

## Problems of Liberalization/Privatization

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In the process of societal development, the transition from the centrally planned economy to the market economy usually took place over a long period of time and to a large degree through evolution. The rapid political changes initiated in Eastern Europe in 1989 have contributed to an unprecedented, extremely fast and dynamic transition process. This process depends on economic analyses based on theoretical premises. Practically, such analyses cannot consider all of the factors influencing the transformation.

Liberalization and privatization of the economies in Eastern Europe consists to a large degree in the elimination of what was left by the centrally managed economy both in the economic and social fields.

The fundamental feature of a centrally planned economy is the system of issuing instructions with the main areas of development decided arbitrarily, without prior objective economic analyses and with total disregard of public opinion, often even disregarding the common good of the majority of society. Since the national property belonged to the state, theoretically all decisions could be easily carried out.

The currency of the countries with centrally planned economies was not exchangeable while prices were lower than in other parts of the world. Considering such conditions, economic analyses were based on erroneous premises with emphasis based on the rules of the political system.

Due to political reasons, the state was very much in favor of developing energy inefficient heavy industry, which offered the easiest way of carrying out economic plans and made it possible to create many jobs, even though the work efficiency left much to be desired. Light industry and services in general were considered to be secondary concerns. The same thinking was applied to problems of environmental protection.

Central management of the economy was facilitated by the fact that the state had a monopoly on trade with foreign countries. The state, however, was the protector of all citizens and guaranteed them payment, social services and provided the necessary resources for education, culture, health care, recreation, etc. Although payment was considerably lower than in developed countries, it did suffice to provide an average level of prosperity.

### Privatization and Liberalization of the Economy

The basic condition of the economic transition from the centrally planned to the market economy was the establishment of economic policy on the basis of economic criteria and the reduction of the influence of the state on the economy, privatization of state property and liberalization of trade exchange. Such changes required proper legislative and administrative regulations.

The success of economic transition depends to a large degree on the state policy for energy.

The arbitrary establishment of prices without consider-

ing the real value of goods and services, so characteristic of the central economy, had an especially negative impact on the energy sector.

All the countries of Eastern Europe imported energy (especially oil and gas) from the former Soviet Union. Financial settlement between these countries and energy suppliers was done mainly through barter, while prices were fixed at a level much below world prices.

The structure of the energy economy of the former Comecom was characterized by strong connections between individual member countries and the energy exporter, the former Soviet Union, while connections between member countries did not exist, even when the countries were close neighbors. Some surplus energy (e.g., coal from Poland) was exported to the OECD countries, which to some degree helped the poor financial situation of the exporters. The per-capita use of primary energy in the countries of Eastern Europe was comparable to energy use in the developed countries, but the national income was much lower which is tantamount to excessive energy consumption and poor energy efficiency.

The excessive energy consumption was mainly caused by low energy prices, which were also the reason for environmental pollution, especially since the main energy source was coal (hard and brown). The excavation of coal and its burning in power stations caused contamination of the atmosphere, rivers and lakes and produced a substantial amount of waste.

In order to turn energy policy into a factor stimulating the economic transition the following activities were undertaken:

1. Restructuring of state-owned enterprises was initiated in order to make them profitable, at the same time reducing state subsidies;
2. Privatization of state-owned enterprises was initiated. Out of large, autocratic enterprises, small units were separated and then privatized. A number of agencies and other institutions were set up in this way and they have an influence on the energy economy, both at the local and national level. There were also a number of businesses established to provide equipment and machinery for efficient energy use and to offer consulting services;
3. Prices of most goods and services were liberalized, but the central government retained control of the price of energy, which was most important for the stabilization of the economy. It was assumed that the process of bringing energy prices up to world levels had to take place gradually in order to avoid excessive inflation;
4. Commercial exchange was liberalized and it is now carried out between enterprises as partners or on a producer-to-purchaser basis, without state intervention;
5. Convertible currencies were introduced;
6. Trade with OECD countries was developed;
7. Banking systems are being reformed and improved; and
8. The social insurance systems are being reformed.

Practically, however, the process of transition is extremely complex and encounters a variety of unexpected obstacles (not foreseen in the transition programs), which were intensified by the rapid pace. Although in definite minority, there were some negative experiences, which appeared in the first period of transformation as described below. These difficulties were responsible for slowing down reform introduction.

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### Difficulties and Problems of Privatization and Liberalization

It appeared that the direct adaptation of the economic model from the developed countries, characterized by tough market economy rules, created a number of new problems and met strong opposition on the part of society and trade unions.

One of the basic problems in the transition period is the restructuring of the economy. Centrally controlled and inefficient enterprises were subsidized by the state. It has been noted that in order to adapt them to the market economy, the subsidies must be eliminated and efficiency increased. The restructuring, however, is usually responsible for a reduction in employment and a consequent increase in unemployment, an experience heretofore unknown in Eastern European countries.

Additional difficulties were caused by the severing of economic relations among countries of the former Comecom. These are now being renewed, though rather slowly. Attempts to speed up the process have proved fruitless so far.

