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ARTICLE: Symposium: A Recipe for Effecting Institutional Changes to Achieve Privatization: FOREWORD

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SUMMARY:
... Both of us have been involved in attempts of developing countries to move from a government, centrally-planned economy to a private-sector, market economy. Of course, neither the division between government and private sector, nor the division between centrally-planned economy and market economy is clear cut, but rather is a matter of degree. ... In contrast, the performance of actors in the private sector, can be measured by profitability to the equity owners (the shareholders). ... Second, as compared to the private sector, the government operates under political and bureaucratic pressures. ... When traumatic experiences occur that shakeup large organizations, both "rejuvenated" government and the private sector can work well. ... In a few limited situations a government may be in a better position to operate a firm than the private sector. ... The private sector includes large, especially multinational, corporations, that are centrally managed. ... Most of us realize that the private sector cannot do it all. ... When people become disillusioned with private sector and market solutions they will turn to the government. ... In those public-sector dominated economies, taxation is far less important than in economies in which the private sector owns the enterprises. ...

TEXT:

The idea for this mini-conference surfaced in a conversation with Professor Rebecca S. Rudnick, n1 who was working at the time on a tax bill for a developing country. Both of us have been involved in attempts of developing countries to move from a government, centrally-planned economy to a private-sector, market economy. Of course, neither the division between government and private sector, nor the division between centrally-planned economy and market economy is clear cut, but rather is a matter of degree. Further, privatization may be followed or accompanied by government regulation; we have numerous forms of economic interaction that contain some features of both.

Depending on the context, the term privatization has many meanings. Narrowly defined, privatization means the sale of a formerly government-operated enterprise, such as a telephone company or a national airline, to the private sector. n2 A broader definition includes a systemic change, which differs with the economy of the country. In the United States, where the economy is already situated towards the purely capitalist end of the spectrum, privatization may mean implementing a voucher system so that consumers may obtain an important public good, such as education from a private organization. In countries, such as China, whose economies were until recently centrally-planned, privatization involves a complete systemic overhaul, moving from government control to private control in innumerable institutions. These examples demonstrate that the movement to privatize is not confined to a particular group of nations, developing countries, for example, but has also taken hold in Western Europe and the United States. Here, the move is from government activities to private sector activities, and within the private sector, from planned economic activities to market, or market-like activities. In short, the privatization movement is global; it is not merely topical and important today, but will occupy us for some time to come. The importance and breadth of the subject makes it worthy of study. The more we engage in study and discussion the better. Hence, the impetus for organizing this mini-conference.

Of the many questions raised by privatization, this mini-conference will focus on the "how" in different countries: developed and developing, Western countries and the Eastern bloc (including China), emphasizing methodology and cultural traits. Clearly, the "how" will differ in fundamental aspects depending on the political and economic conditions of countries in which the process is taking place.

The focus on the "how," however, does not mean that we will not consider other important questions that the movement to privatize raises. The papers presented in this mini-conference reflect a wide range of questions and this forward offers a background for the more detailed discussions that follow.

I. Why Did the Movement to Privatize Arise Recently?

The answer to this question is complex. In some respects, the answer depends on the particular country, for example, whether it is developed or developing. In other respects the answer is general and applicable to all countries. The reasons for privatization are not just economic and social, but may include fiscal political pressure on the government.

One example of political pressure is the current lending policy of organizations such as the World Bank and the International Monetary Fund. n3 These organizations often condition their economic aid upon the implementation of a privatization plan, and exert great pressure on developing countries to privatize. Another form of social and political pressure is the tendency to "jump on the bandwagon" of privatization. Governments may be strongly influenced by success stories of privatization in other countries and find that reason enough to privatize their economies.

The current worldwide pressure on government treasuries provides another very powerful incentive to privatize. n4 Many Latin American countries have been motivated to privatize because of crushing government debt. n5 However, privatization does not necessarily lead to economically sound results. Governments may launch a movement to privatize before they have conducted a complete analysis of its costs and benefits. Further, strong fiscal concerns could overshadow and undermine the underlying goal of privatization - to increase public welfare. For example, the government may receive a much higher price by selling a public enterprise as an intact monopoly, although the responsible choice for the benefit of all sectors of the economy would be to break up the monopoly before sale. n6 In contrast, privatization may be propelled by sound economic reasons that overcome political and social pressures. Where public resources are scarce, governments may choose to privatize in order to divert scarce resources from uses of low priority to uses of higher priority. For example, while a national airline may bring some measure of prestige to a country, health, nutrition, and basic infrastructure are more important. Thus, privatizing can lead governments to shift resources from a national airline to maintaining a working transportation system. n7

