PRIVATIZATION POLICIES AND IMPLICATIONS: THE CASES OF HUNGARY AND TURKEY

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ABSTRACT

Privatization of state-owned enterprises (either partially or fully) has accelerated as a consequence of rapid economic liberalization in recent years. Many studies investigating privatization have arisen parallel to this trend. These have been concerned with several dimensions such as the objectives, the timing, the methods, and the results of privatization.

The incentives and the performance after privatization are usually addressed issues. However the methods and the circumstances matter a lot in evaluating the results of privatization because it is often considered to be insufficient alone to flourish economic efficiency and accelerate economic growth.

The objective of this paper is to overview the economic literature on privatization policies and to develop an idea about whether and how privatization can enhance economic efficiency and improve the economic stance of developing countries. Different methods and the circumstances under which they are suitable are intended to be analyzed making use of the Hungarian privatization experience and a short evaluation of the Turkish privatization process is attempted in light of the Hungarian experience.

Key words: privatization, public enterprises, efficiency, regulation
JEL classification: G18, G32, L33

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1. INTRODUCTION

Since the 1990s, privatization has been a widely promoted policy both in developed and developing countries. It is generally defined as "the deliberate sale by a government of state-owned enterprises (SOEs) or assets to private economic agents" (Megginson and Netter, 2001). The goals that are desired to be met and the incentives behind privatization together with the performance and the impacts of privatization on succeeding in more efficient production schemes are usually addressed issues. However the methods and the circumstances matter a lot in evaluating the results of privatization because privatization is often considered to be insufficient alone to increase economic efficiency and flourish the economic environment. Each economy has different necessities regarding the choice of certain privatization methods that are roughly classified as asset sales, liberalization or deregulation of statutory monopolies and franchising.

This study aims to overview the economic literature on privatization policies and the aims of and the expected gains from privatization and to develop an idea about whether and how privatization can enhance economic efficiency and improve the economic stance of developing countries. The outcomes are intended to be analyzed making an evaluation of the statistical data and empirical research for Hungary. The assessment is expected to cast some light on the Turkish privatization experience.

2. AIMS AND METHODS OF PRIVATIZATION: A HISTORICAL GLANCE

Although modern privatization programs are mostly associated with Margaret Thatcher's Conservative government, which came into power in Great Britain 1979, the first large-scale "denationalization" program of the postwar period was adopted by the

Adanauer government in the Federal Republic of Germany in 1961. During the 1990s, many other European governments such as France, Italy and Spain launched privatization programs mostly relying on public share offering. China and India, being two special Asian cases, adopted major economic reform and liberalization programs beginning in the late 1970s and early 1990s respectively. In Latin America, Chile, Mexico, Bolivia and Brazil undertook liberalization and privatization programs at different years. In sub-Saharan Africa, Nigeria and South Africa have been "the most frequent sellers SOEs" through public share offerings though they were small. The most recent region that has been carrying out privatization programs is the Central and Eastern Europe which is comprised of the former Soviet-bloc countries. In this region, mass privatization was implied in the form of distributing vouchers to the citizens who used these vouchers to bid for shares in privatizing companies, resulting in a massive reduction of state ownership (Megginson and Netter, 2001).

Privatization has been carried out for various reasons. For example, the British privatization during the 1980s and 1990s aimed to (Megginson and Netter, 2001):

- raise government for the state,
- promote economic efficiency,
- reduce government interference in the economy,
- promote wider share ownership,
- develop the national capital market,
- provide the opportunity to introduce competition, and
- subject SOEs to market discipline.

When we are concerned with the theoretical arguments for the advantages of private ownership of companies, the first point to be highlighted is that "a competitive equilibrium is pareto optimal" under some conditions. These conditions such as the non-existence of externalities in production and consumption, presence of negligible information costs and the non-monopolistic structure of the market are usually unrealistic. As far as these assumptions or conditions do not hold, there arises some space for government intervention and state ownership. Privatization, in turn, is supposed to be developed as a tool to solve the problems that stem from state ownership.

A government faces several difficulties while deciding on the method of privatizing a state-owned asset. These difficulties range from economic factors such as valuing the assets right to:

> *… (1) the history of the asset's ownership, (2) the financial and competitive position of the SOE, (3) the government's ideological view of markets and regulation, (4) the past, present, and potential future regulatory structure in the country, (5) the need to pay off important interest groups in the privatization, (6) the government's ability to credibly commit itself to respect investors' property rights after divestiture, (7) the capital market conditions and existing institutional framework for corporate governance in the country, (8) the sophistication of potential investors, and, (9) the government's willingness to let foreigners own divested assets* (Megginson and Netter, 2001: 17).

Privatization is usually implied in the form of direct sales of public assets, liberalization of statutory monopolies and franchising. Respectively, these can mean denationalization, deregulation (introduction of competition in previously monopoly sectors such as electrical power, natural gas and water) and contracting out (lease, contract for concessions, build-own-operate, etc.) (Banerjee and Munger, 2004).

Brada (1996) categorized the methods of privatization into four groups examining the experience of the CEECs: *privatization through restitution, privatization through sale of property, mass or voucher privatization,* and *privatization from below*.

To begin with, *privatization through restitution* is used where former owners of land or other property exist. This method was commonly implied in Eastern Europe, especially in privatizing agricultural land. It was also helpful in privatizing housing and fostering the emergence of a small business sector (Brada, 1996: 69). A problem with this form of privatization is reported to be the necessity of proving the ownership of the related assets, which is usually conflicting.

Privatization through sale of state property is a method which entails the sale of state property often to workers or managers at favorable rates. Through this method, raising revenue for the state, accelerating the process of restructuring firms and welcoming foreign investors into the economy are aimed at. It was preferred mostly in Germany and Hungary. The method is applied either in the form of *direct sales* (or asset sales) of state-owned enterprises to an individual, an existing corporation, or a group of investors or in the form of *share issue privatizations* (SIPs), in which some or all of a government's stake in a SOE is sold to investors through a public share offering (Megginson and Netter, 2001).

The third method Brada (1996) defines is *mass or voucher privatization*, by which eligible citizens can utilize vouchers that are distributed free or at nominal cost to bid for shares of SOEs or other assets being privatized. This method has also been used in the CEECs and many of the successor states of the USSR.

Finally, *privatization from below* is the startup of new private businesses by domestic and foreign entrepreneurs instead of privatization of the state-owned property. It has been widely used in formerly socialist countries and in transition countries. Construction, domestic retailing and trade and services are the sectors in which new businesses are flourished.

Beside these four methods Brada describes, governments can make use of some other methods to increase private-sector participation. However these are the most common ones that have been used in transition economies and developing countries.

3. IMPACTS OF PRIVATIZATION POLICIES: EMPIRICAL EVIDENCE

Parker and Kirkpatrick (2005) introduce two sets of research that assess the effects of privatization in developing economies. The first set they present for our attention includes the studies that make use of statistical data to undertake an evaluation of the impact of private ownership on economic performance that can be represented by variables such as profitability, productivity, costs of production and financial ratios. Usually ownership enters the econometric analysis as an independent variable that influences the dependent variable performance represented by one of the indicators mentioned. The second set of studies is concerned with case studies related to privatization. Through case studies, it is possible to get access to comprehensive descriptive data and to be able to analyze qualitative effects of privatization as well as quantitative impacts.

