign trade companies (such as INDUSTRIALEXPORT, METALEXPORT, ELECTRONUM), and was also used to dilute the state’s stake in two major state-owned banks: BANCA AGRICOLA and BANCOREX.

[28] cf. Gh.Zaman, in *Adevarul Economic no.261/14-20 March 1997*

[29] Corporate governance, therefore, rests on a precarious basis, irrespective of the relative strength of managers and employees, respectively. If the latter are weak (*inter alia*, because they have a not very significant stake in the company), they are prone to be taken hostage by the employees, leading to the old Polish (or Yugoslav) syndrome of “Workers’ Councils in command”. Even if managers are somehow firmly in control (usually, whenever they have used “front-men” to acquire larger stakes, or have engineered “shareholders agreements” preventing shareholders from freely disposing of their acquired shares, and/or have amended the by-laws of the company so as to exercise control without high proportions of shares actually owned), corporate governance is bound to be perverted: pursuing profit maximization would mean sharing with others, while engaging in dubious deals at the company’s expense would enrich managers more and faster than merely collecting dividends.

[30] Theoretically, the very same problems would emerge in case of “free distribution” privatization methods, except that, in the latter cases:

(a) there are weaker barriers to the re-concentration of capital in the hands of “strategic investors” (e.g., no “shareholders agreements” preventing the free disposal of shares); and

(b) the shareholders are not overwhelmed by the obligation to make - over a long period - annual payments on account of the shares initially purchased.

[31] This is more likely in the case of MEBOs than for other “cash sales”, because of the cultural background which makes employees far more eligible for this kind of leniency (because “it is not their fault”) than “capitalist owners” (in whose case the difficulties to honor their payment obligations are regarded as *prima facie* evidence of an attempt to cheat).

[32] It is true that very few COs had been actually exchanged for shares, and those so used had almost exclusively been involved in MEBO deals. Thus, pretty much no concrete demonstration had been made to the public at large as to how COs could be used in “real” privatization transactions. It was only in the spring of 1993 that the POFs first announced a money value of these certificates (ROL 134,000), and they kept adjusting it upwards, to a level of ROL 225,000 when the details of the MPP started to take shape. Quite understandably, a number of COs had been bought and sold for cash at prices determined by their relative supply and demand, much below the values announced by POFs, because of the above-mentioned lack of concrete demonstration of their usefulness. Some concentration in the holding of COs was therefore bound to occur, the more so that this was perfectly legal under the prevailing Privatization Law. The Government fiercely contended that a handful of persons had amassed millions of COs, therefore being in a position of taking over a sizeable chunk of the Romanian economy, after having paid only peanuts for acquiring the means allowing them to do so. **This assertion has never been proven, however.** If anything, the only quantitative estimates available pointed to the opposite: a poll conducted by a specialized institute had found that no more than 900,000 certificates were being held by persons other than the original beneficiaries, while the POFs’ own estimates showed an even lower figure: 700,000 COs. Such evidence was no match for the ruling party, one of whose prominent leaders went as far as saying that “5-6 million COs are held by 34 (sic!) persons, the sponsors of the Privatization Law.

[33] This is not currently a hollow menace, given the hints of some opposition parties at undoing privatization transactions once they will get back in power. Although circumstances are different, the

underlying logic is the same.

[34] Such was the case, in particular, of numerous foreign trade companies and, even more so, of the only two state-owned insurance companies (ASIROM and ASTRA). As far as the largest insurance company operating in Romania is concerned (ASIROM), all the 30 percent stake available for exchange against vouchers has been used up to the exclusive benefit of its own employees!