Increasing the operating efficiency of companies currently managed by government institutions is another economic motive to privatize. Arguably, enterprises can operate more efficiently under private management than under government management. First, government enterprises cannot provide an inexpensive signaling device to determine the proficiency of their performance. Government performance cannot be measured by money (profitability), which is a more precise measure and less costly to use than other measures. In contrast, the performance of actors in the private sector, can be measured by profitability to the equity owners (the shareholders). Even though profitability may not be the perfect measure of efficiency, depending on the definition of efficiency, profitability measured in money terms is closely related to efficiency and is a less costly signal than non-quantifiable measures. Similarly, the managerial effectiveness of the government cannot be measured against that of other competing firms. n8 Absent a proper indicator, measuring government performance is far more costly than measuring the performance of market actors.

Second, as compared to the private sector, the government operates under political and bureaucratic pressures. While the central goal of a private sector firm is profit maximization, the government necessarily commits to other goals, such as public relations and re-distribution of wealth. n9 For example, government officials may keep an obsolete firm in business in order to keep its citizens employed. Whereas competition drives private sector organizations to reorganize and downsize in response to market and technological changes, government organizations are less affected by such forces to efficiently reorganize; they may even be driven to inefficiencies by counter-pressures. Public opinion and lobbying groups can exert strong political influence to keep a certain inefficient operation in place for their own benefit.

When traumatic experiences occur that shakeup large organizations, both "rejuvenated" government and the private sector can work well. However, with time, as the influence of special interest groups increases, it becomes harder to introduce any changes into government organizations. n10 Firms exposed to market pressures experience less difficulty adjusting and changing. n11

In a few limited situations a government may be in a better position to operate a firm than the private sector. These are the situations involving the creation of public goods. The primary economic justification for the creation of public goods is to correct some perceived market failure. Certain types of enterprises, such as telephone or utility companies, are seen as "natural monopolies," which will operate to take advantage of consumers in absence of government regulation. However, technology and financing have enabled the private sector to create competing entities where monopolies, such as utilities, postal and telephone service, reigned before. n12 With the elimination of these monopolies one of the justifications for government management (or strict interventionist regulation) no longer exists.

Third, an important impetus for privatization may be to provide incentives for innovation and investment, both of which are risky activities that benefit society. Experience has shown that privatization increases the rate of technological advancements, growth, and investments in an industry. In an analysis of the improved economic and welfare benefits that have resulted from the privatization of British Telecom, one of our discussants, Professor Ingo Vogelsang, shows that not only has the operating efficiency of British Telecom increased through more accurate pricing of services and the elimination of redundant personnel, but that the rate of investment in Telecom has also increased drastically. n13 Such increases in growth and investment are occurring in other countries as well. In Chile, during the three years since the Chilean telephone company was privatized, the number of phone lines has increased by 72%. n14 In Mexico, since the Aeromexico and Mexicana airlines were privatized, their capacity rapidly increased in both the number of destinations served and the frequency of flights. n15 In the analysis of British Telecom's privatization, Professor Ingo Vogelsang demonstrates that the British telecommunications industry has experienced increased competition from new entrants in the markets and that drastically increased new investment by British Telecom. These cases illustrate the dynamic changes in investment and growth triggered by the privatization of government enterprises.

Arguably, government stifles such incentives. In fact, bureaucracy provides disincentives to the risk-taking necessary for growth and investment. Further, because bureaucracy is often more focused on pressing social matters, it is reluctant to finance new investments in a timely manner. Also, absent competition there is little pressure on the bureaucracy to enhance technological advances, and growth. n16

II. The Cycle: Privatized Markets and Centralized PlanningOrganizations

Commentators have recognized that the movement toward privatization may be cyclical; that is, governments may oscillate between a strong role in planning the economy and a laissez-faire approach depending upon the political, cultural, and economic climate. n17 Such oscillations may be discerned in Latin America and Southeast Asia, where, over the past century, the governments have supported alternatively movements of privatization and nationalization. Such oscillation is also evidenced in the United States where, in the 1930's, the movement was towards centralized planning and management of economic resources by the government and by large, private sector corporations. Today the movement has reversed.