Both sets of studies have some drawbacks besides giving useful hints about how to assess the impacts of privatization. Among these drawbacks are the data and methodology problems with the econometric research and the a-theoretical basis of case

studies. Taking these problems aside, it is intended here to present a survey of these studies in order to shed some light on the impacts of privatization on economic performance especially in developing countries.

Some studies compare the performance of state-owned firms to privately owned firms to analyze the impact of private ownership on firm performance. Boardman and Vining (1989) handle a set of 500 largest non-US firms operating in 1983 and classify them according to their ownership structure as state-owned, privately-owned and mixed ownership enterprises. They examine the profitability ratios and obtain the result that privately-owned companies are significantly more profitable than the state-owned and mixed ownership firms.

Pinto, Belka and Krajewski (1993) question whether privatization is needed to make the SOEs in Poland perform better through an analysis of the state sector in the first three years after the Big Bang reforms of 1990. These reforms consisted of the liberalization prices, fiscal and monetary policy tightening and promotion of competition. They find that this macroeconomic stability package itself was successful enough in increasing the performance of the state sector.

Frydman, Gray, Hessel, and Rapaczynski (1999) deal with the performance of privatized and state-owned companies in the transition economies of Central Europe, and try to answer whether privatization works controlling for selection bias. Looking through a sample of 90 state-owned and 128 privatized companies in the Czech Republic, Hungary, and Poland in 1994, they examine the impact of ownership structure on four measures of firm performance – sales revenues, employment, labor productivity (revenue per employee) and material costs per unit of revenue using panel data regression

techniques. Comparing the privatized group of firms to the non-privatized group, they evaluate that the privatized firms have better performance than the state-owned ones in terms of annual growth rates. However, the authors demonstrate that the positive impact of privatization on performance is limited to certain measures of performance and to the situations where the SOE is sold to foreign buyers.

Dewenter and Malatesta (2001) test whether the profitability, debt and labor intensity levels of privately-owned firms differ from those of SOEs in the list of 500 largest non-US firms in selected years of 1975, 1985, and 1995 and come up with the result that private firms are significantly more profitable, have less debt and less labor intensity than SOEs.

Tian (2000) examines the relationship between state shareholding and corporate performance of 825 Chinese companies in 1998, 513 of which have some government ownership and private ownership together whereas 312 of which are privately-owned. He evaluates that private enterprises perform significantly better than mixed ownership firms.

Boubakri and Cosset (1999) compare the pre- versus post-privatization performance of 16 African firms during the period 1989-1996. Their findings show that capital spending increased significantly in the case of privatized firms whereas they find insignificant alterations in efficiency, profitability and output.

Finally, Black, Kraakman and Tarassova (2000) employ a descriptive analysis involving several case studies and display that privatization in Russia has resulted in a "kleptocracy" and failed to dispense desirable effects in terms of efficiency.

There has also been research on the sectoral effects of privatization. For instance, Ramamurti (1997) examines the impact of restructuring and privatization of the national railroad in Argentina in 1990. The author examines whether a significant change appeared in the productivity, employment and need for operating subsidies following the divestiture. He reports a 370 % increase in labor productivity together with a 78.7 % decrease in employment.

Wallsten (2001) employs an econometric analysis of the results of the liberalization reform (privatization, competition and regulation) in the telecommunication sectors of developing countries. The data set includes 30 African and Latin American countries from 1984 to 1997. He evidences that costs decreased via competition but privatization alone was not helpful in case it was not supported with effective and independent regulation.

Using a panel data set for 23 OECD countries for a period between 1991 and 1997, Boylaud and Nicoletti (2000) examine the impact of liberalization and privatization on productivity, prices and quality of long-distance and cellular telephone services. They observe improvements in the quality and productivity levels together with lower prices as a result of competition in the telecom services. However, they find no significant effect of privatization in the sector.

Bortolotti *et al.* (2002) find that profitability, output, labor productivity and capital investment increase significantly following privatization of the 31 telecommunications companies in 25 countries between October 1981 and November 1998. The data set includes both developed and less developed countries which possibly leads to data heterogeneity problems. Furthermore, although the authors conclude that the financial

and operating performance of telecommunications companies improved following privatization, they highlight that an important part of this improvement stemmed from regulatory changes rather than from privatization alone (Bortolotti *et al.*, 2002: 266). These findings are parallel to those of Wallsten (2001) as mentioned above which point to the necessity of coupling privatization with regulatory effectiveness. Otherwise, privatization appears to be insufficient alone to improve economic performance.

Zhang, Parker and Kirkpatrick (2003) model the impact of privatization in the electricity generating sector in 51 developing countries for the period between 1985 and 2001. Using fixed effect panel data modeling techniques, the authors display that service penetration, capacity expansion, and labor productivity increase through competition whereas the impact of privatization on these variables is found to be insignificant except for capacity utilization. They further point to the importance of the sequence in which the reforms are done. They evidence that higher electricity generation, higher generation capacity and improved capital utilization are achieved only after an independent regulatory authority is established and competition is introduced before privatization begins.

These findings call for a policy implication that necessitates the establishment of effective state regulation and the introduction of competition before instead of after privatization begins. Otherwise, privatization appears to be ineffective and unsuccessful to flourish economic performance empirically. But, in sum, they have a common idea that "privatization works" in terms of economic performance.

One point that should be stressed about these studies is that there has been a general tendency to concentrate on a comparison between the situation before and after

privatization. This is has been found to be more appropriate than pursuing a counterfactual comparison that considers what would have happened in the absence of privatization due to the limited availability of data and the ease of methodology compared to the counterfactual approach.

Another point is that some studies have mixed data from industrialized and developing countries using samples that are heavily biased towards the industrialized countries. It can be noted that there has been little attempt to analyze both sets of countries or individual countries separately. In studies which have used separated samples, there is the problem that included countries differ a lot in terms of institutions and governance.

The study of Cook and Uchida (2004) differs from these earlier studies in the sense that it concentrates on an analysis of enterprises drawn from a wide range of developing countries, with a larger sample than used in previous works, that it makes a distinction between privatized enterprises that are in regulated and non-regulated sectors of the economy and that it makes a comparison of performance between different periods of privatization and not with pre- and post-privatization episodes. Their findings represent that "much of the earlier optimism about privatization, and indeed the effectiveness of regulation in respect to the utility industries, may have been premature" (Cook and Uchida, 2004: 4). Operational efficiency and financial performance are found to have deteriorated particularly in the regulated utilities sector while in some cases they are found to have improved in the years following privatization. Decreases in efficiency and output levels in many privatized enterprises have been observed, capital investment has declined, and a significant number of enterprises have found to experience an increasing

level of indebtedness. Furthermore, the study reports differences between the performance of enterprises in different sectors and across countries, indicating that performance is influenced by the institutional and structural context.

