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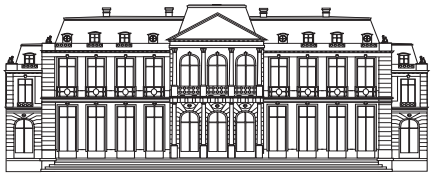

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Peter MIHALYI
Department of Economics
Central European University
(Hungary)

Privatisation and Pension Reform in Transition Economies

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I. Background

Across the OECD countries, now including three former socialist countries (Hungary, the Czech Republic and Poland), the design of **old-age security systems** varies widely. Behind this diversion, however, only two major paradigms can be discerned.

a) The origins of the German Bismarckian system go back to the series of social security reforms of the 1880s. In its pure form, this system is contribution-financed. The burden is directly levied on dependent employees and their employers. In the scientific jargon of our times, this principle is often referred as the 'pay-as-you-go' principle (PAYG). The link between employment and pension eligibility is very important, since the prime objective of the Bismarckian scheme was to maintain the accustomed living standard of the insured employees.

b) By contrast, the Beveridgean concept of 1942 put an other social objective in the focus. In line with its famous slogan 'freedom from want', the scheme implanted in Britain was designed to guarantee an adequate income support in old age – irrespective of the pre-retirement earning levels. In its practical applications, the Beveridgean system boils down to a tax-transfer system, where the tax base is extended beyond the world of employment.

As time passed, the flaws of these two models have become manifest in many ways. There are five salient facts affecting most countries:

(1) the demographic trend of decreasing fertility rates;
(2) the advancement of medical science in lengthening the life of retired people;
(3) the return of unemployment levels back to pre-World War II levels[1].
(4) the weakening of trend rate of economic growth in Western Europe;
(5) long-lasting rise of stock prices on several markets, and in the US in particular.

Since the middle of the 1970s long-term growth rates are in the 3-4 percentage range – at best. Simultaneously, the past 20 years saw a boom of stock markets world wide and in the US in particular. Affluent, well-educated **retirees have started to discover that PAYG schemes perform poorly** in such a comparison. Their conclusion is that they would have been better off, if instead of paying mandatory insurance contributions, they had invested the money on the stock exchange.[2]

Thinking on the role of government has changed, too. It has become a widely held view that elected governments are the prisoners of pressure groups and this prevents them to pursue rational, long-term policies. For similar reasons, the confidence has been eroded in the usefulness of tri-partite decision-making, which is an important component of the Bismarckian model.

Beyond the facts (1)–(5) mentioned above, transition economies (TE) suffer from other problems. It was clear from the onset of the pro-market reforms that the 'premature welfare-state' (*Kornai* 1992), as enshrined into the laws and regulations of most countries was unsustainable. Market pressures and the competing political pressure of other interest groups have pushed down the real value of pension entitlements. There is a sever compliance problem. Tax evasion, non-payments of social security contributions, misuse of disability pension provisions are widespread. The state is weak. The lack of administrative capacity to monitor a rapidly changing enterprise sector and the will to enforce regulations hampered greatly the existing PAYG system to function (see Box 1). In worse cases, pensions are not paid

[1] This is true foremost in Western Europe. Unemployment levels in the US are at historically low levels. By contrast, the threat of mass unemployment as a serious possibility is a new development in Japan and South Korea.

[2] As Martin Feldstein (1997) put it "The problem with the [US] Social Security program is not its prospective bankruptcy but that it has become a bad deal for participants."

regularly at all (e.g. Russia and several other successor states of the former USSR). In countries like Poland or Slovenia, successive governments were willing to protect the acquired rights of pensioners. But the price was high: 14-15 % of GDP. This is not sustainable for long.

Box 1.

Evasion of contribution payments in the transition economies

A major difficulty has arisen in all TEs from the unexpected depth and prolongation of the output decline after 1990 and the ensuing rise in unemployment. When policy makers opted for the re-introduction of Bismarckian-type, payroll based social security systems, nobody counted with the possibility that a shrinking labour market would not be able to generate the expected volume of contributions.

