

Privatizing Privatization: The Czech Experience

A Conversation Between Jan Vrba and Pedro J. Pick

As the dust begins to settle almost three years after the collapse of the Iron Curtain, the Czech and Slovak Federal Republic (often referred to as the C.S.F.R.) has emerged with what is arguably the boldest policy on privatization among the former Eastern Bloc countries. Unlike Hungary, Poland, and the former East Germany, where control over the privatization process lies mostly in the hands of one central authority, the C.S.F.R. has transferred most of the responsibility for the privatization process to the individual companies being privatized. These companies must prepare their own privatization projects for approval by the relevant ministries. Thus the privatization process itself has been privatized. The result has been an enormous decentralized mobilization of resources and a massive and rapid ongoing privatization process, the likes of which has never been experienced anywhere.

This process has included a mass denationalization of many assets by means of a virtual giveaway of company stocks to the Czech public. The government has sold vouchers or coupons to some 8.5 million Czechs and Slovaks for approximately one thirtieth of the estimated value of the shares for sale. Holders of the coupons can use them to buy shares in any companies they like.

Critics of this controversial experiment say that the shock therapy of Czech and Slovak privatization may kill the patient before the patient can respond to the medication of restructuring and market conditions. Furthermore, many argue that the groups and individuals who will gain ownership by using coupons will not necessarily be better owners than the State was, and that changing a company's owner without taking the time to restructure it is unlikely to raise its competitive ability. In contrast, proponents of this method of denationalization and privatization argue that the most crucial factor in achieving a prosperous free-market economy is speed. In their view, delay will almost certainly prove fatal. Bankruptcy, unemployment, and even economic collapse are risks that must be accepted in exchange for the probability of tremendous success. The jury on this issue is still out.

Meanwhile, foreign investors have found the C.S.F.R. to be mostly uncharted territory, where every newcomer must find his or her own means of realizing joint ventures and acquisitions. The government's attitude toward foreign capital participation is favorable, provided that a potential partner shows a sense of long-term commitment to the company, its employees, its Czech or Slovak shareholders, and the C.S.F.R. in general.

In the following interview, Jan Vrba, who was Minister of Industry of the Czech Republic for the two years preceding the elections of June 6, 1992, discusses the current progress in the transformation of the C.S.F.R. economy with Pedro Pick, head of Arthur D. Little's Prague office. This conversation took place on April 17 in Prague.

Pedro Pick I would like to ask several questions about the current situation at the Ministry of Industry. First, what are the objectives of the Ministry and how has its role changed during the first two years after the Velvet Revolution?

Jan Vrba The Ministry of Industry is a branch ministry. It came into being through the consolidation of the former Czech Ministry of Industry (responsible for the chemical, rubber, and consumer goods industries) with the Ministry of Construction and the Machine and Electrotechnics Ministry. Under the former centrally planned economic system, the role of branch ministries was to take the plan developed by the Ministry of Planning and break it down into individual tasks for individual industries and further for individual enterprises. When central planning was halted (as of January 1, 1991), both the role of this Ministry and the situation of enterprises changed substantially. Most enterprises welcomed the new approach because they had been hindered by the old planning system. But few enterprises had any experience with Western-style general management.

The success of a director within the centrally planned economy (under the former regime) depended on his good relations with the branch ministry. He received his plan according to the quality of those relations and based on his relationship with the relevant party secretary. Thus, the director always had one eye fixed on the Ministry of Industry or on the relevant branch ministry, carefully observing what kind of plan he was to receive. Naturally he tried to arrange a favorable plan (using acceptable and not-so-acceptable means). Meanwhile, his other eye was carefully observing the actions of the relevant party secretary.

After the revolution, the party secretary disappeared and the Ministry of Industry began to disappear, especially with respect to central planning. However, a new stakeholder emerged: the customer. It was still important during this transitional period for the manager to observe the Ministry of Industry with one eye, not in connection with a plan but rather with regard to deregulation. But now, for the first time, the manager had to keep the other eye always on the customer, as is customary in a market-oriented economy. (Naturally, the management must also have peripheral vision in order to keep track of competitors.) The current role of the

Ministry is to support this shift in focus on the part of the enterprise's management from the former central plan to the customer. So the Ministry devises and implements very practical measures aimed at changing both the orientation and the behavior of enterprises. By concrete measures I mean privatization and restructuring.

All of Czechoslovakia's industry was formerly oriented toward Eastern markets. The results of this orientation are now apparent: when the former Soviet Union dissolved and the markets of the former East Germany disappeared, we lost approximately 30 percent of our export markets.

To further complicate matters, after price liberalization in our domestic market, the structure of demand changed. Our greatest problem is modifying production to correspond to the change in the demand structure. At the same time, we must modify the markets themselves along Western lines.

Pedro Pick This is, of course, a very challenging undertaking. Which industrial sectors are likely to have an easier time of it – that is, which are most competitive – and which will find restructuring most difficult?

Jan Vrba The sectors mostly oriented toward Eastern markets are the most vulnerable and least competitive. The sectors and enterprises that exported to Western markets before the revolution are doing much better. In fact, their success is in direct proportion to the amount of their exports to convertible-currency markets. Specifically the cut-glass manufacturers occupy the best position. Chinaware and artificial jewelry manufacturers are generally in a good position. Some segments of the machine and textile industries, as well as hunting-arms manufacturers, are in good positions as well. Interestingly, some small sectors within the steel industry are able to keep up at a fairly high level, generally because somebody on their staff was well informed, could visit foreign countries, and had successfully held on to some interesting and competitive production facilities. However, these categories together constitute only some 15 to 20 percent of the overall Czech industry.