[35]cf. Earle and Telegdy (1998): *The Tortuous History of the Mass Privatization Program. The first empirical evaluation*, pp.11-12

[36] This is not a simple theoretical speculation, as illustrated by two categories of situations that occurred in the real world:(a) the case of companies which have declared themselves, as a result of the vote of the majority of shareholders, “closed companies” (i.e., whose equity is not publicly tradable, and where existing shareholders enjoy pre-emptive rights every time new equity is issued): SOF has thus become *de facto* the hostage of the other shareholders;(b) the legal requirement introduced in 1997, according to which - if proper land titles have been obtained and the value of that had not been included in the equity capital - SOF is barred from selling its shares before the corresponding increase of the share capital; yet, according to an additional requirement introduced in 1998, the product of the share capital increase of the land is to revert to SOF alone. Insofar as other shareholders enjoyed a majority of voting rights (or, at least, a blocking minority), they have constantly opposed in the general meetings of shareholders the dilution of their own stakes, thus rendering the privatization task of the SOF impossible to fulfill.

[37] The latter conclusion does not intend to prejudge on the rightfulness of the position of the SOF, as opposed to that of other shareholders. Simply, it states a fact: given the legal and cultural environment in which it operates, SOF’s goals cannot always be identical to those of the other shareholders. The latter are perfectly entitled to pursue what they perceive as being in their best interest, but so is the SOF!

[38] There was a certain merit in having recourse to this very solemn method of appointing Board members: insofar as the POFs shareholders were the Romanian citizens in general, it should be acceptable that Parliament was the representative venue by which their decisions could be made.

[39] If SOF were to accept payment with vouchers, it would - conceivably - become a shareholder in the POFs and even, given the large volume of vouchers it was bound to absorb, a controlling one. Alternatively, POFs could - theoretically - buy from SOF, with cash, the shares needed for making up for the difference between the 30 percent stakes they held and the up to 60 percent stakes offered for public subscription with vouchers. Yet, this would have gone directly against the above-mentioned portfolio maximization function of the POFs, not to mention that it would have been practically impossible for POFs to muster the kind of funds needed for such an exercise.

[40] Interesting to note, there would have been a simple way to cut this “Gordian knot:” mandating the SOF to bow to the requests formulated by the ex-POFs and to accept any of the latter’s proposals for compensation, provided that a theoretical balance, resting on the par value of the shares exchanged, is struck. This would have been the only reasonable solution, since the reverse - asking POFs to “swallow” whatever they are offered and/or to cede whatever they are asked - would have amounted to a direct interference with private businesses. Yet, the legislators (as well as the Government) preferred to leave the “hot potato” with the SOF, which - in its capacity of administrator of the state’s wealth, and absent any instructions to the contrary - felt compelled to engage in fierce negotiations with the ex-POFs. The rationality of SOF’s choice in this matter is implicitly confirmed by the most recent piece of legislation dealing with the regularization process: Government Emergency Ordinance no.54/28 December 1999 specifically allows SOF to accept from the ex-POFs shares worth close to nothing in market terms, i.e., shares in companies subject to liquidation/reorganization procedures. Conversely, had this empowerment not have been granted, SOF would have been expected to “battle” fiercely in order to obtain the best deal

possible.

[41] As of end-September, this still did not happen, thus rendering very dubious the basis on which - according to public information available - the SIFs have been recently been accepted to be listed at the Bucharest Stock Exchange.

[42] The fact that, in early-1997, the management teams of the SIFs had been reconfirmed by the “general meetings of shareholders” does not change the picture. Hundreds of thousands of shareholders with equal voting rights, many of which did not exercise them or gave ‘proxies’ to the existing managers upon the latter’s written proposal, can barely be regarded as a serious test for the existing managers.

[43] While the former explanation is a bit too specious, the latter cannot be fully discounted. Albeit its relevance is not uniform: the privatization of banks and the sale of state-owned stakes to portfolio investors have been much more affected than, say, cash sales to foreign strategic investors.

[44] To be fair, this diversion of resources was not entirely the outcome of the MPP. In some cases, it was rendered necessary by other factors beyond SOF’s control (e.g., wherever SOF ended up with shares in a company it had previously privatized as a result of legal provisions mandating the increase of the equity capital with the equivalent of the land for which valid deeds could only be obtained after the first privatization transaction). In yet other cases, it was SOF itself who deliberately rendered its privatization task more resource-consuming, as a result of decisions by its Board to the effect of splitting the share packages put on sale, in the (ultimately, vain) quest for “maximizing the transaction value.”