In the period 1990-94, this problem became acute in most TEs (perhaps the two successor states of Czechoslovakia being an exception), as large industrial enterprises were closed or shed workers in large numbers in order to remain viable. This was the beginning of a **vicious circle**. In some TEs non-payment of contributions was more or less limited to the circle of bankrupted companies. If this was the case, sooner or later, non-payment of contributions became a stock problem (i.e. as arrears of defunct companies). In many less fortunate TEs, non-payment of contribution became a flow problem, as non-payment became widespread even among relatively well working companies. The mechanism was simple: first, the troubled enterprises failed to pay contributions (and taxes) to the central government. Then the central government stopped paying for its purchases to enterprises and discontinued regular payments to its own employees. Once this happened, state-financed institutions (e.g. army, police, railways, and schools) suspended their contribution payments, which in turn somehow legitimised the non-payment of the enterprise sector as well.

Grey economy and moonlighting are hotbeds of evasion, too. In the *de novo* private sector only 30-50% of the business are rendered against proper invoices. For the rest, neither taxes, nor contributions are paid. Another problem is the avoidance of contribution payments on the part of small entrepreneurs, farmers, individual artists, journalists, etc. In this case, "evasion" is not a proper word, since the low level of willingness to pay has been already incorporated into the legislation. E. g. in Poland farmers are not even supposed to pay, while in Hungary, farmers are allowed to pay a favourable rate – close to or identical with the minimum statutory wage. The same is true for most of the other above-mentioned categories.
In Hungary, there is a dramatic increase in the number of employees registered at minimum wage so that also a minimal contribution is paid after them. In reality, virtually all of them wage earners receive higher wages. The difference goes directly into the pocket of the employees or it is received in the form of benefits, which are not subject to social security contribution payment.
At a higher level of abstraction, the problems of arrears and evasion have the same causes. On the part of the insured and his/her employer there is virtually no incentive to pay contribution. Eligibility to pension is only very loosely related to declared lifelong earnings and earnings-based contributions.[3] The other explanation is the weak – and often still weakening – authority of the state. Although there are sanctions in the legislation (e.g. bankruptcy law, penal sanctions for tax and contribution fraud), the insurance funds do not have the capacity to administer the system[4] or to exclude non-payers.

[3] Except for the last 5-10 years. These are taken into account in most PAYG schemes.

[4] Since the collapse of communism, the number of enterprises from where contribution payments are expected to come has risen thousand times (In Hungary e.g. from 2 000 to 2 million). This is a gigantic leap and there is little wonder that IT systems of the old organisations are unable to cope with this change.

Conclusions. The above mentioned developments have *all* contributed to the change in thinking about old-age retirement both in DMEs and TEs **(Table 1)**. Politicians, scientist and even multilateral organisations have started de-emphasise the role of the *etat provident*, to depoliticise the issue of pensions and to praise the social and economic importance of linking individual effort and reward. In the context of the pension reform the new doctrine means a shift from single nation-wide pay-as-you-go systems to privately owned and privately managed, fully funded (FF) schemes, where the insured accumulates a fund over the entire working life.[5]

[5] The FF scheme is not a novelty in itself. Historically many Bismarckian schemes were fully funded, until world wars swept away the accumulated wealth.

TABLE 1

Comparison of motives behind pension reform proposals in transition economies and in the developed market economies

	Transition economies (TEs)	**Developed market economies (DMEs)**
(1) Demographics		
---- increase in life expectancy due to improvements in life style and health care technologies	**xx**	**xxx**
---- decreasing fertility rates	**xx**	**x**
---- insufficient immigration	**x**	**-**
(2) Labour markets		
---- high level of structural unemployment	**xxx**	**xx**
---- generous disability and early retirement schemes	**xxx**	**x**
---- increased mobility on the regular job market		
---- within a country	**xxx**	**-**
---- within the EU	**-**	**x**
---- increase in non-regular jobs	**xxx**	**x**
(3) Weakened financial sustainability of existing PAYG systems		
---- marked slowdown of economic growth (end of industrialisation)	**xx**	**-**
---- weakened state authority to collect contributions	**xxx**	**-**
---- poor chances for "mutuallisation" based on small-scale initiatives	**xx**	**-**
(5) IT constraints		
---- little experience in handling gigantic data sets	**xxx**	**x**

Note: Number of "x"-s denotes the relative importance of the matter.