As previously noted, in the centrally planned economies energy and fuel prices were considerably lower than market prices and it is necessary to raise them to world levels in order to transform the economy. It is obvious, however, that raising prices sharply results in inflation. Apart from this it will also increase family fuel and energy expenditures. The impact of this cannot be underestimated, given the low income levels. In light of inflation and social protests, the process of raising energy prices has been slowed.

Due to the limited resources of Eastern European energy suppliers, these countries have no option but to import some energy. This must now be done at international prices. This is definitely a burden on the low budgets of the importing countries and weakens their export capabilities during the transition period. Some of these countries have large amounts of coal, but the brown coal is in most cases excavated solely for the use of power stations situated in the vicinity of the mines, while the hard coal is found deep below the surface and is expensive to excavate. Costs of hard coal excavation were referred to as *low* during the time when the economy was centrally managed. When the prices began to approach world levels, it appeared that the hard coal mining industry was not profitable and though many attempts were undertaken to remedy the situation, they have not been effective.

The unavoidable slowing down of the raising of energy

prices to world levels creates additional difficulties in economic decisionmaking, and results in various parts of the transition moving at a differing rates. In turn this results in the economic analyses originally used in the planning no longer being current.

The fundamental problem of the countries going through the process of economic transition is inflation, which always follows the increase of energy prices. To fight it, tough monetary policy must be applied, which understandably causes social protests.

Another problem is the lack of financial resources for the restructuring of the economy. It has been estimated that energy sector investment needed through 2000 in the countries of Eastern Europe amounts to about US\$150 billion. Without financial assistance from the OECD countries it is not possible to make this investment. Unfortunately, the aid actually forthcoming has been less than earlier promised. This has slowed the pace of reform and caused a change of political attitude.

Maintaining the course of economic policy depends to a large degree on the parliament and social pressure. Instability of political and social conditions is the reason why many economic decisions are taken as *stop gaps* and in an arbitrary way to solve conflicts, without the necessary analyses to assess the accuracy of the decision.

During the transition most of the members of management teams were changed. The new managers were selected considering their political affiliations and they are not prepared professionally to tackle the problems of massive economic structural change. It should further be noted that the political parties with which the new managers are closely connected, do not have clearly defined ecological programs.

In the centrally planned economy, economic decisions were undertaken at the central level, without consultations with society. One of the conditions of transition to the market economy is to make the process of decisionmaking a societal one. It is also important to grant economic decisionmaking to local authorities and enterprises.

Following the advice of experts from developed countries, the state stopped interfering with economic processes. After the first enthusiastic period, difficulties began to emerge in large national enterprises adapting to the new conditions. The attempt to match salaries to the actual work effort resulted in substantial differences among employees.

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## Problems of Liberalization (continued from page 23)

This was a new experience in a society accustomed to equal distribution of income. This contributed to the slowing down of the privatization and liberalization of the economy. There was also an increase in commercial activities based on loopholes in the laws and in the so called *black market*.

When reforms were initiated, the determination of society was overestimated. Also not considered was the lack of a clearly defined concept of socioeconomic change to the new conditions. This caused strikes and numerous social protests, especially since the lower standard of living was followed by a more limited, protective role by the state. The budget deficits necessitated the limiting of resources for health care, education, culture, recreation, sports, etc., which brought about a significant deterioration in these areas of socioeconomic life.

The lack of funds and privatization of companies made it impossible to quickly overcome economic recession. Weak economies of the Eastern European countries without the necessary financial support find it especially difficult to solve their problems. Due to social reasons, some of the unprofitable companies will have to be supported by the state. However, the lack of funds and social resistance slow down the reform process, which only further complicates the problem. The assistance offered by the OECD countries has so far been relatively insignificant in this matter.

An improvement of some areas of socioeconomic life did take place *several years* after economic reforms were initiated. The positive aspects in the majority of Eastern European countries are:

- An increase in energy prices, followed by lower inflation and economic stabilization in a significant number of companies;
- Strengthening of the currency and the development of the individual consumer market;
- Progressive privatization of national property;
- Structural changes in the job market; an increase in employment in the private sector and lower unemployment;
- An increase in international trade especially with the developed countries;
- Lower energy consumption in transportation; and
- The use of OECD countries' assistance (credits, subsidies).

### Aims of Energy Policy in the Transition Period

The aim of energy policy for energy management in countries in the transition period is to introduce into the energy sector the principles of the market economy. This means:

- To provide the national economy with energy safety and a sufficient amount of high quality energy with prices based on economic realities. (The import of oil has been increased from Middle East and European countries. In 1995, the Czech Republic, Poland, the Slovak Republic and Hungary joined the energy network of Western European countries);
- To render energy policy independent of outside and

subjective factors;

- To negotiate profitable agreements with energy suppliers based on competitive prices;
- To eliminate monopolies of energy producers and to modernize energy systems on the basis of developed country standards so that energy users have the possibility of choosing their suppliers. Since elimination of monopolies in the short period of time is impossible, systems for social control of prices should be developed. One possible solution is to entrust the problem to local authorities;
- To use modern technology, making possible more efficient energy consumption, including introduction of mechanisms to stimulate and obtain social acceptance for these activities;
- To protect the environment in all energy sectors;
- To educate society about efficient energy use on the basis of experience from the developed countries; and
- To consider the implications of the principles of sustainable development.