[45] The most prominent criticism concerning the content of the legislative changes has been prompted by the cancellation, in September 1997, of a provision contained in the MPP Law of 1995, according to which up to 60 percent of proceeds derived from an individual privatization transaction could revert to the privatized company itself. For a long subsequent period, SOF has singled out this decision as being the root cause of its failure to deliver more privatization transactions concerning “large” companies.

This disregards the unavoidable trade-off between the price paid by the buyer and access to the “refunding” of part of the price paid. A close examination of underlying circumstances shows that the refund mechanism had been devised as a *sui generis* compensation for the fact that the MPP Law and its implementing norms were unduly imposing minimum prices (largely derived from the book value) on privatization transactions.

By the time the “refunding” provision was abrogated, however, the straitjacket entailed by the existence of mandatory minimum prices had already been eliminated. All other things being equal, nothing should have prevented SOF to start selling at lower prices than those previously inflated due to the 60 percent refund possibility. And, *a priori*, potential investors should have preferred the simpler venue of paying a low price from the outset, rather than making a higher payment and then trying to ensure that a part of it reverts to the investee company. This is because the latter option entailed much more uncertainty: “refunds” could only be made for pre-determined purposes, namely extinction of debts previously incurred by the company (subject to confirmation of their existence by the Ministry of Finance) and “productive investments” (on the basis of feasibility studies submitted to SOF’s vetting).

[46] Following this broad designation, the SOF proceeded with identifying the companies pertaining to each of the categories defined by the Decree, thus ending up with the following break-down:

- 50 companies slated for secondary public offerings;
- 2296 companies destined to auctions;
- 753 companies where direct negotiations with preferred buyers were to be attempted (all these companies were providing services to farmers or were buying the produce of farmers for processing purposes, this being the reason why farmers had been granted a preferred status); had the direct negotiations not been successful, the fall-back method prescribed by the Decree consisted of auctions;
- 806 companies slated for direct negotiations.

[47] This is not a mere theoretical speculation. The same twisted logic has already been used by the Court of Audit when it challenged some of the “pilot privatizations” carried out by the National Agency for Privatization in 1992-93, because they provided for favorable payment terms: small down-payment; installments spread over a relatively long period; favorable interest rate. Because “soft” payment terms - moreover, with specific figures attached to them - had only been explicitly provided for in the 1994 MEBO Law, the Court of Audit came to the conclusion that granting similar payment terms before the 1994 law went into effect had been illegal.

[48] This mentioned that, within auctions, apart from the “call price” there should be a “bidding step” of 2-5 percent of the “call price.” Effectively, this was the maximum amount by which the initial price can be reduced at each round if the whole share package put on sale is not awarded at the initial price. Because the order empowered the SOF-appointed commissions to establish the maximum number of bidding steps, the latter have consistently avoided allowing the price to be reduced by more than 40 percent of the initial level.

[49] Concretely, the “bidding step” has been enlarged to 5-15 percent. At a first auction, the “call price” can be reduced by up to 50 percent. At a second auction, the reduction can be of maximum 80 percent of the initial “call price,” and no inferior limit exists for the third auction.

[50] Nevertheless, one could hardly see over the past decade that any efforts have been made by the decision-makers to instill more reasonable expectations to the public at large. Instead, the politicians of all nuances have used privatization as a means for “scoring points” against their opponents. In such a context, the cultural impediments to fast privatization, rather than being reduced, have grown larger because continuously fed by very populist discourses.

[51] For instance, SOF has recently (July 1999) made public a list of over 70 companies where investment commitments had not been honored, and this only includes some of the privatization transactions carried out until 1997.

[52] Cases have been reported of subsequent increases of the share capital of the company, thus diluting the stake of the state held back as guarantee, followed by cancellation of the investment program and handing back to SOF the full disposal over a share package which does not confer control any longer.