II. Time horizon and definitions

In **Western market economies**, privatisation and pension reforms had distinctly different evolutions in time. *Privatisation* surfaced as an important policy issue already in the 1970s. The first waves of divestment of state owned enterprises (SOEs) were seen in the Anglo-Saxon countries (UK, USA). Continental Europe followed the trend with 5-10 year delay (France, Germany, and Spain). Later, idea of SOE privatisation was embraced by many developing countries of Latin America, Africa and Asia as well. Interestingly, privatisation had not been originally conceived as a complex theoretical problem. *Corporate governance* is a buzzword of the 1990s. Prior to that, market economy and good governance of business enterprises were regarded as two sides of the same coin. Management consultants and business journalist had implicitly challenged this assumption long time ago. When differences between "good" and "bad" companies were analysed, or management forms in Japan were contrasted with standard Anglo-Saxon practices, everybody must have realised that different corporate governance schemes are equally compatible with the notion of the free market economy. But for decades, economic theory didn't react to this challenge. It happened only in the early 1990s, that mainstream economists accepted the coexistence of different market institutions. Suddenly, it became fashionable again to distinguish between ownership and control, to see a conflict between the interest of shareholders and the managers, as some authors proposed earlier. (*Berle - Means* 1932, *Galbraith* 1967). *Pension reforms* are the product of the late 1990s. Although, the pioneering Chilean reform had been launched as early as 1981, the issue didn't attract much attention in Europe and the United States until recently.

In the **transition economies**, by contrast, *privatisation*, *corporate governance* and *pension reform* became topical almost simultaneously from 1990 onwards. In a way, all three issues – together with competition - were viewed as necessary elements of the 'transition agenda'. Radical reformers as twin policy objectives treated the dismantling of state ownership in the sphere of production and in the sphere of social services. So far, only Hungary (1998), Kazakhstan (1998) and Poland (1999) have made irrevocable shift to FF systems. For solid fiscal and political reasons, however, all three countries have opted for a gradual transition, whereby the PAYG and the FF scheme are envisaged to co-exist for decades. Other countries are still in the preparation phase (Bulgaria, Slovenia).

The collapse of communist systems in East and Central Europe was an event with its own logic. But once this happened and the people of the region expressed their desire to introduce (or re-introduce) Western-style political institutions, to join the EU and NATO, the governments of these countries had hardly any alternative to SOE privatisation. The room of choice was limited to the modalities only. The reform of the social security systems - and within this, the introduction of pension reforms - is entirely a domestic policy issue. The adherence to Western institutional structures – or the ambition to be accepted by these institutions – does not imply an imminent need of changes in the countries' pension systems. It is difficult to imagine that NATO or the European Union would reject the application of any Eastern European country just because the applicant did *not* reform its pension system.

In order to avoid unnecessary terminological debates, it is important to give a clear definition of our key terms:

Privatisation is used hereafter to refer the divestment of existing state owned firms to private entities. This is not self-evident. Many scholars prefer to speak of privatisation in a broader sense, which includes the creation of entirely new companies (green-field investments), the commercialisation of telecommunication wavelength, the introduction of tolls on highways, etc. In the most recent American debates on the future of the US pension system, the advocates of radical reforms go even further: e.g. *Feldstein* (1998) speaks of 'the privatisation of the social security system'.

In Western market economies, SOE divestment means, in most cases, the sale of company shares owned directly or indirectly by public institutions (central government, local governments). In the countries of Central and Eastern Europe, the state owned firms had to be corporatised first. Partial or complete divestment of this portfolio could be a second step only.

The term "**pension reform**" will be used only to denote the switch from pay-as-you-go (PAYG) schemes to fully-funded (FF) schemes. Reforms within public PAYG schemes – e.g. a higher retirement age, a downward adjustment of benefits – are left out. Such a delineation, of course, is not intended to belittle either the actuarial importance of such changes in the old age security system, or the potential welfare redistribution effects on subsequent cohorts.

It is recognised that the choice of definition is already loaded with a certain amount of value judgement. We are aware that the monopolisation of the term 'reform' for the radical solution, as opposed to gradual balancing of the existing PAYG schemes, has already been vehemently criticised both in the academic literature, as well as in the sphere of political negotiations. For analytical purposes, however, it seems important to uphold the term 'reform' for the fundamental paradigmatic departure from the collectivist system towards a decentralised, individualistic solution.

