

INTRODUCTION

There are two fundamental alternatives for the ownership of any property: individual ownership or state ownership. As we approach the Year 2000, the folly of state ownership has been well demonstrated: by the failure of totalitarian socialism in the East and of economic socialism in the West. As humanity has learned, at the cost of immeasurable suffering, state ownership means massive bureaucracy, corruption, waste, stagnation, poverty, and slavery.

Individual ownership means the freedom to control your own property and your own destiny. Individual ownership is the necessary economic foundation for any prosperous and free society.

Privatization is a logical and humane way of returning property from state control to individual control. It is a movement that is now sweeping the world. In this essay, Robert Poole explains how privatization can quickly move Eastern Europe from poverty and stagnation, to prosperity and progress.

WHAT IS PRIVATIZATION?

Around the world in the 1980s, governments sold off \$185 billion worth of assets and enterprises. This dramatic shift from state ownership to ownership by individuals and businesses is unprecedented in human history. But an even larger and more dramatic shift will take place in Eastern Europe during the 1990s.

Privatization can take many forms, but the word generally refers to three main types of activities. The first is *denationalization*, in which assets or enterprises are shifted from state ownership to private-sector ownership. The second form of privatization is government purchase of services from private-sector firms instead of producing the services itself. This is usually called *contracting out*, and is especially common for providing municipal services. The third type is the provision of infrastructure by a private *concessionaire*, a firm or group of firms which receives a government franchise or concession to finance, build, own, and operate the project.

A WORLDWIDE PHENOMENON

Because much privatization has taken place in Britain, it is sometimes mistaken as a phenomenon only of conservative governments such as Margaret Thatcher's. But in fact, privatization is

taking place in countries governed by every type of ideology. Spain's socialist government sold off \$1.3 billion of state enterprises in 1989, and New Zealand's Labor government is one of the most radical converts to privatization, even selling off the trees in its national forests. The social welfare states of Israel and Sweden are also privatizing state enterprises.

And privatization is not limited to first-world countries. In terms of numbers of privatizations, Africa leads all other continents in privatization, with major programs in Guinea, Nigeria, South Africa, Togo and others. South America's new generation of democratic reformers -- in Argentina, Brazil, Mexico, and Peru -- are strongly promoting privatization. They have observed how the government of Chile, despite its shortcomings on human rights, made dramatic economic improvements by shrinking the role of the state.

Major new infrastructure is being developed by private enterprise: the Channel Tunnel between Britain and France, new airports in Japan and Hong Kong, toll highways in Spain, Mexico, and Malaysia, and sewage-treatment plants in the United States. And municipal services are increasingly provided by private contractors in Britain, Japan, the United States, and West Germany.

EASTERN EUROPE: PRIVATIZATION'S NEW FRONTIER

While privatization has found widespread acceptance in the First and Third Worlds, the task will be more difficult in the countries of Eastern Europe. Most Third World countries already had significant private sectors when they acquired their independence. Moreover, they possessed a legal framework in which business could take place.

Consider some of the basics that are lacking in Eastern European countries:

- * A legal framework for private ownership of land, buildings and equipment.
- * A code of business law, setting out legal procedures for setting up corporations and partnerships, enforcing contracts, etc.
- * A price system which accurately reflects the real values of goods and services,
- * Normal accounting practices and expertise.
- * Commercial banks, bond markets, and stock markets.

In Eastern Europe, these institutions have to be created -- very quickly -- in order for privatization to take place.

HOW TO PRIVATIZE EASTERN EUROPE

There is a growing agreement that land, housing, and industry must be returned to private ownership in order for Eastern European economies to be revitalized. Yet there is an even more fundamental reason to privatize: To prevent the return of centralized power and control over people's lives and property. Decisions to buy or sell, to own or lease, must be made by those directly affected, and not by distant officials with arbitrary power. It is essential that property be privatized as quickly as possible.

There is great concern in Eastern Europe over how privatization will be carried out. Some fear foreign domination of their economies if many assets and enterprises are sold quickly. Others fear that hasty privatization may permit the *nomenklatura* to regain control of state-owned enterprises.

One basic principle will minimize both of these problems. It is that the land and businesses now in state hands rightfully belong to the people, not to the state. Privatization should give the citizens shares of ownership in state-owned assets and enterprises.