These findings can be explained by the declining trend in infrastructure investment after 1997 in developing countries as indicated by the World Bank. Partly, it may be due to the case that examining a mixture of industrialized and developing country experience, with a sample bias towards the former, may have masked what had been happening to privatized enterprises in developing countries. Finally, the analysis of Cook and Uchida strengthens the view that legal institutions and their implications in practice, market structure, and systems of regulation do make a difference across different economies and have varying impacts on effectiveness between different sectors.

4. PRIVATIZATION EXPERIENCES OF HUNGARY AND TURKEY

4.1. A General Look at the Enlarged Europe

Based on the evaluations of previous studies, it is now easier to understand that the impacts of privatization in developed and developing countries vary substantially due to differences in many aspects ranging from the structure of product, labor and capital markets, protection of private property rights, the efficiency of regulatory bodies and administrative institutions to differences in management skills and standards of business conduct. Parker and Kirkpatrick (2005) summarize these differences as in Figure 1 below. Developing countries have been displaying a poor picture in terms of these characteristics. Thus, the desired effects of privatization generally fail to be experienced in developing countries.

Figure 1: Privatization: Summarizing the Differences between Developed and Developing Economies

Developed countries	Developing countries
Competitive product markets	Imperfectly competitive and incomplete markets
Organised and competitive labour markets	Regionalised and sometimes ethnically distinct labour markets, with appointments through connections
Competitive capital markets	Under-developed capital markets
Competitive managerial labour markets; institutionalised management training	Management weaknesses and patronage in appointments
Protected and well-defined private property rights; understood standards of business conduct	Poorly protected private property rights; under-developed business codes of behaviour
Relatively high standards of probity in public administration	Relatively low standards of public administration, including cronyism and corruption

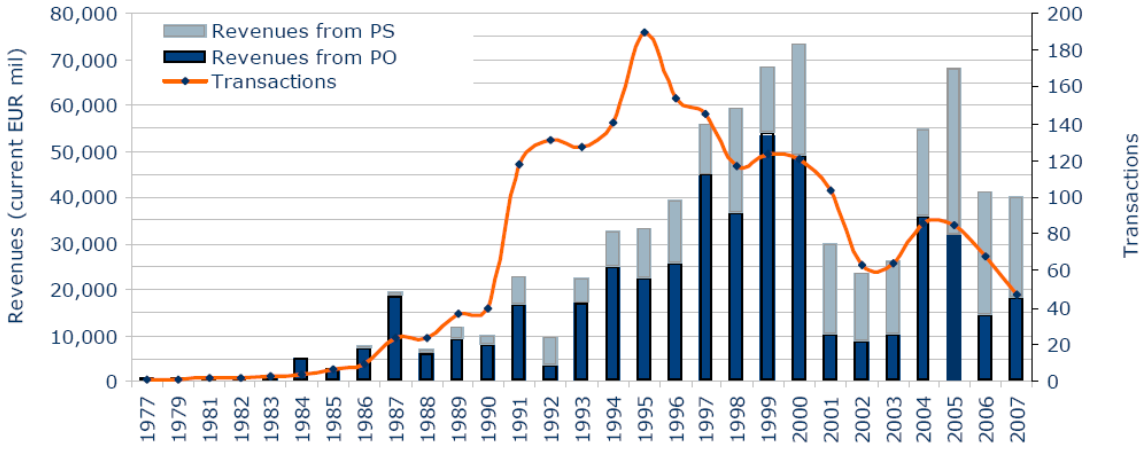
Source: Parker and Kirkpatrick (2005)

Keeping these differences in mind, we can now have a look at the privatization patterns in the enlarged Europe and then in Hungary as a developing and a transition country which has engaged in the privatization process since the beginning of the 1990s.

Privatization Barometer (www.privatizationbarometer.net) is a website that provides information and data on the privatization activities and trends in Europe. Figures 2, 3 and 4 are evaluated from the website's semi-annual reports that aim at monitoring the most recent trends, presenting aggregate data on privatization revenues and transactions and collecting updates statistics at both country and sector levels.

Figure 2 displays the total revenues and the number of transactions gained through privatization between the years 1977 and 2007.

Figure 2. Privatization in the Enlarged Europe: Total Revenues and Transactions 1977 – 2007



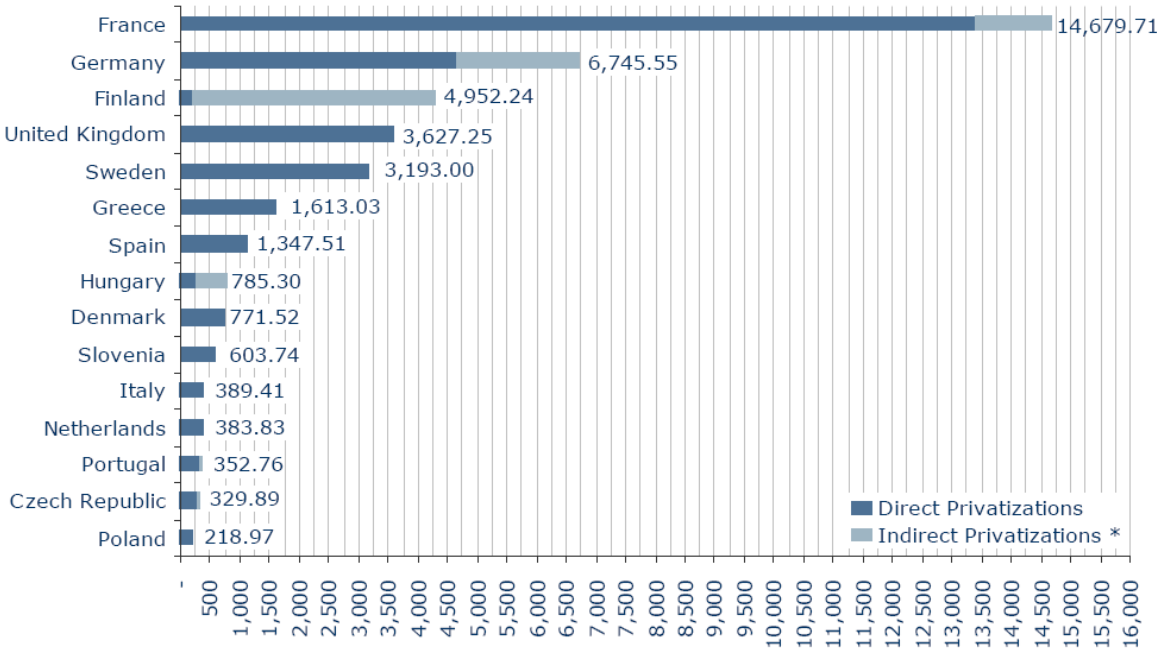
Source: Privatization Report for Europe 2007, Privatization Barometer

It is obvious that the year 1995 is the time when the number of transactions makes a peak. In 2000, the value of the total revenues from transactions is at its highest level.