There are many explanations for the cyclical phenomenon of privatization/nationalization. Some explanations are based on politics or culture - for example, that these cycles are triggered by cataclysmic events such as the Great Depression or the breakdown of the Soviet Union. Cycles may also reverse under the pressure of political movements, such as intense nationalism, directed both externally or internally. Privatization traditionally leads to an influx of foreign investment; it has the potential to create a dual economy, where foreigners reap most of the benefits of privatization, or at least appear to do so. A backlash of nationalization may be a xenophobic response to the infusion of foreigners into the economy. Political jockeying between different ethnic groups within a country in order to assert their ethnic and national character may also be a factor in rising nationalism and the associated drive to nationalize enterprises. n18 Another explanation of the cycle is based on Marxist political economy, suggesting that, during periods of free enterprise, wealth may concentrate in the hands of a small number of affluent people while the standard of living for the majority of the population decreases. This leads to a popular movement to nationalize the economy. After such a period, when the ideals of nationalization fail to materialize, governments may return control to the private sector to increase productivity. Whatever the reasons for the cycles, they have a significant effect on the national and world economy. The cycles are costly because they force national economies and government bureaucracies to reorganize.

It should be noted that a centralized-planned economy is not synonymous with a government-planned economy. The private sector includes large, especially multinational, corporations, that are centrally managed. Economies based on such large private enterprises and government-run enterprises contrast with market economies composed of small enterprises.

At first glance, it seems that centralization and privatization are motivated by the opposite political and economic reasons growing out of different conditions and, consequently, different power structures. Nonetheless, movements toward centralization and decentralization may converge within a given economy. Take, for example the case of the modern multi-national corporation. There is substantial literature that explains why corporations have come into being and continue to exist. Explanations include the high transaction costs associated with market activities. Corporations serve to ensure orderly supplies necessary for orderly and standardized production. n19 Therefore, both in the private and the public sector, the movement toward privatization (markets) can be accompanied by a simultaneous movement toward its opposite: central planning. While we do not currently see a strong movement toward central planning in government, we do see a convergence towards mammoth, private sector, multi-national organizations that can be viewed as semi-governments. Nowhere is that movement more manifest than in the areas of new technology such as communications and computers. It is significant that these newly-formed, large organizations are still sufficiently flexible to reorganize in response to changing environments. Until the special interest groups within these organizations, or even outside them, coalesce and strengthen, the organizations will probably grow. Thereafter, we might see a break down of the centralized structure and the development of a market either within a very loose organization or within large markets.

In contrast to a cyclical movement, privatization may also be regarded as an inevitable progression in society, "the culmination of a world-historical learning process." n20 Some people may believe or hope that the functions of the government can be performed by the private sector, and that government may eventually become unnecessary and disappear. Most of us realize that the private sector cannot do it all. The question is: under what circumstances does the pendulum swing toward government management of economic resources, or at least toward substantial government intervention in the management of economic resources? I believe that whether the government will play an increasing role in managing economic resources may depend on the extent to which the markets will meet the demands of the population in terms of services, safety, quality of life, and prices. If far away localities do not have post office facilities, the government is likely to interfere. If products contain serious hidden risks, or monopolies arise, the government will interfere. If disparity among various classes of the population becomes too great for the acceptable mores of society, the government will interfere. When people become disillusioned with private sector and market solutions they will turn to the government.

III. What Are the Pre-Existing Conditions Necessary for Effective Privatization?

There is no consensus on how privatization should be effected, but there is a general consensus as to the preexisting conditions necessary for privatization to succeed.

A. Cost/Benefit Analysis

Any government considering privatization of a state-owned enterprise or industry should perform a cost/benefit analysis to determine whether private enterprise is the most efficient mechanism for such enterprise or industry. That is, the government must compare the public welfare under continued government operation and welfare under private operation to determine whether divestiture should take place. n21

B. Political Stability

Assuming that privatization will optimize welfare, the government must establish an environment conducive to privatization. Such an environment requires, first and foremost, political stability. For many developed countries seeking to privatize, stability may not be an issue, but in former Soviet bloc countries and other developing nations, the crucial condition of political stability is problematic. Another condition is the recognition of the "rule of law." The "rule of law" is necessary to offer predictability to market actors and enhance their ability to plan and enforce their agreements. C. Free Flow of Information and Capital n22