Successful pension reforms are not stand-alone experiments. Usually, governments resort to such radical changes at times, when other things need to be fixed as well (e.g. taxation, incomes policies, exchange rate policies, banking system). More specifically, the large actuarial deficit of the existing PAYG systems often requires fresh government money, which in turn necessitates the acceleration of privatisation (e.g. France). Although packaging the shift from public PAYG to private FF schemes in a large envelope helps to reform the old-age security system itself, the simultaneity of events complicates the evaluation of any single measure.

Outside of Eastern Europe, there has been so far only one example, where two reform agendas were linked in significant ways. This is the Bolivian case, where in 1997 the country's 6 largest SOEs were divested for this purpose. More precisely, the Bolivian government sold 50% of the shares (and the proceeds from the sale were ploughed back into the companies), while the remaining 50%, worth $ 1.7bn, were put into the Collective Capitalisation Fund. This fund is managed by the same fund management companies and subject to the same investment rules as the newly created pension funds thus minimising the danger of government involvement in investment decisions (*Queisser* 1998).

III. Ambitious proposals

A) From privatisation to pension reform: Hungary prior to 1990

In Hungary, proposals to link both reform agendas were raised much before the collapse of communism. There were several levels of the argumentation. Since the beginning of the privatisation discussions, there was a discernible **capital market** school that proposed a unidirectional link between privatisation and pension reform. In Hungary, this view was strongly present in the writings of Sándor Kopátsy, Lajos Bokros and György Matolcsy since the late 1980s. Although the emphasis was put not always on the same issue, these authors consistently stressed the following arguments:

- in modern market economies, such as the United States, pension funds play a fundamental role on capital markets;
- it is desirable to create dispersed ownership for the largest Hungarian companies (e.g. energy companies, telecommunication, banks) in order to guarantee a system of checks and balances of management control;
- cross-ownership of banks and industrial companies is desirable and possible; this needs to be enhanced by the presence of pension funds.

Sándor Kopátsy originally developed this view[6] in 1981/82 in the course of reform committee work, under the leadership of Tamás Sárközy[7]. Matolcsy[8] and Bokros[9] – colleagues and disciples of Kopátsy - developed and coloured it with new facets during the next ten years. The original proposal of Kopátsy recommended the creation of 20 branch-oriented pension funds. He proposed that within three years SOEs of the competitive sector should be corporatised and their shares should be distributed among the pension funds. The pension funds themselves would not be allowed to manage their portfolios directly. This job will have to be given to banks and other financial institutions.

Another way of looking at the issue is the **populist approach**. In this framework, the stock of assets embodied in state owned enterprises (SOEs) is considered as a heritage of the communist past, the fruit of decades long effort of ordinary workers. These assets are viewed as the natural collateral of the future stream of pensions. From this assumption, two different conclusions can be drawn. Either the state doesn't privatise anything and uses the annual profits of SOEs to support the pensioners. Alternatively, all shares of SOEs should be given to the pension "sector" (i.e. to a single, state controlled pension fund or to several pension funds if they exist) as a buffer to equalise periodic ups and downs of payments obligations. Although, this has not been clearly expressed, the populist view is based on suggestion that

[6] Sándor Kopátsy belongs to the old generation of Hungarian reform economists. After 1990, he was – for short period – board member of State Privatisation Agency. After 1993 he was member of the Assembly of the Pension Insurance Fund, until the Assembly was dissolved by government in July 1998. In his writings Kopátsy himself used the populist argument many times.

[7] Tamás Sárközy is a well-known, influential law professor, specialised on privatisation matters. He was Deputy Minister of Justice under the last communist government. He was the *spiritus rector* behind the Company Law of 1990 and the Privatisation Law of 1995.

[8] György Matolcsy was Secretary of State in the first post-communist government. Mr. Matolcsy is one of the principle advisers of the present Hungarian Prime Minister, Viktor Orbán.

[9] Lajos Bokros was the first Chairman of the Budapest Stock Exchange. In 1995-96, Mr. Bokros served as Minister of Finance.

ownership changes should be constrained to green-field investments only. What remained from the past, should belong to those elderly cohorts, which created that.