Figure 3 shows the distribution of revenues between countries. The developed countries of the region, France and Germany, attracted the largest amounts of revenues from privatization during 2007. The less developed ones, Poland and Czech Republic, are the ones that attracted the smallest amounts of revenues.

Figure 4 is a representation of the distribution of privatization revenues by sector during the year 2007. Finance sector appears to be the one that brought in highest revenues while the trade industry sector has the lowest portion. Revenues in the utilities sector are also as high as about 9,000 million Euros.

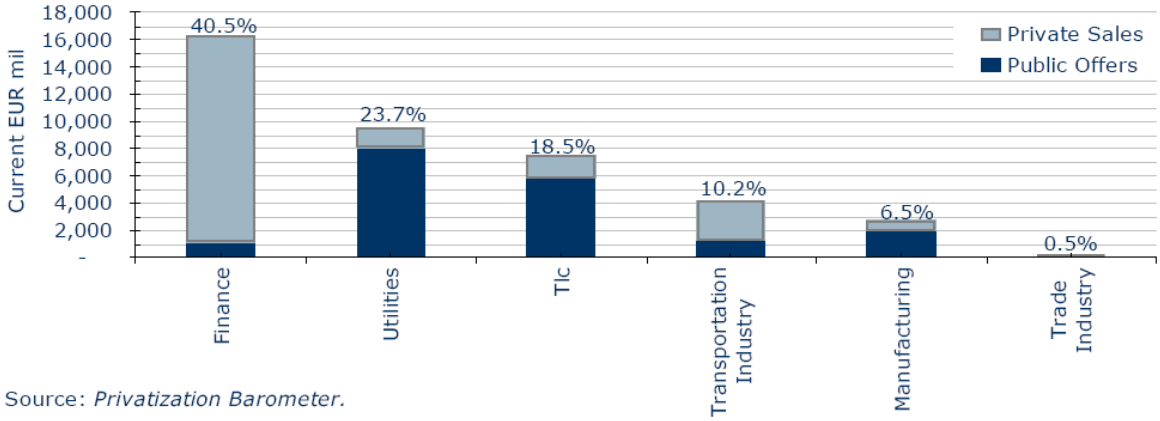
Figure 3. Distribution of Privatization Revenues by Country, 2007



*Direct privatizations refer to the sale of government's direct stakes. Indirect privatizations include spin-offs and transfer of shares from government owned companies.

Source: Privatization Report for Europe 2007, Privatization Barometer

Figure 4. Distribution of Privatization Revenues by Sector, 2007



Source: Privatization Report for Europe 2007, Privatization Barometer

4.2. An Overview of Privatization Patterns in Hungary

In 1990, the first post-communist Hungarian Government based its economic policy on achieving three goals: quick privatization, further liberalization and simultaneous stabilization of the economy (ILO, 1997). Árpád (2001) divides Hungarian privatization into three basic stages in the report of the State Audit Office:

▫ *Until 1994 the state sold off profitable firms that were relatively easy to sell, and encouraged as many domestic small investors as possible to purchase assets.*

▫ *Between 1995 and 1997 the sale of large strategic firms (energy suppliers, banks, strategic firms) was accelerated. The new owners were mainly strategic investors.*

▫ *From 1997, the focus was switched to capital market methods of privatization (open issues, stock exchange sales) and the more difficult sales of minority stakes* (Árpád, 2001: 47).

Hungarian privatization adopted a market approach that avoided giveaways on one hand but reduced the speed of the process and restricted its scope on the other hand. At the beginning, only small-scale privatization (which mainly regarded small commercial businesses) and the divestiture of some enterprises held by the State Property Agency took place. Afterwards, "management buyouts, with the granting of soft loans; the inclusion of workers in the group of shareholders; the purchase of enterprises by former owners expropriated by the Communist regime with government-issued indemnification certificates; and franchising for hotels and tourist facilities" took place (Privatization Barometer).

Figures 5 and 6 display total privatization revenues and transactions and the distribution of revenues by sector between 1989 and 2007 respectively.

Figure 5. Hungary: Total Privatization Revenues and Transactions

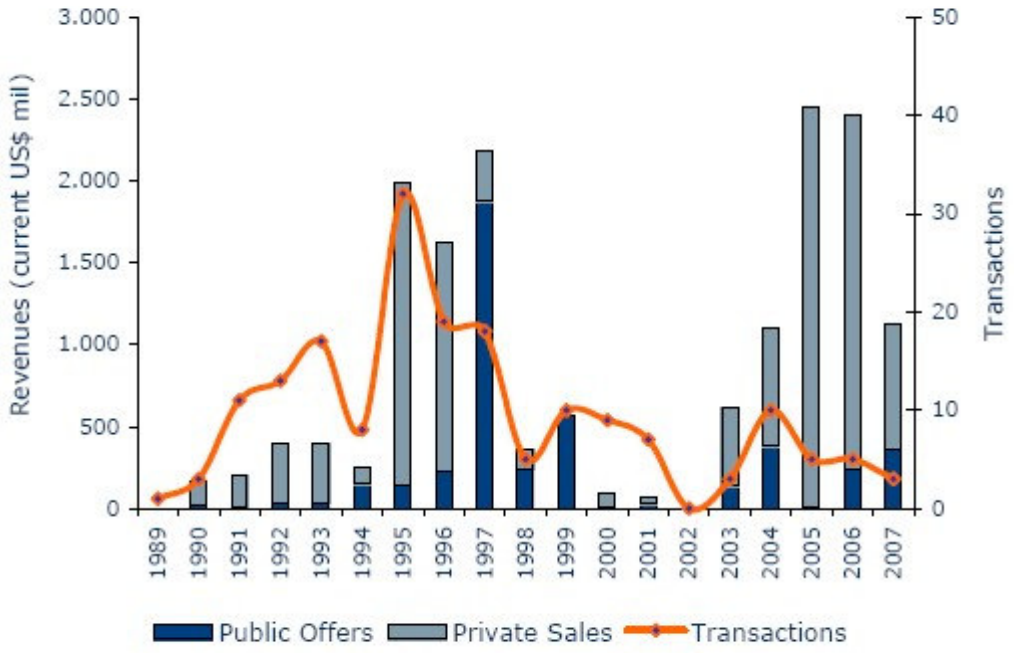
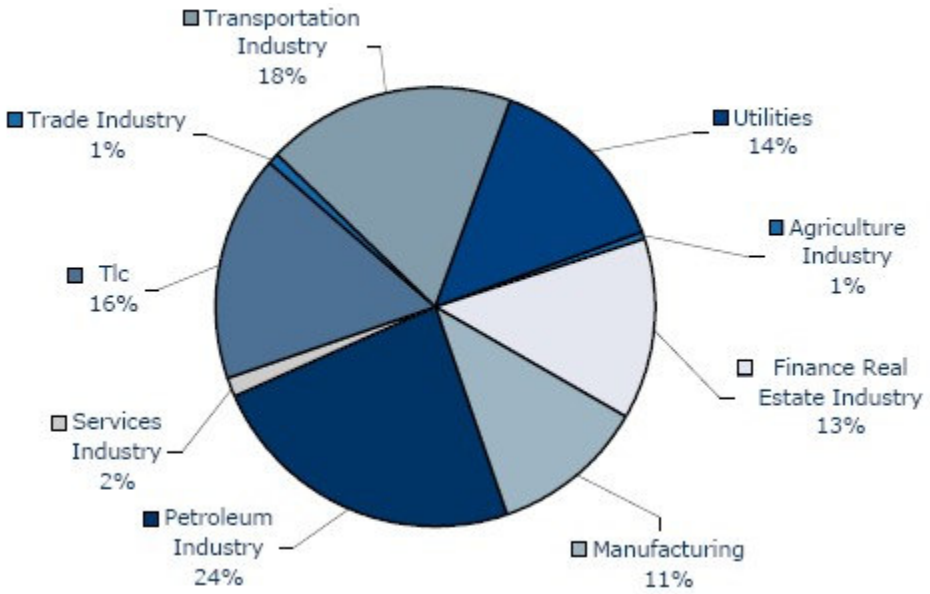