[53] Initially supposed to cover some 34 companies, the program has subsequently scaled down to just three medium-sized companies, and yielded extremely disappointing results for the subscription of SOF shares, offered for sale against cash (subscription rates of only 4-24 percent percent). It is true that, at that time, the Romanian capital market hopelessly lacked logistics (the Stock Exchange was only inaugurated in 1995, and the over-the-counter system - RASDAQ - in 1996), but the main stumbling block stemmed from unreasonable pricing. By end-1995, SOF had identified another batch of 50 companies destined to public offerings but, eventually, nothing happened.

[54] The share sales carried out in 1998 averaged 70 percent percent of the nominal price (against the background of individual transactions concluded at less than 60 percent percent of the “call price,” which used to be the “maximum concession” accepted in the case of auctions), whereas those concluded in the first 7 months of 1999 have averaged only 31 percent percent of the nominal value (thus anticipating the more relaxed pricing conditions attached by the legislation to the auction sales).

[55] For instance, it does not serve anybody’s purpose to perpetuate such blunders in the privatization legislation as mandating that the “offer price” be equal to the monthly average prior to the formulation of the public offer, since the latter only becomes valid after the approval of its prospectus by the Securities Commission, that is, days after the seller has computed this average. Not much benefit can be derived either from the insistence by which the Securities Commission sticks to its own regulation which only allows public offerings to be carried out either at a fixed price, or via the “Dutch auction” mechanism,

whereby the initial price can only decline. It should not take a big effort to formally introduce the possibility of competitive auctions, which would allow the transaction price to increase if there is over-subscription at the initial price level. This would, nonetheless, tremendously simplify the task of the seller, who, currently, is legally prevented from even trying to fulfill the legal provision of the privatization legislation which stipulates that the “transaction price can be *higher*, equal, or lower than the offer price”: thanks to the Securities Commission’s own regulations, **the transaction price can never exceed the offer price.**

[56] Sadly, this idea still has influential proponents in Romania, including those at high decision-making levels. Two illustrative examples:

- the assertion of a former Prime Minister, according to which the heavy industrial equipment producer IMGB should never have been sold for a contract price of only USD 0.5 million, since only one fixed asset of the company (commissioned during his tenure in office) had entailed an investment of USD 14 million;
- the assertion of a current State Secretary in the Ministry of Industry, according to which, “notwithstanding the large debts they have incurred, should [the oil refineries] PETROMIDIA and RAFO be privatized, I would not accept a single penny under USD 500 million, *cash*, for any of them”. The statement of the distinguished official was made after both companies have been twice offered for privatization, without any concrete result.

[57] In such cases, the new owners were to commit themselves to ensure, over a period of 2 years, “a number of workplaces dimensioned in such a way as to allow the realization of the company’s object of activity under conditions of economic and financial efficiency.” The formulation was extremely elliptical and also redundant. It is difficult to see why the state should have been more concerned with the efficiency of the business than the owners who had made investments in it and who had a direct personal stake in its economic performance. This raises the suspicion that the formulation, despite its rather innocuous character, has been used more as a pretext for imposing stringent employment preservation conditions in the privatization contracts concluded.

[58] Thus, Law no.103/16 June 1999, on the “horizontal” regime for severance payments, has made an attempt to cover the privatizations carried out directly on the capital market, implicitly recognizing that the older stipulations were largely non-applicable. However, this law had an existence of only 8 days, being superseded by a Government Emergency Ordinance (no.98/24 June 1999) which sought to consolidate the whole severance payments regime, previously scattered among “horizontal” pieces of legislation, and legal acts dedicated to particular sectors. Employees made redundant following the privatization of a company became entitled to severance payments if the privatization contract contains explicit stipulations regarding the collective layoffs. For privatizations realized by sales of shares via public offerings on the capital market, the prospectus has to make reference to the number of redundancies envisaged, and the shares sold as a result of the public offering should represent at least 1/3 of the total number of shares (this is different from the solution previously adopted by Law no.103/1999, which provided for a less demanding threshold: simply 1/3 of the number of shares publicly offered).