Free flow of information is necessary to promote privatization. So, too, is the free flow of capital to finance the privatization process, especially capital from foreign investors. D. Banking System

The proper functioning of the emerging market economy requires the establishment and maintenance of a strong, private banking system. n23

E. The Formulation of the Body of Business Law Necessary to Support a Market Economy n24

Business law includes a number of areas, and property rights are the fundamental starting point of such a legal framework, and must include rights regarding real property, movable property, and most importantly in the modern era, intellectual property. Next in the genesis of this fundamental legal system is the establishment of contract law. The effective enforcement of agreements is one of the most important determinants of the performance of a market economy. n25 Laws ensuring the maintenance of fair competition (e.g., antitrust laws) are also crucial. n26 It is further necessary to establish a method for allowing firms to exit the market because some businesses will inevitably fail, and there must be some means to balance the competing rights of creditors, the firm's employees, and the firm's shareholders. Absent a bankruptcy system, creditors and employees will rush to the debtor firm's assets and, inevitably, the resulting disorderly process will be unfair to all parties. Furthermore, without such a system in place, creditors will operate in an uncertain environment. Without a reliable means of predicting the consequences of insolvency, they will not be able to accurately determine the terms of the credit agreement, such as interest rates and repayment schedules. n27

F. Policies

In addition to laws, governments must follow certain policies. For example, competition policy must be the focal point for post-communist countries in their transition to a market economy. n28 As Professor Pankaj Tandon argues, without robust competition the benefits of privatization may never be realized. n29 The fact that private sector operations are less expensive than operations in the public sector may largely be explained by the higher degree of competition that actors face in the private sector. That is why a public enterprise operated as a competitive commercial enterprise may perform just as effectively as a private sector enterprise, and a private enterprise in monopolistic market, without the pressure of competition, is likely to perform just as poorly as one run by the government. In his presentation, Professor Tandon focuses on the privatization of airline and telecommunication companies in Mexico to illustrate the significance of competition policy. n30 The privatization of Aeromexico and Mexicana, with a focus on competition policy during divestiture, has benefitted consumers greatly due to the increased capacity of the airlines and a significant drop in prices. n31 On the other hand, the primary focus of the divestiture of Telmex was to generate revenues for the government, not to enhance the competitiveness and performance of the telecommunications industry. n32 The government supported the monopolistic position of Telmex and benefitted greatly from the price increases for telephone services but the consumers ended the losers. n33

Another policy that is conducive to privatization is the establishment of investment funds. n34 These funds are believed to play a pivotal role in the success or failure of a privatization program. As watchdogs over the managements of the companies in which the funds invest, they are expected to protect the funds' investors. Because the funds can diversify their portfolios, they can reduce the issuer risks for individual investors. Fund managers have more financial clout than individual investors and they have more access to financial resources, and particular access to international contacts. n35 However, the funds pose serious problems, including fraud, insider trading, ineffective or irresponsible management, and potential opportunities for these managements to exert monopolistic pressures. n36 Therefore, laws must be enacted to regulate fund managements, structures of investment funds, and nascent stock markets to prevent or reduce these problems while at the same time maximizing the benefits they offer in newly privatized economies. n37 Thus, in theory funds facilitate privatization. In practice they may fail to perform the task.

IV. How Should the Legal Infrastructure Be Designed?

No doubt, creating the needed legal framework raises difficult questions. Where shall the laws come from? Should laws be established through the common law process or through codification? The temptation to make a wholesale transfer of a code from a developed capitalist economy to economies in transition must be resisted. Although such a legal transplant may be expedient, it is not likely to address the needs of each society and its historical, cultural, and political development. As a result, it will most likely fail to take roots.

From my experience in advising Chinese officials on the drafting of China's Banking Law in 1992, I conclude that a transfer of a specific rule, which is necessarily tied to the environment in which the rule arose, is less appropriate in the context of privatization than the transfer of general models including concepts, standards, and legal techniques that can be used in numerous rules. n38 However, even general models may not be readily transferable. Certain legal models, for example, mortgages and liens, used in the United States and the Western World to resolve particular problems - security for creditors - are useless to the Chinese in solving similar problem because, in China, land and many inventories of failing enterprises have no markets. Yet, other models, such as disclosure, were extremely useful to the Chinese in resolving problems in entirely different contexts.