Figure 6. Hungary: Distribution of Privatization Revenues by Sector, 2007



Source: *Privatization Barometer*

The number of transactions made a peak in the year 1995 and the value of transactions was highest in 2005. Petroleum, transportation and telecommunication sectors were the highest receivers of privatization revenues in 2007.

State Audit Office of Hungary reports that 2576 privatization transactions were administered by the privatization bodies (State Property Agency, Hungarian State Holding Company, Hungarian Privatization and Holding Company) from 1990 to 2000 excluding nearly 11000 shops and restaurants that were sold under the pre-privatization programme. The following table gives the methods and techniques applied in the course of the 2576 transactions mentioned above.

Table 1. Methods of Privatization, 1990-2000

Applied method or technique	% of total number of transactions	% of transactions by contract value
Tender (open, closed, invitation, etc.)	55	55
Capital market methods (public issues, private placements, stock exchange sales, etc)	7	29
Sales to bearers of **compensation vouchers**	4	9
Sales to **employees**	22	4
Other (management buy-out, auctions, leasing, etc.)	12	3

Source: State Audit Office, Hungary (2001), "Privatization in Hungary 1990-2000", p.36

The table shows that the *tender system* was the most frequently used method in terms of both number and value of transactions. Mostly sectoral and strategic investors were the buyers of this kind of enterprises submitted by tender.

It is noticeable that the proportion of transactions made through *capital market methods* was 29% in contract value while the proportion of those transactions in number was as small as 7%. This indicates that fewer but more valuable firms such as the ones in

the energy and communication sectors, and banks were sold in this way. The higher value of the sales made through capital market methods further points to the willingness of financial and institutional investors to purchase Hungarian securities and invest in Hungarian firms. This is an indicator of their confidence in the Hungary's economy and in the Hungarian government. Large investment funds, insurance companies, and merchant banks are the primary buyers on the international capital markets (State Audit Office, 2001: 36).

Sales to bearers of compensation vouchers made 9% of the value of total privatization sales between 1990 and 2000. Compensation vouchers were granted to people who could prove that they had suffered damages under the previous political system. However, the value of received vouchers was usually just a small fraction of the real damage being only a consolatory or token amount (State Audit Office, 2001: 37).

Employees' participation in ownership accounted for an important part of Hungarian privatization making up the second most significant method applied with a share of 22% of the total number of transactions. There are two particular forms of it, being the Employees' Share Scheme and direct sales to employees (employees' shares). The Employees' Share Scheme necessitates the acquisition of property collectively by employees in the form of employee shareholding trusts. Employee shares, on the other hand, are purchases by individual employees. Due to the limited capital resources owned by employees, employees' participation method constituted only 4% of the total value of transactions (State Audit Office, 2001: 38).

Transactions made through *other privatization methods* formed about 3% of the total value. Among these methods, the more important ones are auctions, management buy-

outs, and direct non-tender sales. The amount and significance of the privatization leasing method was negligible (State Audit Office, 2001: 38).

After reaching these levels, at the end of 2000, it was announced that the "substantial conclusion of the process" as "a level of public participation in the economy similar to that of the other Western European countries" had been achieved. Subsequent governments until today have also embraced the continuation of the privatization process as a priority. The current Hungarian government adopts the strategy to continue with its impressive privatization program. For example, Privatization Barometer website reports that under the privatization act, Hungary plans to reduce its stake in the post operator Magyar Posta to 75 percent.

Largely due to privatizations, the share of GDP derived from private sources increased from 7.1% in 1988 to 55% in 1994 and 75% in 1997. The private sector contribution to GDP in 1997 is close to that of the US in the same year which is as high as 82% (European Bank for Reconstruction and Development, 1997). Saving (1998) reports that privatization reached near normal Western levels, constraints on private business creation were substantially reduced and price controls had been largely abolished by the year 1997 in Hungary.

Table 2. Ownership Structure of Companies (% in Assets)

	1992	1993	1994	1995	1996	1997
Total domestic private owners	25,1	29,0	32,9	35,2	34,7	38,2
Foreign owners	10,1	16,1	18,9	28,4	31,5	35,3
Total private ownership	35,2	45,1	51,8	63,6	66,2	73,5
Total state and other	64,8	54,9	48,2	36,4	33,8	26,5

Source: Voszka (1999)

Table 2 above shows that the share of property in domestic private hands reached almost 40% in 1997. 35.7% of the property was owned by foreigners. Thus, the share of total property in private hands was about three-fourths in 1997.

4.3. Lessons From Hungarian Privatization

The success of Hungarian privatization can be assessed in terms of various criterion variables. These can be revenues to the state, allocation of revenues in the sector, management quality, technological improvements, cost reduction, efficiency levels, product quality, success of marketing, vertical integration, optimal size, employment level and regional impact. It is difficult to obtain detailed data for these indicators. However, in this section, it is attempted to provide some statistics, tables and results from related empirical research in order to shed some light on the evaluation of the results of the Hungarian privatization experience.

Table 3 displays several economic indicators for the Hungarian economy during the transition process. According to the statistics given, GDP and GDP per capita levels have been on an increasing trend. The growth of fixed capital formation fluctuates between negative and positive values. Employment levels appear to have decreased sharply in 1990 and 1995 where privatization made a peak and unemployment seems to make a high portion of the labor force after 1990. Prices experience high increases in percentages in 1990 and 1995 but go well below 10 % in the following years. Wages have been on a decreasing trend since 1990. Although it is difficult to attribute all the changes in these indicators to privatization, it is much likely that privatization has played an important role in shaping the economy and has contributed to the fluctuations in these variables.