It is not difficult to find the logical error in this argumentation. At the dawn of transition, the heritage of the post-socialist economies contained not only assets (namely the SOEs), but liabilities as well. With the exception of Romania, all former socialist countries were indebted up to their neck **(TABLE 2)**. Thus, SOEs should have been considered as the collateral of this external debt. Understandably, foreign banks and the multilateral lending agencies did represent this view firmly *vis-à-vis* Hungary, given the particularly high level of indebtedness. If this was the case, the best use of privatisation proceeds was the servicing the external debt.[10]

[10] Such views were voiced repeatedly both in Hungary and Poland. In fact, the large privatisation revenues of 1995, were used in Hungary to reduce foreign debt.

Table 2
Net foreign debt of Eastern Europe and the USSR
(Billion US dollars)

Country	***Net debt***	
	(End-1990)	(June 1998)
Albania	…	0.4
Bulgaria	10.5	7.4
Czechoslovakia	7.0	11.2 (Cz. R) + 7.6 (Sl. R.)
GDR	23.5 (1989)	…
Hungary	16.1	15.0
Poland	44.0	14.8
Romania	-2.0	5.7
Yugoslavia	11.1	..
Croatia	...	4.9
Slovenia	…	0.8.
Macedonia	…	0.9
Soviet Union	53.9	136.1 (Russia)

Source: United Nations Economic Commission for Europe

B) From pension reform to privatisation: Polish debates in 1997[11]

In Poland Wojciech Topinski and Marian Wisniewski proposed for the first time to seize the historical opportunity to finance radical pension reform with privatisation proceeds. Their draft was written in 1991. The logic run from the necessity to reform the pension system and not – as in Hungary – to find an answer to the "ownership problem". In the run-up to the pension reform, this idea has been widely used and modified by different organisations.

The proposals can be summed up as follows.[12]

1. Office of the Government Plenipotentiary for Pension Reform I. (1997): proceeds from privatisation or privatisation bonds should be directed to Social Security Fund
2. Solidarity Movement (1997): SOE shares should be given – free of charge – to pension funds[13]
3. Office of the Government Plenipotentiary for Pension Reform II. (Ewa Lewicka[14]) (1997): proceeds from privatisation should be credited to accounts of the individual insured citizens
4. Ministry of the State Treasury (1997) revenues from privatising the 15 national investment funds (approximately 60 bn PLN) should be credited to private pension fund accounts.[15]

C) "Killing to birds with one stone": Bulgaria 1998/99

Although this argument was also used in the Polish discussion, the Bulgarian government (elected into office in 1997) was the first that openly embraced the idea of tactical marriage of convenience.[16] In their view, linking the two agendas would help to strengthen a political constituency for both type of reforms. Market oriented young generations would embrace the privatisation part, the old generation would like the pension part. More specifically, the government proposed that the country's 3 mn adult citizens should use their privatisation vouchers (individually valued at 250,000 old leva) as a deposit with **voluntary pension funds** (VPF).

Under the proposed scheme, pension funds can also participate at the auctions, with equal rights to the existing 81 **privatisation investment funds** (PIFs) between July 1998 and 31 December 2001. The voluntary pension funds can take over the vouchers of the population and

[11] For a succinct overview and a detailed description of the Polish case see in Gessell – Müller – Süss (1998).

[12] *ibid.*

[13] In a seminal article, K. Chwila based the proposal on the "populist argument". State-owned property is the result of the work of all generations of Polish citizens, who therefore are the legitimate heirs of these assets and should receive 'enfranchisement vouchers".

[14] Ewa Lewicka was Vice-Minister of Social Affairs and after the 1997 elections, Government Plenipotentiary for Pension Reform.

[15] Proposals (3) and (4) came from the same political party, AWS.

[16] The term "tactical marriage of convenience" was used in Charlton et al. (1998)

use them as a means of payments to buy company shares, whereby 1 investment voucher will be equal to 1 BGL.[17] Technically such transfers will not require physically movement of the securities, since the whole process will be transacted in computers only. This is one of the obvious advantages of the proposal: the simplification of mass privatisation through dematerialization.