Therefore, rather than provide the Chinese with our rules, we engaged in a three-pronged method of analysis. We identified problems that China faced; we proceeded to examine the reasons for these problems, and whether the reasons were similar to those in other countries. At the next stage, we attempted to find solutions to problems in China through numerous models taken from related and unrelated areas of the law in the United States and other countries. Many times, I jumped to the conclusion that the United States could offer China ready-made, off-the-shelf solutions in the forms of statutes and regulations. Each time, I found that the process of forming a legal framework for privatization is a much more complex undertaking. The final step in the process of implementing privatization is the enactment of specific regulations which authorize and define the process. Although these regulations vary greatly from country to country, some fundamental requirements apply to all: the process must be fair, widely publicized, and streamlined (within one government agency) without sacrificing the underlying goal of increasing public welfare. Thus, the analysis and form of privatization is country specific. France or Great Britain may accomplish privatization through large scale sales or auctions of publicly owned enterprises but this form will probably be inappropriate for one of the former communist countries. n39 Furthermore, any plan must solve the problems intrinsic to that country's social and cultural environment.

V. How Should State-Owned Enterprises Be Valued and Prepared for Sale?

One significant problem with which many countries attempting to privatize grapple is valuation. How do we value an enterprise that has until now existed outside of the market? Valuation of such an enterprise can be a very subjective, arbitrary process, which may undermine a privatization program. n40 How to prepare the state-owned enterprise for sale is another potential problem. The enterprise must be significantly restructured before privatization. For example, the East German privatization agency, the Treuhandanstalt, is required by law to break up most state-owned enterprises into separate companies to prevent the transfer of large monopolies to the private sector. n41 Further, sequencing of the privatization stages poses difficult questions. Which firms should be privatized first? Often, the most inefficient firms should be privatized first, but this raises the question of which nationalized firms are the most inefficient.

VI. At What Pace Should Privatization Be Introduced?

Another important question relating to privatization is whether to implement privatization at a gradual rate or by drastic measures designed to have a strong immediate impact. n42 Those who opt for a gradual removal of government control seek small, incremental changes, over a longer period, thus prolonging the social and economic "pain" but at a lower level. This method may avoid the social upheavals of the drastic change, and produce a more stable transition. Those who would "rip" away government control propose a high level of "pain," but for a relatively short period. Under this more revolutionary view, unless changes occur in a "big bang," the existing system of nationalization may become even more entrenched or, in the alternative, the population may become dissatisfied with visible results from the privatization program and reverse the process.

This mini-conference reflects the controversy. Dean Ronald A. Cass argues that the optimal pace of privatization may differ according to the social, cultural, and institutional background of the country effecting the change, but that in the long-run it is better to err on the side of a fast-paced change rather than perpetuating the existing economic inefficiency. n43 Professor Robert B. Seidman posits that the relevant issue may not be a choice between "big-bang" or gradualist theories, because both forms of transition have resulted in a great deal of "pain" for the population. n44 Instead the focus should be on the decision-making process, and the legal and economic theories underlying the form of the transition to a market economy. He argues that, thus far, these theories have been relatively divorced from the social and institutional framework. In his opinion, economic and legal theory should be tied to an understanding of the functioning of the country's institutions.

Regardless of the merits of the big-bang and gradualist theories, a big bang reform strategy has been very difficult to implement in practice. Professor Richard K. Gordon reminds us that establishing the fundamental framework of business law may sound theoretically simple, but in reality is a daunting task. n45 The lawyer attempting to arrive at the proper policy choices underlying such law is confronted by a wide array of legal options borrowed from other capitalist countries, all of which may be viable solutions, or all of which may be totally inappropriate in the social and cultural climate of that country. The lawyer must determine what rules should apply in privatizing countries - the legal "software - and examine methods for enforcing these rules (either through administrative agencies or courts), that is, the legal "hardware." n46 These difficulties explain why a big bang theory of privatization reform has been hard to implement in former centrally-planned economies.

Clearly, the question of how to implement privatization involves far-reaching implications and should be approached differently depending upon the country. Developed countries that are not as concerned with the fundamental overhaul of their economy may focus only on the privatization of a specific industry; they may search for the Pareto optimal level of privatization or for the proper legal methodology of selling public enterprises to the private sector.

Former centrally-planned economies and developing countries are more likely to focus on the problems of creating an environment conducive to privatization, formulating a fundamental legal framework including property, contract, competition, bankruptcy, and securities laws, and the appropriate pace of the change.