Table 3. Selected Economic Indicators for Hungary

	1990	1995	2000	2005	2006	2007 Estimate
Memorandum items			*(Denominations as indicated)*			
Population (end-year, million)	10,4	10,2	10,0	10,1	10,1	10,1
GDP (in billions of forints)	2.261,2	5.614,0	13.528,6	22.055,1	23.757,2	25.373,9
GDP per capita (in US dollars)	3.448,6	4.359,5	4.773,7	10.962,9	11.206,2	13.794,0
Share of industry in GDP (in per cent)	na	23,1	27,3	26,6	23,0	21,8
Share of agriculture in GDP (in per cent)	na	5,9	4,5	5,8	5,4	3,6
Current account/GDP (in per cent)	0,4	-3,7	-8,4	-6,8	-6,5	-5,0
External debt/GDP (in per cent)	56,1	71,9	62,6	76,2	92,2	95,9
Output			*(Percentage change in real terms)*			
GDP	-3,5	1,5	5,2	4,1	3,9	1,3
Gross fixed capital formation	-7,1	-4,3	7,7	5,3	-2,8	1,0
Industrial gross output	-9,3	4,3	9,6	4,3	8,6	na
Agricultural gross output	-4,7	2,6	-7,9	-2,4	-6,1	na
Employment			*(Percentage change)*			
Labor force (annual average)	4,7	-2,6	0,6	0,8	1,0	-0,2
Employment (annual average)	-3,3	-1,9	1,2	0,0	0,7	-0,1
			(In per cent of labor force)			
Unemployment (end-year)	1,4	10,2	6,4	7,2	7,5	7,4
Prices and wages			*(Percentage change)*			
Consumer prices (annual average)	28,9	28,2	9,8	3,6	3,9	8,0
Producer prices (annual average)	22,0	28,9	11,7	4,3	6,5	0,2
Gross average monthly earnings in economy (annual average)	27,2	16,8	13,5	8,8	8,1	na

Source: based on EBRD data

Voszka (1999) draws several conclusions from the Hungarian privatization process. To begin with;

"… its changeable and mixed nature has made it difficult for participants to evaluate the process and has led to a certain lack of transparency. On the other hand, the flexible and pragmatic approach has offered good opportunities to several groups of investors. It also contributed to the significant expansion of the private economy." (Voszka, 1999: 15)

Second, the methods of privatization have been very influential on the outcomes. For instance, the free distribution of assets actually decreased the speed of privatization due to the uncertainties regarding both the beneficiaries and the assets. The process was able

to accelerate only when decision-making was decentralized away from bureaucratic state institutions to private consulting firms. Voszka (1999) reports that self-privatization and small privatization programs (the auction sales of retail trade operations, shops and restaurants) appeared to be the most successful in terms of the number of firms privatized.

The third conclusion Voszka (1999) derives is that the standard selling methods such as the use of auctions (mainly to local buyers in small-scale privatizations), and direct sales to local and foreign investors via public competition, public tender, private placement of shares, and public share offerings on the stock exchange have appeared to yield higher state revenues than the special distribution approaches such as the existence loans (i.e. E-loans, which are long term credits with a five-year grace period and an interest rate well below the rate of inflation).

The Hungarian statistical yearbook presents the revenues accrued from privatization for different privatization methods. The revenue from direct sale is recorded under 'cash' in Table 4 in absolute and in Table 5 in relative terms. It appears that cash revenue constituted the main part of privatization revenue between 1992 and 1998. Tables 4 and 5 confirm that throughout all the years up to 1998, except 1994, a year of national elections, the share of foreign investors in overall privatization revenue was substantial, in most of the years reaching above 50%.

Fourth, privatization did not lead to getting rid of national or regional monopolies immediately. Despite the fact that several big firms were divided into smaller companies as a result of *spontaneous* privatization or direct governmental decisions, usually previous state monopolies and some other firms were reluctant to change their

management in order to maintain their monopoly power. In some sectors, a few large firms continued to dominate resulting in less competition and more vulnerability of the Hungarian economy to the changing strategies of foreign investors and to market cycles. For example, a decline in domestic production or exports by even a small number of the most dominant and biggest firms could bore troubles for the whole economy (Voszka, 1999: 17).

Table 4. Revenue from privatization, Hungary (Ft billion)

	1992	1993	1994	1995	1996	1997	1998
Cash forint	17.51	17.55	27.61	25.71	25.09	108.8	60.58
Cash foreign exchange	40.98	110.67	10.95	412.05	77.5	208.4	38.62
Cash total	58.49	128.22	38.56	437.76	102.59	317.2	99.2
Compensation notes	2.26	14.56	64.2	18.48	41.63	22.66	4.19
E-credit	9.07	21.72	29.27	3.92	2.44	0.3	0.99
Foreign exchange credit	0	0	16.84	0	0	0	0
Asset returns	7.41	5.41	7.8	13.81	11.31	9.57	7.44
Total preferential methods	18.74	41.69	118.11	36.21	55.37	32.53	12.62
Revenue total	77.23	169.91	156.67	473.97	157.96	349.8	111.8

Source: Hungarian Statistical Office, 1999.

Table 5. Revenue from privatization, Hungary (% of total)

	1992	1993	1994	1995	1996	1997	1998
Cash forint	22.67	10.33	17.62	5.42	15.88	31.12	54.18
Cash foreign exchange	53.06	65.13	6.99	86.94	49.06	59.58	34.54
Cash total	75.73	75.46	24.61	92.36	64.95	90.70	88.71
Compensation notes	2.93	8.57	40.98	3.90	26.35	6.48	3.75
E-credit	11.74	12.78	18.68	0.83	1.54	0.09	0.89
Foreign exchange credit		0.00	10.75	0.00	0.00	0.00	0.00
Asset returns	9.59	3.18	4.98	2.91	7.15	2.74	6.65
Total preferential methods	24.27	24.54	75.39	7.64	35.05	9.30	11.29
Revenue total	100	100	100	100	100	100	100

Source: Hungarian Statistical Office, 1999.

Finally, Voszka (1999) points to the social ambiguity that arose about the legitimacy of privatization and its positive effects. Lack of transparency and direct political influence interfering in privatization decisions have contributed to this public opinion. Initially, the Hungarian society was supportive of privatization. They had considered it as an opportunity to participate in ownership. Soon afterwards, it was started to be questioned due to the loss of jobs during the closure or rationalization of firms, to the fear of foreign ownership of domestic enterprises and to the danger that centralization would increase as firms became consolidated and to the occasions of previous illegal privatizations carried out by past officials.

Brown, Earle, and Telegdy (2005) estimate the effects of privatization on firm-level wages and employment in four transition economies; Russia, Ukraine, Hungary and Romania. They use longitudinal data on manufacturing firms and conclude that their fixed effect and random trend models consistently fail to support workers' fears of job losses from privatization, and they find no large negative effects on wages. However they find (3-5%) negative wage effects for domestic privatization in Hungary and Russia. They attribute these small negative effects to effects on scale, productivity, and costs that are large but offsetting in Hungary and Romania. They evaluate that both employment and wages in all four countries are affected positively by privatization to foreign investors. This is considered to stem from the substantial scale-expansion effect that dominates the productivity-improvement effect, and the positive wage outcome from a productivity effect that dominates the effect on cost reduction as a result of foreign ownership.

