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PRIVATIZATION OF STATE-OWNED ENTERPRISES IN ESTONIA: POLICIES AND IMPLEMENTATION

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The article treats the privatization of state-owned enterprises in Estonia. An overview and analysis of the formation of ownership reform policies with regard to the state-owned enterprises (inc. the analysis of the factors which have affected the policies), as well as the implementation of privatization policies in Estonia, are provided. Two principal approaches to privatization, namely 'economic approach' and 'political approach', have been distinguished. The author tries to show that the privatization scheme applied in Estonia involves the elements of both approaches, being a compromise between the two. At the same time, the privatization policies based on a mixture of political and economic considerations involve contradictions and complications.

1. THE FORMATION OF OWNERSHIP REFORM POLICIES WITH REGARD TO THE STATE-OWNED ENTERPRISES

1.1. Formation of privatization concepts

In Estonia privatization became an important issue in the beginning of 1990. The need for implementing major privatization started to grow after the independence movement in Estonia had already begun (in the middle of 1989) and found its culmination in the middle of 1990 with the adoption of the Law on Ownership in June 1990, which basically meant a shift from the Soviet ownership doctrine to an ownership doctrine based on private property.

As the first steps in legalizing private ownership and entrepreneurship had already been taken and the course towards implementing privatization principally approved, a clear-cut vision about the privatization programs started to form in the fall of 1990. In September 1990 the Government Concept On the Basic Principles of Privatization was completed and approved. It envisaged a step by step strategy of ownership reform with at least four to five years spent on the main stage of privatization.

As immediate and direct privatization was neither possible nor expedient due to a number of reasons (the absence of infrastructure appropriate for a market economy, shortage of capital, absence of Estonia's own currency, etc.), the course was taken first towards a broad use of several intermediate forms (e.g. state-owned joint-stock companies (SOJSCs) created via commercialization, lease enterprises) for the transformation of state property.

The privatization of state-owned enterprises (SOEs) was meant to be started with the privatization of small-scale units (including also pilot privatization of some larger enterprises) and continue with partial sales of the shares of SOJSCs. Extensive privatization of larger SOEs had to await the introduction of the Estonian currency, basic macroeconomic reforms, and the adoption of major laws (e.g. the laws on competition, bankruptcy, etc.).

However, until the summer of 1991 the very fundamental issues of ownership reform had not yet been clarified. Despite the facts that restitution and compensation of unlawfully expropriated properties had principally been approved, there was still neither a clear-cut evidence on the extent and exact place of restitution/compensation nor strategies put in place in the process of ownership reform. Though there was a rather large variety of influential interest groups with sometimes radically different aims[1], in general the struggle occurred between two approaches, namely between the 'economic approach' and the 'political approach' to ownership reform. Of course, these approaches cannot be regarded as purely economic or political.

The economic approach, in general, supported the implementation of commercial privatization (sales were regarded as the main form of privatization), placing the value on the creation of motivated active owners and revenues from the privatization. The mass distribution by means of vouchers (distributional privatization) was ruled out. The settlement of restitution/compensation problems was envisaged to be separated as much as possible from primary privatization.

The political approach, in general, gave priority to the restitution of property rights (inc. compensation) and the general interests of citizens. The radical and immediate[2] transfer of state property into private ownership by application of vouchers and mass privatization was supported. The possibilities for the domination by former *nomenklatura*, insiders, the newly rich, and foreigners in the privatization process were negated. The value was placed on the creation of a wide circle of domestic small-scale owners.

Though both approaches gained considerable support, the political objectives became more forcefully in the forefront in the formation of ownership reform policies, being mainly induced by the need to defend national interests in connection with the restoration of independence.

In the summer and fall of 1991 two fundamental legal acts were adopted: the Law on the Fundamentals of Ownership Reform (June 1991) and the Land Reform Act (October 1991). These acts, in establishing the basis for launching an extensive restitution and compensation process (see also Kein & Tali, 1993) as the principal process of ownership reform, as well as envisaging the voucher privatization, represented basically the main principles of the political approach[3]. However, these acts did leave open the actual privatization of SOEs and, hence, provided enough flexibility for further disputes about the fundamental issues in large-scale privatization. As the economic approach was mainly supported by the

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[1] The interest groups included: 1) insiders demanding preferential treatment in the process of privatization either by free distribution of shares or significant pre-emptive rights; 2) former owners and their descendants demanding extensive restoration of former ownership rights; 3) new domestic entrepreneurs-outsiders demanding basically openness of privatization; 4) *nomenklatura* wishing to maintain their *status quo* in the hierarchy of society, therefore supporting preference of insiders; 5) foreign investors demanding free entrance in the privatization process; 6) local governments demanding free-of-charge municipalization of profitable objects and land; 7) 'passive' citizens demanding free distribution schemes.

[2] The simultaneous stress of restitution and speed are in obvious discordance as extensive restitution and compensation of properties are the most complicated and time-consuming parts of ownership reform.

[3] The political approach, especially the extensive restitution and compensation of unlawfully expropriated properties, was widely supported and strongly demanded by one of the perhaps politically most influential and strongest interest groups – the former owners (among them, the Estonian expatriates who left Estonia in the 1940s), whose role, finally, was essential in the adoption of the extensive restitution/compensation program in Estonia.