Mr. Harvey E. Bines, Partner at Sullivan and Worcester, surveys the methods used by the governments of a number of these economies - Poland, Hungary, and the Czech and Slovak Republic - to effect the transformation from a centrally-planned to a market economy. n47 Mr. Bines examines specific legal constructs in these countries, including the format of contracts, the legal rights of creditors, and the protection of stockholders. n48 He also focuses on the area of strategic and financial investment, including the problem areas of employee participation in investment, management of risk, and sources of financing. n49

VII. Post Privatization: What Will Be the Continuing Role of Government in the Economy?

An important policy decision concerning privatization relates to the role of the government in the economy after enterprises have been privatized. Under a system of nationalization, government's role as producer of public goods was merged with its role as owner of enterprises, and in centrally-planned economies, as owner of all the means of production. Frequently, the government's role as benefactor of the public was overshadowed by its economic role. In Poland, the government devoted extensive natural resources to state-owned industries, depleting Poland's natural resources and harming the environment. n50 Under privatization, the government may focus on protecting the public good, for example, with efforts to protect natural resources.

After implementing privatization, the government should play an active role in two major areas. First, government should continue to monitor and regulate divestiture techniques and measure the overall success of the privatization program. The government should enforce the newly-created legal framework in areas such as private property rights, contract rights, bankruptcy, prohibition of monopolies, and the regulation of investment funds. The need for monitoring and enforcement is illustrated in Professor Karla Simon's examination of the methodologies of privatizing the social and cultural sectors of an economy, for example, health care and museums. n51 Professor Simon discusses the experience of Central and Eastern Europe and the newly independent states of the former Soviet Union, where the usual method of accomplishing privatization is by transferring state assets to a newly formed not-for-profit organization. n52 After such a transfer, it is vital that the public interest be protected and that the potential for corruption be curbed. In Romania, the new government privatized forty county youth organizations by transferring their assets to newly formed foundations. n53 With no monitoring, the potential for mismanagement became a reality within a year. n54 Most of the physical assets and much of the cash of the foundations had disappeared, and the playgrounds of the youth organizations were destroyed. n55 The government's monitoring role is especially important with respect to the privatization of social and cultural enterprises. Professor Simon argues that in order to monitor effectively the government must define the public interest, and select the regulations or legal institutions appropriate to safeguard the public interest in these social and cultural institutions, and - most importantly - establish mechanisms for enforcing these laws to prevent abuse and corruption. n56

Second, the government should help reduce macro-economic changes that have a negative impact on society. Whether the privatization process is gradual or revolutionary, some degree of transitional problems in society will occur due to macro-economic changes, such as inflation and declining real incomes. n57 One of the most pressing problems for a centrally-planned society undertaking such a transition will be the high rate of structural unemployment. The distribution of this "pain" is not governed by economic theory but by the response of social and political institutions. In Poland, for example, the impact of unemployment was cushioned by income-replacement for dislocated workers. Such safety nets are necessary to ease the pain of the sweeping changes in a privatizing economy. n58

After privatizing the economy, governments will be faced with a new issue: taxation. n59 When governments manage most enterprises in the economy, they draw on the profits of the enterprises, as any owner would, to support their operations. In those public-sector dominated economies, taxation is far less important than in economies in which the private sector owns the enterprises. In such economies governments need revenues to provide public services, and taxes are the main source of their revenue.

Professor Rebecca S. Rudnick examines tax issues in the context of privatization, providing a survey of the methods for taxing foreign investments in real property. Five basic taxes may be applicable to foreign investment: income and capital gains taxes, property taxes, value-added taxes, net wealth taxes, and transfer taxes such as inheritance taxes. n60

Professor Richard K. Gordon specifically scrutinizes the tax implications of privatization by using pension funds. n61 While the pension fund method of privatization has several advantages, one of the primary questions raised by such a method is whether the pension funds should or should not be tax exempt. n62 Professor Gordon analyzes the taxation issues of tax exempt pension funds and non-tax exemption pension funds used to privatize the economy. n63

The question of the continuing role of government in society is especially critical for former centrally-planned economies. Will the Central and Eastern European economies transform themselves into capitalist economies with little government intervention, along the lines of the Western world, or will they metamorphose into a new and original economic system with a level of government intervention somewhere in between capitalism and communism? The answers to these questions remain to be seen.