Clearly, the existence of 81 privatisation funds, helped to legitimise the idea that Voluntary Pension Funds should be allowed to participate at the privatisation auctions. After all, the provision of pensions is more "noble" idea than simple profit seeking. But this is exactly, where the trap is. By wishing to help VPFs, the planned changes in the auctioning rules are creating a competitor for the privatisation funds. If, however, the government attempts to give special privileges to VPFs, there is a danger that the existing PIFs will quickly re-construct themselves to VPFs.

[17] Prohaski (1998)

IV. Supporting the PAYG schemes

It was argued in Section II., that merely bolstering the existing state-run PAYG scheme is *not* a pension reform, even if it is linked to the privatisation process. Nevertheless, is several countries, national parliaments passed laws which aimed exactly that.

A) The successor states of Yugoslavia

In the case of Yugoslavia and her successor states, a particular obstacle to sound privatization was the awkward constitutional position. According to the basic law inherited from the communist past, employees were endowed with inalienable rights to manage social capital in their workplace.[18] The solution to this problem was the creation of republican development funds, as nominal titleholders of the enterprises. Then, employees were asked by the government to sell their management rights (not shares!) to these funds, so the funds could become real owners. This strategy, however, didn't work at all. Employees simply didn't sell their "rights", in spite of a 6-month bonus offered to them. Only at this point, came the idea to transform all Yugoslav enterprises into shareholding companies and to issue new shares (Transformation Law). These new shares – "internal shares", as they were called - were sold to employees at a considerable discount (Brabant 1992, pp. 260-262). Once the employees exhausted their purchasing rights, the remaining shares were simply transferred to the republican development funds and the republican social security funds.
Within this general model, the individual republics have opted for somewhat different modalities in the details.
Croatia[19]
The 1991 package of transformation and privatisation laws envisaged that the two pension funds (*Retirement Fund for Employees* and *Retirement Fund for Agricultural Workers*) were also entitled to participate in the ownership transformation of enterprises. According to the detailed regulation, which was finally enacted in December 1992 only, the funds received, without compensation, residual shares of the first privatization round. Approximately 1/3 of the total portfolio was earmarked for the funds. Let us recall, that in Croatia, as in most other successor states, employees of the privatised companies, employees of non-privatised SOEs and state employees were guaranteed a privileged position in the first round. In addition, the Croatian law permitted that external investors could also buy shares, ahead of the two pension funds.
In the first round of auctions 1186 joint stock companies and 127 limited liability companies were sold (with a book value of DEM 3.5 bn), from which more than 800 landed in the portfolio of the two pension funds (DEM 1.2 bn). The portfolio was divided between the two funds at a rate of 7:3. As it was to be expected, the subsequent years were spent largely on theoretical and political discussions how to manage these portfolios. Finally in November 1997, the two state-guaranteed funds agreed to set up a joint asset management company, the Croatian Pension Investment Company. One of the main aims of this company is to establish the *Pension Investment Close-end Fund* (another joint stock company for accumulating and investing financial resources) and to collect additional resources by issuing shares of that fund.

Slovenia

[18] The 1974 constitution explicitly stipulated that "no one has property rights over social means of production – neither socio-political communities, nor organisations of associated labour, nor groups of citizens, nor individuals".

[19] Alibegovic (1998)

In the period 1991-92, there were several drafts on transformation. In all version 10-20% of shares were earmarked for the *Slovenian Old Age and Disablement Insurance Fund.* Finally, the percentage was reduced to 10 % only.

Macedonia

The 1992 Privatisation Law envisaged that 15% of the (non-voting, preferred shares) shares must be transferred, free of charge to the *Pension and Disability Insurance Fund.* This stipulation meet at least two concerns: it made the status of the pensioners consistent with people who were still employed and secured a certain percentages of the funds that must be appropriated for retirement beneficiaries. It was envisaged that the free shares should earn for the fund a fixed 2% dividend.

B) The Hungarian fiasco of HUF 300 bn[20]

In February 1992, the Hungarian parliament decreed that the State Property Agency (SPA) should transfer, free of charge, a portfolio of HUF 300 bn (= $4 bn) to the newly created social security funds, the *Health Insurance Fund* and the *Pension Insurance Fund*. The act stipulated a deadline (31 December 1994) for the completion of the transaction and determined the rule of division between the two funds (approximately 56:44). Thus, from the perspective of the PAYG pension system, a portfolio of HUF 167 bn was to be expected.