Extremely important is the development of long-term energy policies of the states on the basis of reliable, multi-criteria analyses and balances. These policies should consider not only problems of the countries, but also economic trends in the market. In developing these policies, Western European solutions could not be totally adopted, since these are only partly helpful for countries in a transition period. Fast liberalization and privatization irrespective of the social costs actually slows down the process of transition. Moreover, such solutions are not well prepared and do not consider the very important social problem of unemployment.

### Problems of Environmental Protection

The restructuring of companies in the energy sector is related to problems of environmental protection.

The most effective method of environmental protection is saving energy. The less energy consumption and the more effective the use of energy, the less the deterioration of the environment. This is why energy sector development should take place on the principles of sustainable development.

In the time of centrally planned economies, for political and social reasons, heavy and mining industries were generally developed with relatively high energy consumption and environmental contamination. Limited financial resources did not permit attention to environmental considerations. The problems of environmental pollution were considered a secondary issue and sometimes were even used as the reason for undertaking economic decisions. This is why the current ecological costs are so enormous. They cover not only new investments but also modernization of old ones.

Programs for environmental protection encounter financial problems. Ecological investments in the energy sectors are very expensive. Companies trying to carry out such programs encounter difficulties including high interest rates. If a profitable company does decide to go ahead with the investment, then prices will increase and inflation will be higher. In order to avoid this situation, some of the most urgent projects are financed from state budgets, but considering the limited resources of Eastern European countries, it will take a long time before significant environmental protection in the energy sector is achieved. It is possible to speed

up this process only with assistance from developed countries and this assistance cannot be limited only to consulting and advice, but must include financial resources as well, on conditions it is possible for the Eastern European countries to accept.

Elimination of barriers in trade and liberalization will increase the amount of transported goods and will cause environmental deterioration, especially since it will be mostly road transport requiring new routes causing an increase of toxic emissions, noise, etc. This will probably present new problems, which will have to be solved. So far not much attention has been paid to this issue.

#### Further Reforms

It is necessary to carry out the complex reform of companies in the energy sector and to set up competitive structures. The majority of companies in the energy sector still operate as national enterprises. This means that these companies have a monopoly in the field of energy supply and are able to effectively protect their interests at the expense of energy consumers. Once the monopoly is abolished, or at least limited, the opportunity may appear for competition in the field of energy supply.

In the first stage, after small companies were privatized, the second stage was initiated, in which large enterprises were turned into state treasury ventures. Total privatization is expected to be completed in the third stage, after legislative processes have been finished, the value of the property has been realistically established and energy prices have risen to world levels. The strengthening of the private sector and its development is necessary to increase the efficiency of the energy sector and the effectiveness of energy use.

Further changes should include:

- Establishment of an institutional basis to support the transition process;
- Introduction of new methods of economic management adapted to market conditions;
- Modernization of the technical infrastructure in the energy sectors including environmental protection; and
- Reaching the status in which both import and export of energy are possible on the basis of the market economy; this may happen only after complete convertibility of the national currency has been introduced.

One of the significant problems here is to consider equal rights of the energy users in relation to the rights of producers and distributors of energy.

#### Fossil Fuel Production Costs *(continued from page 25)*

term for balanced production between OPEC and non-OPEC regions, that is, until the beginning of the next century. After that, modifications in the geopolitical environment and in the supply-demand balance could completely change the picture. I will, therefore, conclude on a low-key note by simply expressing my confidence in the creativity and capacity to adapt of our industry in meeting the challenges that are bound to arise. There is a saying in France that "uniformity leads to boredom." Well, we shall never be bored in the oil and gas industry.

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#### Polish Association Elects Krawczynski

The IAEE Polish Affiliate has elected a new President, Dr. Franciszek Krawczynski, Director of Energy Planning in the Ministry of Planning, Warsaw. At the same time the members adopted a new program to take a more active role in promoting international energy issues in the economy of Poland, most importantly to reflect the views and needs of consumers on the direction of energy policy. There are now 30 individual members and five institutional members of the Polish IAEE Affiliate, the Association for the Polish Energy Economy.

Zbigniew Mantorski

## Conference Proceedings 19th IAEE International Conference Budapest, Hungary, May 27-30, 1996

The Proceedings from the 19th International Conference of the IAEE held in Budapest, Hungary, are now available from IAEE Headquarters. Entitled *Global Energy Transitions, with Emphasis on the Last Five Years of the Century*, the proceedings are available to members for \$55.95 and to non-members for \$75.95 (includes postage). Payment must be made in U.S. dollars with checks drawn on U.S. banks. To order copies, please complete the form below and mail together with your check to:

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