FOOTNOTES:

n1. Professor Rebecca S. Rudnick was a visiting Professor at Boston University during the 1994-1995 academic year. Professor Frankel is referring to A Recipe for Effecting Institutional Changes to Achieve Privatization, an Interdisciplinary Mini-Conference held at Boston University School of Law on April 26, 1995.

n2. Ronald A. Cass, The Optimal Pace of Privatization, *13 B.U. Int'l L.J. 413 (1995).*

n3. Rafael A. Porrata-Doria, Jr., Privatization of Public Enterprises in Latin America, 1993 Am. Soc. Int'l L. 124, 125.

n4. Mary M. Shirley, The What, Why, and How of Privatization: A World Bank Perspective, 60 Fordham L. Rev. S23, S23 (1992).

n5. Porrata-Doria, supra note 3, at 124.

n6. In Mexico, the government, seeking to privatize the telecommunications company Telmex, chose not to break the monopolistic company up, apparently because of the revenue motive. Pankaj Tandon, Welfare Effects of Privatization: Some Evidence From Mexico, *13 B.U. Int'l L.J. 329 (1995).*

n7. Shirley, supra note 4, at S25.

n8. Ingo Vogelsang, Micro-Economic Effects of Privatizing Telecommunications Enterprises, *13 B.U. Int'l L.J. 313 (1995).*

n9. Id.

n10. Note the difficulties of eliminating any subsidies and entitlements even after the rationales for providing such subsidies have disappeared.

n11. For arguments to the contrary, see discussion infra part II.

n12. Vogelsang, supra note 8.

n13. Id.

n14. See Shirley, supra note 4.

n15. Tandon, supra note 6.

n16. Of course, some critics may argue that government provides the seed money for basic research either directly (through universities) or for government purposes (e.g. through the defense department), and then shares the research with the private sector. Therefore, in many cases the private sector avoids investment in risky basic research and invests in technology only after the basic research has been done and proven successful.

n17. Amy L. Chua, The Privatization-Nationalization Cycle: The Link Between Markets and Ethnicity in Developing Countries, *95 Colum. L. Rev. 223, 225-26 (1995).*

n18. *Id. at 226.*

n19. Oliver E. Williamson, The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting 295 (1985); Oliver E. Williamson, Markets and Hierarchies: Analysis and Antitrust Implications 1-2 (1975); Ronald H. Coase, The Nature of the Firm, 4 Economica 386 (1937). See also Professor Manuel A. Utset's paper presented in this mini-conference, Markets in the Age of Mechanical Reproduction, *13 B.U. Int'l L.J. 351 (1995).*

n20. Chua, supra note 17, at 225.

n21. For an economic analysis of how to conduct this cost/benefit examination, see Leroy P. Jones et al., Selling Public Enterprises: A Cost Benefit Methodology 16 (1990). See also M.E. Beesley & S.C. Littlechild, Privatization: Principles, Problems, and Priorities, in Privatization, Regulation, and Deregulation 23, 30 (1992).

n22. Unfortunately information regarding enterprises in former communist countries is often lacking.

n23. On the current weaknesses of the banking systems in the newly privatized economies in Eastern Europe see Roman Frydman & Andrzej Rapaczynski, Privatization in Eastern Europe: Is the State Withering Away? 84-85, 128-34 (1994).

n24. See generally Tamar Frankel, The Legal Infrastructure of Markets: The Role of Contract and Property Law, *73 B.U. L. Rev. 389 (1993).*

n25. Paul H. Rubin, Growing a Legal System in the Post-Communist Economies, *27 Cornell Int'l L.J. 1, 3 (1994).* These conditions are not yet fully met in the former centrally-planned economies.

n26. See Michele Balfour & Cameron Crise, A Privatization Test: The Czech Republic, Slovakia, and Poland, *17 Fordham Int'l L.J. 84, 89-90, 99-102, 118-20 (1993).*

n27. Evan D. Flaschen & Timothy B. DeSieno, The Development of Insolvency Law as Part of the Transition from a Centrally Planned to a Market Economy, *26 Int'l Law. 667, 668-69 (1992).*

n28. Competition policy takes on an even greater significance because such laws should be implemented before a country may join the European Economic Community. Eastern European countries with formerly centrally-planned economies are now modeling their competition laws on those of the European Community, in the hope of someday securing membership. See Carolyn Brzezinski, Competition and Antitrust Law in Central Europe: Poland, The Czech Republic, Slovakia, and Hungary, *15 Mich. J. Int'l L. 1129, 1133, 1141, 1149-52 (1994).* Competition law should include a methodology for controlling mergers, preventing the abuses of market dominance and monopolistic practices, breaking up monopolies, and removing tariff and other non-tariff barriers to foreign trade.