This can be done as follows:

1. *Profitable* state-owned businesses should be privatized by universal stock distribution to all citizens. Additional capital can be raised by issuing additional shares, to both domestic and foreign investors.
2. Unprofitable state-owned businesses, for which there are no potential buyers, should either be shut down or given to their workers and managers, via an Employee Stock Ownership Plan (ESOP). The ESOP can then seek loans for restructuring or seek to issue additional stock to investors. In either case, they must develop a business plan leading to profitability.
3. State-owned assets -- such as forests, other tracts of land, and less-tangible assets such as specific bands of the electromagnetic frequency spectrum -- should be legally defined and privatized via universal stock distribution to all citizens. Investors wishing to use these assets productively will then have to buy

enough shares for majority control.

4. State-owned housing should be divested to their current occupants, with fee-simple title to houses or apartments. Apartment buildings, can be organized as either cooperatives or condominiums.

To make all of this possible, the government must also create a proper legal code; encourage the use of modern accounting systems; end all subsidies and price controls; and permit the creation of private capital markets.

HOW PRIVATIZATION WILL WORK

The complete privatization of the State's current assets and enterprises, via widespread citizen and employee ownership, will dramatically increase the real wealth of every citizen. This will greatly cushion the blow of the temporary unemployment created by the shutdowns and reductions in the workforce that will occur in uneconomical enterprises.

In many countries, old-fashioned and greatly over-staffed industries have been restructured and modernized via privatization. State-owned British Steel in 1980 was the highest-cost producer in Europe. Today, a privatized and modernized British Steel is Europe's most efficient steel company. Likewise, British Airways (BA) used to be referred to by passengers as "Bloody Awful". Today it is ranked as one of the world's best airlines. The same kinds of transformations can happen in Eastern Europe.

Large-scale new investment will be needed, and should be welcomed, not only to modernize industries which are viable but also to develop a modern infrastructure. New or expanded airports and airlines, high-speed toll roads, high-speed rail lines, containerized port facilities, high-tech waste-disposal plants, digital and cellular telecommunications systems are all needed to make Eastern Europe competitive in the world market. The private sector is creating such infrastructures in countries all over the world, investing its own capital and creating numerous jobs.

Privatization is the key to bringing Eastern Europe into today's world economy. Done properly, it can make each citizen into a property owner and give every man and woman a direct stake in building a modern society.

Robert Poole is President of the Reason Foundation, a free-market think-tank in Southern California. He wrote the world's first book on privatization in 1980, is the author of numerous policy papers on various aspects of privatization and is considered by many to be the world's leading authority on the subject.

REFERENCES:

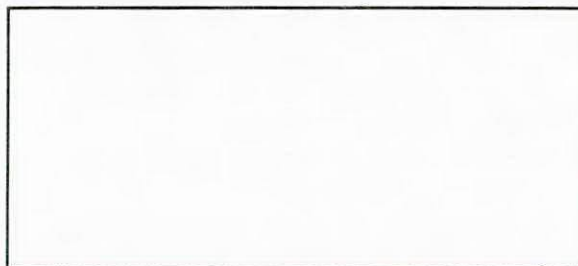
The following books are available through Free Forum Books, 1800 Market Street, San Francisco, California 94102 Tel: (415) 864-0952.

1. Philip E. Fixler, Jr., et al., *PRIVATIZATION 1990*, Santa Monica, Calif.: Reason Foundation, 1990.
2. Randall Fitzgerald, *WHEN GOVERNMENT GOES PRIVATE*, New York: Universe Books, 1988.
3. Steve H. Hanke, *PRIVATIZATION AND DEVELOPMENT*, San Francisco: Institute for Contemporary Studies, 1987.
4. Madsen Pirie, *PRIVATIZATION: THEORY, PRACTICE AND CHOICE*, Aldershot, England: Wildwood House, Ltd., 1988.
5. Robert W. Poole, Jr., *CUTTING BACK CITY HALL*, New York: Universe Books, 1980.
6. Gabriel Roth, *THE PRIVATE PROVISION OF SERVICES IN DEVELOPING COUNTRIES*, New York & London: Oxford University Press (for the World Bank), 1987.
7. E.S. Savas, *PRIVATIZATION: THE KEY TO BETTER GOVERNMENT*, Chatham, New Jersey: Chatham House, 1987.

Additional copies of this pamphlet available for 5c apiece (minimum order \$1.00). Write for prices on bulk quantities.

If you would like to learn more about the International Society for Individual Liberty's activities around the world, and receive a sample copy of the *FREEDOM NETWORK NEWS* newsletter, please write:

INTERNATIONAL SOCIETY FOR INDIVIDUAL LIBERTY
1800 Market Street, San Francisco, California 94102 USA



PRIVATIZING EASTERN EUROPE

By Robert W. Poole Jr.

Introduction by
Jarret Wollstein