Pedro Pick What about the less competitive sectors? How do you see their future?

Jan Vrba I would divide all enterprises into two categories, regardless of the industries they belong to. In the first category are enterprises that are structured along the lines of modern businesses. These enterprises can compete – even with our cost levels – and can achieve reasonable results within a short time, provided that they have capable management.

In the second category are the enterprises that are not viable at present and that must be restructured before or during privatization. This is the category for which we are encouraging foreign capital participation. I would break down this second category into two subgroups. The first subgroup is in a better position because there is some foreign interest in them. We can try to privatize and restructure them simultaneously with the help of foreign capital.

Enterprises in the second subgroup are unprivatizable in their present form and there is no interest in them. They must first be restructured and then privatized as soon as possible. The truth is that there are viable as well as unviable segments in both subgroups. Thus, as a first step, it is necessary to separate the viable elements from the unviable elements and to start developing the viable ones.

Pedro Pick Which enterprises or sectors have already been restructured or are clearly on the path toward restructuring?

Jan Vrba Heavy machinery is well along the path. *Yesterday* we celebrated the first anniversary of the signing of the contract between the automotive operations of Skoda and Volkswagen. Separately, Skoda Pilsen, a major conglomerate that manufactures everything from machine tools to locomotives, is now negotiating two contracts with Siemens, one with the Energo Division and another with the Transport Division. Those negotiations are progressing well. Furthermore, this new Skoda-Siemens cooperation has expanded to include negotiations with Chevron's Swiss affiliate regarding the production of electrotechnical component parts of locomotives and other products. These talks, too, are going well. Skoda Pilsen is a good example of restructuring that has been performed with the help of foreign capital, that is, restructuring linked with privatization.

Similarly, CKD Praha, another giant manufacturing firm, is progressing well in the process of being restructured with the help of foreign capital. The process shouldn't take more than two years. Conversations are under way with the German company AEG and with Chevron, while Borzik Company will improve competitiveness of CKD's compressor division.

We have also made the first significant steps in the restructuring of truck manufacturers, such as Avia and Liaz, with Mercedes helping in the privatization process. It appears that Iveco will enter into a partnership with Tatra Koprivnice.

These are examples of large enterprises for which negotiations are nearing an end. However, there are many other negotiations going on, which are at various stages. For example, Prvni Brno is negotiating with ABB and with General Electric.

Pedro Pick What about other industries, such as the chemical industry?

Jan Vrba Things are not moving as fast as we would like in the chemical industry, especially in the case of oil refineries, which face difficulties similar to those in the steel industry. Our oil refineries were originally designed to process approximately 18 million tons of oil per year. Our present domestic oil consumption ranges between 11 and 12 million tons. The installed technology did not allow for extensive oil processing, so this industry was and still is working rather inefficiently. This problem is still waiting to be solved.

But the biggest problem, as I have already mentioned, is the steel industry, which has been producing 15 to 16 millions of tons of steel annually, or one ton for each baby born in the C.S.F.R. When we calculate the likely demand for steel in our restructured domestic market and add to it our real export potential, we will need only about 8 million tons of steel every year.

Pedro Pick You have mentioned the phrase „privatization process“ several times. If you look back at the past two years, how would you assess the privatization process, and how is it going now?

Jan Vrba If it were possible to start again, I would suggest a different approach from the one we chose. I would recommend thinking twice and then privatizing, rather than the other way around; in other words, I would suggest restructuring those companies that need it and only then denationalizing them through coupons. We started privatizing rapidly and only then started thinking.

We understand that our biggest problems are the structural changes we must make in the Czech production system to reflect the fact that we have lost our former customers forever. There is not, and presumably never will be, any Planning Commission to command the customer to buy something. So we are forced to reorganize things in the factory. This means coming up with a basic strategy and plan for restructuring. Only then can we adapt the methods and process of privatization to that plan.

Pedro Pick Do you consider joint ventures indispensable, or is foreign investment sufficient?

Jan Vrba Both joint ventures and foreign investment can play key roles in privatization. Toward that end, I recommend privatizing privatization and not allowing the legislative part of the government to tamper with it. The government should just issue the request for proposals, and experienced teams of consultants should manage the whole problem, from the initial restructuring studies through financial issues and marketing up to legal issues.

Pedro Pick Just one final question. It seems to me that Czechoslovakia finds itself today at a historic moment, in the midst of truly radical change. Do you think there is a real possibility for the emergence of truly competitive modern industry, or will industry here continue in much the same way it has in the past?

Jan Vrba Anybody who thinks and who can receive feedback is capable of correcting his actions. I think this country will learn a powerful lesson from our recent experience, and that our actions in the future will be notably different. I think there will be significant changes for the better.

Jan Vrba was Minister of Industry of the Czech Republic for two years preceding the elections of June 6, 1992.

Pedro J. Pick is a vice president of Arthur D. Little, Inc., and managing director of Arthur D. Little, Prague. He is an associate of the Harvard University Center for International Affairs. His experience is in the general management of large private and public sector activities.