n29. Tandon, supra note 6.

n30. Id.

n31. Id.

n32. Id.

n33. Id.

n34. Richard K. Gordon, Privatization and Legal Development, *13 B.U. Int'l L.J. 367 (1995).*

n35. Matthew J. Hagopian, The Engines of Privatization: Investment Funds and Fund Legislation in Privatizing Economies, *15 Nw. J. Int'l L. & Bus. 75, 75, 81-83 (1994).* See also William C. Philbrick, The Task of Regulating Investment Funds in the Formerly Centrally Planned Economies, *8 Emory Int'l L. Rev. 539, 541-42 (1994);* Andrew Xuefeng Qian, Riding Two Horses: Corporatizing Enterprises and the Emerging Securities Regulatory Regime in China, *12 UCLA Pac. Basin L.J. 62, 63 (1993).*

n36. See generally J. Robert Brown, Jr., Order from Disorder: The Development of the Russian Securities Markets, *15 U. Pa. J. Int'l Bus. L. 509 (1995)* (examining the abuses that have taken place in the Russian securities markets, including problems of advertisements which greatly exaggerated the potential returns of investment funds).

n37. Balfour & Crise, supra note 26, at 90-93.

n38. Tamar Frankel, Knowledge Transfer: Suggestions for Developing Countries on the Receiving End, *13 B.U. Int'l L.J. 141 (1995).*

n39. To design the proper method, we should inquire as to who will receive ownership rights under the privatization scheme and how ownership rights will be distributed, directly or through some indirect form such as a share in an investment fund. See Frydman & Rapaczynski, supra note 23.

n40. V.V. Ramanadham, Privatization and After: Monitoring and Regulation 118-19 (1994).

n41. Thomas Raiser, The Challenge of Privatization in the Former East Germany: Reconciling the Conflict Between Individual Rights and Social Needs, in A Fourth Way?: Privatization, Property, and the Emergence of New Market Economics 3, 3-15 (Gregory S. Alexander & Grazyna Skapska eds., 1994) [hereinafter A Fourth Way].

n42. Cass, supra note 2; Gordon, supra note 34; Robert B. Seidman et al., Big Bangs and Decision-Making: What Went Wrong?, *13 B.U. Int'l L.J. 435 (1995).*

n43. Cass, supra note 2.

n44. Seidman, supra note 42.

n45. Gordon, supra note 34.

n46. Id.

n47. Harvey E. Bines, Some Views on Privatization in Central and Eastern Europe 1991-1995, Presented at the Interdisciplinary Mini-Conference: A Recipe for Effecting Institutional Changes to Achieve Privatization, at Boston University School of Law (Apr. 26, 1995) (videotapes on file with the Boston University International Law Journal).

n48. Id.

n49. Id.

n50. Stanislaw Biernat, The Uneasy Breach with Socialized Ownership: Legal Aspects of Privatization of State-Owned Enterprises in Poland, in A Fourth Way, supra note 41, at 19, 26.

n51. Karla W. Simon, Privatization of Social and Cultural Services in Central and Eastern Europe: Comparative Experiences, *13 B.U. Int'l L.J. 383 (1995).*

n52. Id.

n53. Id.

n54. Id.

n55. Id.

n56. Id.

n57. Ramanadham, supra note 40.

n58. Jackie Ruff, Job Security in Poland: Economic Privatization Policy and Workplace Protections, *7 Temp. Int'l & Comp. L.J. 1, 10-14 (1993).*

n59. One of the most important tax issues that former centrally-planned economies will face is how to tax without absorbing funds necessary to fuel investment in the new market economies. One answer may be a consumption tax, such as a value-added tax, which will increase the savings rate rather than absorb the savings available for investment. See Frydman & Rapaczynski, supra note 23.

n60. Rebecca S. Rudnick, Taxing Foreign Investment in Real Property, *13 B.U. Int'l L.J. 395 (1995).*

n61. Gordon, supra note 34.

n62. Id.

n63. Id.