There were two arguments behind the proposal. First, it was argued that the two funds need a solid financial buffer in order to compensate for the seasonal mismatches between incomes and expenditures. It was assumed that a 10% annual dividend of the portfolio would suffice for this purpose. Second, a variant of the already quoted populist argument was cited. According to this view, the one hundred years old Hungarian trade union movement needs to be compensated for its confiscated property. The proponents of this view claimed, though never produced any evidence, that the post-war losses of the trade union movement was equal to HUF 1000 bn (at 1990 prices).

Whatever the motives were, the decision was not preceded by any serious economic calculation or legal work. Nobody tried to estimated how this claim of HUF 300 bn can be satisfied from the SPA's portfolio valued at approximately HUF 2000 bn. What is the wish of Parliament? Should SPA decide alone, or it is up to the social security funds to choose? The lack of asset management rules was an even bigger problem. The two social security funds already operated from 1993 onwards, but nobody told them what to do with the assets. What is the purpose of the transfer? Should the funds behave as long-term investors or should they sell as much as possible if this is required to eliminate current deficits?

In 1992 the funds already had some securities in their portfolios. Between 1989-1992, the two funds were 'asked' by the government to invest their current surpluses into government issued bonds (HUF 13,1 bn). In addition to this, the two funds bought on their own some securities, mostly shares in banks. Furthermore, the administrations of the two newly created funds were in great need of office space. From the government's perspective it was logical that the SPA was given the task to provide the funds with buildings of defunct enterprises.

Clearly, there was a sharp institutional conflict with the privatisation agency. The SPA used the legal vacuum as a pre-text to delay the asset transfer. Later, the whole affair was further complicated, because the government decided to set up a second privatisation agency (or company to be more precise) as the asset manager of the "blue chip" strategic companies, such as telecommunication, energy, banks, etc. Needless to say, that the newly created Hungarian State Holding Company allied itself in this issue with the SPA and refused to transfer assets to the social security funds. In the mean time, the administration of the two funds became less enthusiastic as well. They realised that professional brokerage firms or

[20] In details see Mihalyi (1998) pp. 232-236. and Vanicsek (1998) pp. 24-46.

investment banks were unwilling to provide asset management service to them, if the portfolio consisted of Hungarian company shares only.

During the next three years, the issue remained unsolved. Although, the two funds and the state privatisation agency did negotiate all the time, little progress was made.

> In order to give the flavour of the debated issues, it is worth quoting at length a seemingly neutral account of the situation. The text below is taken from a 1994 paper presented by the General Manager of SPA. (The italics are added – P. M.). His account shows how complicated the deal was from the perspective of the privatisation agency. "The social security funds are, as defined by the law, eligible to receive state assets free. The assets to be handed over (…) must be *marketable* and *profitable*. This does not, however, preclude the handing over of assets that are not profitable at the time of turnover or that bear only marginal profits but have the potential to become profitable ventures after a *few years* of *professional* management. The handing over of certain assets can also be dictated by the *special scope of tasks* of the social security administration and its obligation to provide certain services. The social security funds should not, in general, be *majority owners* of productive corporate assets. Another group of exceptions is *real estate*. Assets are turned over at *market value*. The offer price of the property is to be determined by the price at which shares have been sold in the past or the longer term average price prevailing on the secondary capital market, or the price set through asset valuation. The value or share price mutually agreed upon is to be shown in the asset transfer contract. The legal relationship between the donor and the beneficiary is identical to the one uses in share or real estate purchase contracts. (*Csepi – Lukács* 1995, pp. 187-188)

In May 1995, the government and the trade union movement agreed on a much smaller amount (HUF 55 bn) and a new deadline (31 December 1995) was set, too.[21] But even this new deadline was not meet, thus it was lengthened once again until 31 December 1997. After a long bargaining process on the selection of the portfolio, this HUF 55 bn worth of assets was finally turned over to the funds.