Brown and Earle (2006) analyze the effects of privatization, product and labor market liberalization, and obstacles to growth in the new private sector on reallocation and its productivity in Hungary, Romania, Russia, and Ukraine. The authors detect that "market reform has resulted in a large increase in the pace of job reallocation, particularly that occurring between sectors and through firm turnover". They highlight that aggregate productivity growth has accelerated as a result of job reallocation during the transition. Moreover, privatization has not stimulated both intra-sectoral job reallocation and the state firms resulting in a more productive private sector.

Claessens and Djankov (2000) analyze the changes in the performance of over 6000 privatized and state-owned manufacturing enterprises in seven Eastern European countries, one of which is Hungary, over the initial transition period. They find that privatization causes significant increases in sales revenues and labor productivity, and, to a lesser extent, with fewer job losses. The positive effect of privatization is found to be stronger in economic magnitude and statistical significance as more time passes after privatization. Their analysis shows that the majority of industries in Hungary had positive growth in terms of the average growth of real sales for 1992–1993, 1993–1994, and 1994–1995 for each firm. Furthermore, they detect no evidence of a difference in the rates of labor shedding between privatized and state-owned firms. In terms of median labor productivity growth by industry, only 9 out of 95 sectors in Hungary exhibited negative median productivity growths. Besides, the difference in labor productivity growth between privatized and state-owned enterprises is found to be statistically significant.

To sum up, Hungarian privatization experience has shown that the outcomes related to the success of privatization (such as revenues accrued, sectoral impacts, productivity levels, employment and wages) rely highly on the methods of privatization. The transparency of the privatization process gains importance in raising public support for the transactions.

4.4. Turkish Privatization Experience

Privatization has been on Turkey's agenda since 1984 starting with the enactment of Law No. 2983. Afterwards, the Istanbul Stock Exchange (ISE) initiated its operations on January 1, 1986, having fifty companies on the list. In 1989, all barriers to foreign investment were removed legally, giving *(1) the foreign investors the right to invest in Turkish stocks and mutual funds without getting the permission of the government and (2) the domestic investors the right to invest in foreign markets* (Simga-Mugan and Yüce, 2003). Consequently, the privatization process of Turkey started in 1986 and still continues.

Privatization Administration reports that state shares in 246 companies, 103 establishment, 22 incomplete plants, 8 toll motorways, 2 Bosphorus bridges, 1 service unit, 393 real estates and 6 ports have been taken into the privatization portfolio so far.

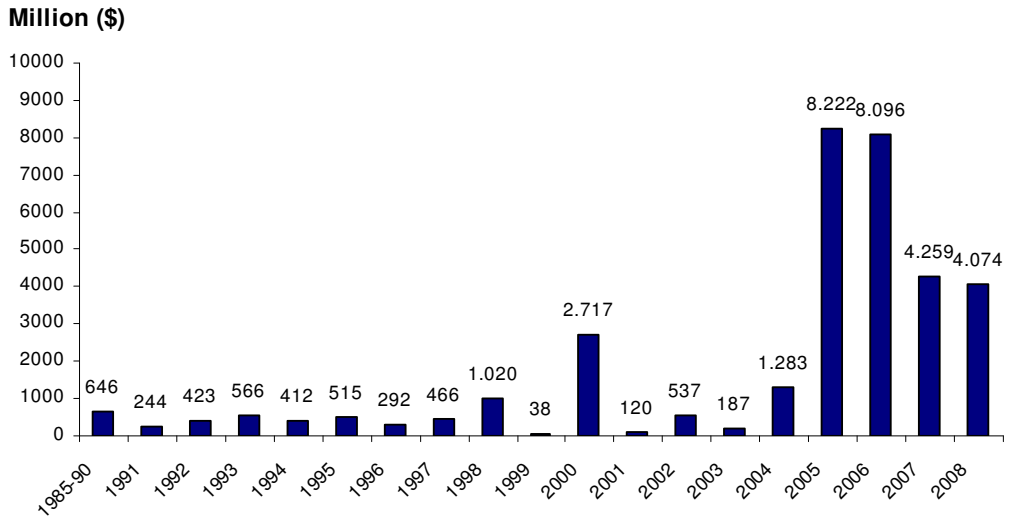
TEDAŞ ELECTRICITY DISTRIBUTION, TCDD BANDIRMA and SAMSUN PORTS, TEKEL (Tobacco, Tobacco Products, Salt and Alcoholic Beverages Inc.), ANKARA NATURAL ELECTRICITY PRODUCTION and TRADE JOINT STOCK COMPANY, MAZIDAĞI PHOSPATE PREMISE, TCDD DERINCE PORT, PETKİM, and IZMIR PORT are the privatization implementations within the tender phase.

Considering the whole transactions and total revenues since 1985, Privatization Administration reports that:

- *The state completely withdrew from cement, animal feed production, milk-diary products, forest products, catering services and petroleum distribution sectors.*
- *More than 50 % of the state shares were privatized in tourism, iron and steel, textile, sea freight and meat processing sectors.*
- *State has withdrawn from most of the ports and petroleum refinery sector.*
- *Privatization of public banks has commenced with Sümerbank and continued with Etibank, Denizbank and Anadolu Bank. The international and domestic offering of the 12.3 % state shares in İş Bank in May 1998, has been the largest public offering in Turkey until that time and recorded as one of the largest privatization proceeds among the emerging European markets.*
- *Public shares in Netaş and Tofaş were issued to foreign investors through international public offering for the first time, which served as a driving force of the integration of Istanbul Stock Exchange's (ISE) with foreign capital markets.*
- *Public shares in many companies were issued to the public, particularly in the beginning of this decade and this enhanced the institutionalisation of Istanbul Stock Exchange.*

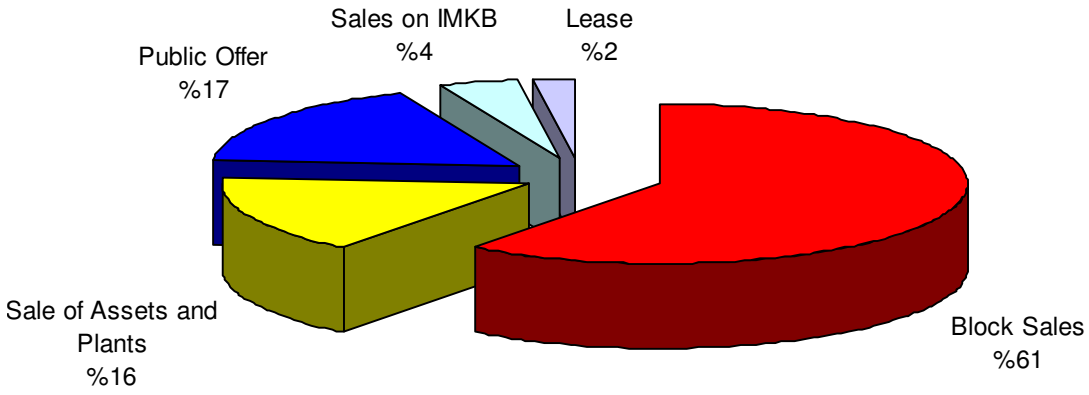
Figures 7 and 8 present total privatization revenues and the methods through which privatizations have been carried out in Turkey. Until today, total proceeds from the privatization implementations sum up to USD 30 billion. Block sales to real and legal entities make up 61% of these transactions. Shares of public offers and sales of assets and plants amount to 17% and 16% respectively.