Needless to say, that the prolongation of the transfer process and the substantial reduction of the amounts concerned, did not invalidate the economic and legal reservations, which were mentioned earlier. In fact, the opposite can be said. Relative to the size of this reduced portfolio(s), the administrative costs of asset management increased only. As a solution of this long and politically bitter tug-of-war[22], the government finally decided to take back everything from the two funds. This decision was made in June 1998. However, legally speaking this decision was never implemented, because the trade unions threatened with a recourse to the Constitutional Court. Taking into account this possibility, the current state of affairs is the following. The social security funds were forced to give a sell mandate to the privatisation agency for all marketable shares. The budget law of 1999, envisages that the whole transaction will be completed in 1999 and the privatisation revenues will be used to cover the current deficit of the funds. In reality, this deadline is far too optimistic, given the legal complications and the weak state of the Hungarian capital markets.

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[21] The deal was very much against the wish of Finance Minister Bokros, who tried to stop the asset transfer all together.

[22] The whole process was heavily loaded with politics from the very beginning. When the right wing government of József Antall accepted the idea of transferring HUF 300 bn to the social security system, their assumption was that the funds would be controlled by trade unions of the right wing. The social security elections of 1993, however, brought a clear victory for the trade unions close to the Socialist Party. In 1995, when the HUF 300 bn figure was reduced to HUF 55 bn, the country was ruled by a coalition of the Socialist and the Liberal parties. In June 1998, this Social-Liberal coalition was replaced by another right wing coalition. When they decided to take back the company shares from the funds, they used this political opportunity to abolish the funds' autonomy as well.

V. Summary and conclusions

As Kornai (1989) noticed early on, the collapse of the populace has unconsciously interpreted the communist state as if it were the sudden death of a tribal patriarch leaving behind a bequest for his fatherless orphans. Only this metaphor can help us to understand the penetrating success of different kinds of distributive privatisation strategies. Equitable and just distribution were the key ideological motives behind many policy decisions.

This metaphor seems to apply also to our topics – the linkage between privatisation and pension reform.

The feeling of the public – often echoed and thus strengthened by the politicians - was both an advantage and a disadvantage. On the one hand, it was easy to convince the people at large that the SOE bequest belongs to the elderly generation, which had created that. On the other hand, the fatherless orphan metaphor appealed to other social groups as well. If "equity" and "justice" are the name of the game, each and every living citizen can present a claim (voucher privatisation). But the metaphor supports the claim of the employees of the privatiseable companies, too. After all they are the ones who will be mostly affected by the sudden departure of the patriarch (the state). And this is still not the end. Municipalities can also open their hands. "We gave the industrial land to the companies." – they say. The environmentalists can present their claim, in the name of Mother Earth. "The industrial companies were built at the detriment of nature. Let us use all the privatisation proceeds to heal the wounds of Mother Earth." Last, but not least, foreign lenders could make a claim on the stock of SOEs. "We lent you money. Your companies were your implicit collateral. Don't discard them free of charge. We want our money back."

When the former SOEs were transformed into shareholding corporations, the technical possibility was open for everything. If titleholders of the state property decided to do so, the shares could be sold for cash. If the titleholders preferred free distribution to the entire populace or to a sub-group of the people (.e.g. pension fund members), that was possible too. Considerations of short-term political nature were often decisive in the choice.

An interesting second-generation conflict arose in those countries, where voucher privatisation had been widely used at an early stage and later the wish was expressed to link privatisation with the pension reform. Typically, voucher privatisation gave birth to a large number of privatisation investment funds (PIF). Once the government introduced the idea of transferring assets to fully funded pension funds, the two types of finds became competitors to each other. The problem is that PIFs are inherently risky ventures, while pension funds must radiate the aura of reliability and low risk. It will be very difficult to find a common regulation that suits to both type of finds, without killing the different advantages of the two.

In several successor states of the former Yugoslavia, as well as in Hungary, there was a strong political desire to recapitalise state-controlled, PAYG pension funds with SOE shares. With hindsight, this attempt can be only sceptically viewed. In the post-Yugoslav states, the revenues generated from these portfolios are of very little significance. In Hungary, the process had to be reversed.

Let us be cautious, nonetheless. There are more than 25 post-socialist economies. Privatisation is not over everywhere, the pension reform has only started in a few. Surprises still can come in large numbers.

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