Figure 7. Turkey: Total Privatization Revenues, 1985-2008



Source: Privatization Administration

Figure 8. Turkey: Privatization Methods



Source: Privatization Administration

When the results of the privatization are considered, we need to examine various indicators and the analyses of empirical research again.

A number of studies that have investigated the results of privatization of the cement industry in Turkey have come up with the following conclusions. Tallant (1993) finds that labor productivity of the privatized enterprises became higher than before while the already private enterprises have highest levels of labor productivity. The impact on employment is found to be negative in the privatized cement enterprises. Cakmak and Zaim (1994), on the contrary, discover that transfer of ownership was not sufficient to improve productive efficiency. Saygili and Taymaz (1996) evaluate that ownership and privatization have significant impact on increasing technical efficiency together with other determinants such as the effects of regional demand, firm's export rates and market power. Ozmucur (1997) obtains the result that capital-labor ratios increased following privatization in the cement industry.

Simga-Mugan and Yuce (2003) examine the productivities of sample firms privatized by different methods. Starting with plant sales, they observe that when plants were sold with the condition that they should continue production and keep the production at a certain level, most of the 65 plants generally achieved and passed the benchmark by the second year after privatization. Labor productivity is observed to increase due to the increase in production and the decrease in the number of employees. At the end of the second year, the selected companies are observed to operate with around 66% of the labor force that was available before privatization. However, the authors emphasize that the production level of such companies decreased by about 32% and, what is more, some of them have even closed, resulting in a sharper decrease in the labor force. Hence, the

authors argue that the privatization of such plants did not cause any improvement in the domestic production but decreased the amount of burden on the central budget. They make a further analysis of the performance of some companies that were privatized by block sales. They examine a sample of nine companies in which the state had more than 50% ownership. They report that the new owners carried out new capital investments in these companies except one special case where the Privatization Administration paid for 40 percent of the investments. They observe an increase from 63% to 67% in the average capacity utilization of this steel factory which was sold to the employees for a very minimal amount of money. The authors further display that the cement companies face a decrease in their capacity utilization rates (by almost 9%) following privatization and a 50% reduction in employment. Another interesting finding of the authors is that they started to incur losses in profitability after privatization although they were profitable prior to privatization.

Karatas (2001) argues that the goal of wider share ownership by encouraging small savers and employees to buy equities has not been achieved due to the preferences of most of the shareholders to dispose of their stocks with high profits in a short period of time. He further mentions the need to consider workers' displacement as a result of the privatization process. There should be serious evaluation of the unemployment effect of privatization and remedial measures should be raised. These measures could aim to compensate employees in the case of job losses, or give priorities to employees in purchasing the shares of privatized companies, or provide alternative employment to the displaced workers.

To sum up, Turkey has achieved partial progress in the privatization of state-owned economic enterprises. However, the performance of the privatized companies through plant and block sales presents a highly doubtful picture in terms of achieving the initially stated and desired objectives in privatization plans.

5. CONCLUSION

This study aimed to overview the literature on privatization focusing on its objectives and methods from a historical perspective, the expected impacts and empirical evidence on privatization performance relying on country and sector studies and attempted to examine the privatization experience of Hungary in terms of its trends, methods used and outcomes derived from an account that is involved in an assessment of the success or failure of privatization policies in Hungary. The study also aimed to screen a summary of the Turkish privatization experience in light of the empirical findings. Both being emerging market economies and developing countries, the experiences of Hungary and Turkey can help us derive some common lessons regarding privatization and can shape our understanding about the aims and impacts of privatization. It is also possible that the framework provided here can help to develop some policy implications.

The objectives of privatization range from raising revenues for the state to promoting economic efficiency and competition. Depending on the incentives behind, the choice of techniques of privatization can change. What is important here is that the priorities and the necessities calling for privatization should be well-defined. This also enables to assess the consequences and performance in a more efficient manner.

Another point is that privatization should not be an aim itself. It should be part of a compact set of reforms that are idealized for the objective of a well-functioning economy. This required the support of privatization with some other measures such as arrangements in the legal system, social security system and the improvement of capital markets. These needs stem from the historical facts which we dealt with in the third section. One of the main implications of privatization is that the results are very sensitive to the circumstances it is applied in. The impacts vary in developing countries versus developed countries and even across sectors within a country. Since developing countries lack sufficiently competitive markets and are restricted with underdeveloped capital markets, management weaknesses and lower standards of public administrations, the implications of privatization may result in undesired and unexpected outcomes.

Moreover, empirical findings call for a policy implication that needs to couple privatization with effective regulations and a competitive environment. In the absence of these regulatory arrangements, privatization has occurred to fail to generate the expected fruits for the economy even in more developed countries.

The Hungarian experience shows that the changeable and mixed structure of privatization has led to a lack of transparency on one hand but offered good opportunities to several groups of investors on the other hand. The expansion of the private economy is mainly due to the privatization process. Direct sales to local and foreign investors and auctions have proven to yield higher state revenues than other methods of privatization. We have also mentioned the social ambiguity about the legitimacy and advantages of privatization in Hungary. One can argue that privatization should be a more social process which attracts the support of citizens and which eases the direct participation of

citizens in the transactions. However, this is usually difficult to achieve because people usually do not have enough savings or incentives to invest in such processes.

The evidence also suggests ambiguous influence of privatization on wages and employment. Some studies conclude that privatization has positive effects on wage levels and employment levels whereas a considerable number of studies detect a negative effect. A common finding of most of the studies examined here is that it increases the sales revenues and labor productivity levels.

Relying upon these findings, a short evaluation of the Turkish privatization experience has also been made here. Starting from the 1980s, Turkey engaged in a dense privatization process which still goes on. As an immediate result, the state completely withdrew from a number of sectors such as cement and petroleum distribution. The revenues accruing through privatization have accelerated in amount especially in the last four years. The largest proportion of these transactions is implemented in the form of block sales. Studies on the implications of privatization in Turkey commonly echo the increase in labor productivity levels in the examined sectors. However, the results show that employment levels in privatized firms decrease, sometimes bringing together a fall in the production levels. These analyses necessitate a serious evaluation of the unemployment effects of privatization. Remedial measures should be developed in order to cope with job losses.

The Hungarian and Turkish experiences show that the implications change according to the conditions privatization takes place in and to the methods of it. The similarities are that the revenues have accelerated in both countries in the last few years and most of these revenues originate from direct sales. The consequences and impacts on some

economic performance indicators resemble in some studies and depart in others according to the choice of the specific performance criteria used, the sectors investigated and the supportive measures and arrangements formulized.

We can conclude that a well-defined privatization plan supported with regulatory arrangements and suitable institutions can generate desired outcomes. However, it should not be taken as a must for the whole sectors in the economy. A careful assessment should be made in why, how and in which sectors it should be implemented.

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