Government and the political approach espoused by the majority in the Parliament, such opposition contributed to the stumbling of Estonian ownership reform in 1991–92. While the Government tried to avoid the realization of the restitution and voucher-centered ownership reform scenario proposed by the Parliament, which they believed was economically unacceptable, the Parliament, in turn, did not accept the step by step initiative presented by the Government and rejected the respective bills. Thus, several privatization programs to be launched by the Government could not start during these years. Even small-scale privatization could have stalled, as the respective law was adopted in December 1990 with only one majority vote.

2. IMPLEMENTATION OF PRIVATIZATION POLICIES

2.1. Small-scale privatization

The implementation of privatization policies began in Estonia in 1991 after the Law on the Privatization of State-Owned Service, Retail and Catering Enterprises was passed in December 1990. It was thus started with small-scale privatization, involving mainly small-scale (book value up to EEK 50,000, from 21 May 1992 up to EEK 0.6 million) service, trade, and catering establishments[4]. The total number of objects subject to small-scale privatization has been estimated at 2850 (among these 1200 service establishments, 500 shops, 350 booths, and 800 catering facilities).

The privatization of small-scale units was arranged either in centralized way by the Department of State Property (DSP), which was founded specially for the purpose to organize ownership reform, or by municipalities (in that case the municipalization took place beforehand). The basic form of privatization was the sale by auction. However, until summer 1992 (i.e. until the alterations and amendments to the small-scale privatization law) the auctions were gradual auctions, where usually (in case of 90% of objects) the insiders were granted prerogative rights to buy the property. Because of the lack of competition, approximately 80% of the small-privatization objects sold by the DSP were sold at their initial price to insiders, which often was significantly lower than their market value[5].

Such practice of preferring insiders was abandoned in summer 1992 due to strong criticism. The amendments and alterations made in the so-called small privatization law (on 21 May 1994) introduced more openness to the privatization process, diminishing the insiders' prerogative rights (the insiders still maintained the pre-emptive right to buy the property, but only in case they accepted to pay the final price offered on public auction) and widening the range of obtainers eligible to purchase the property to be privatized (i.e. also foreigners were granted the right to participate in the privatization process).

The distinct course towards public auctions was important: it enabled the state to get higher revenues from privatization, alleviated the initial valuation problem

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[4] As of 21 May 1992, with the alterations and amendments to the Law, the privatization program was extended to all branches of economy. However, small-scale privatization involved mainly trade, service, and catering establishments.

[5] Under the circumstances of the delay of privatization and hyperinflation the DSP was unable to make regular revaluations. In addition, the initial valuation methodology did not take into account such important price determinants as the location and quality of premises, which in reality was often the main factor determining the final sales price on auctions. Thus, for instance when real auctions took place the final sale price usually exceeded greatly the initial sales prices (in about 20% of the cases about 5–9 times and in about 10% of the cases even 10 or more times).

and social tensions. However, the need for credit increased as public auctions, the sale of objects together with buildings and major objects led the final sales prices to increase significantly. Still, the raising of credit from banks remained rather complicated, primarily due to the absence of laws concerning pledges (e.g. mortgage). To alleviate this problem the State started to use installment plans: allowing buyers to pay the price by installments.

Despite the problems faced in the small privatization process we can say that small privatization has been rather successful. By December 1993, 825 small privatization objects (with the total initial price of EEK 115.5 million) were privatized, the total sale price of which reached EEK 174.4 million. However, several objects designated for privatization have remained unsold in the small privatization process. They have been, as a rule, transferred into the municipal ownership. Competition has emerged and the economic effect is significant.

While advantages for insiders existed during the first stage and to some extent also in the second stage of small-scale privatization, the preferential treatment of insiders was abandoned by the new privatization law (June 1993).

The new Privatization Law does not distinguish between small- or large-scale privatization programs any more. However, this does not mean that the privatization of smaller entities has stopped – the privatization continues, but under the unified privatization program carried out by one huge executive body – the Estonian Privatization Agency (EPA).

2.2. Large-scale privatization

2.2.1. Start-up conditions

As elsewhere in the post-socialist countries the privatization of state-owned enterprises has been an extremely difficult and complicated task for the policymakers to design also in Estonia, due to the existing start-up conditions:

– overlapping of privatization with the transition period from planned to market economy;

– overlapping of privatization with the period of restoration and underpinning of the independence regained;

– extensiveness of the state sector, i.e. enormous number of SOEs potentially subject to privatization;

– backwardness of SOEs (in technological and managerial sense);

– artificiality (irrationality) of existing economic structures (often the SOEs involve integrally inexpedient structures, units);

– existing economic crisis based on the collapse of a political (economically irrational) socialist economic integration (between enterprises and states) and hence the collapse of import and export markets;

– absence of own currency;

– absence of market economy institutions and functioning markets (e.g. capital markets, money markets, real estate markets, etc);

– existence of large diversity of interest groups (about interest groups see footnote 1 and also Kein & Tali, 1993).

2.2.2. Development of the large-scale privatization program

Following the initial principle that considerable deregulation and liberalization should precede privatization in order to introduce substantial entrepreneurial freedom (freedom in economic decision-making) critical for an efficient functioning of enterprises, the large-scale privatization program was

launched only in the fall of 1992 after the basic macroeconomic reforms (liberalization of prices, foreign trade, wage policies, etc.), which eliminated the constraints in the economic decision-making, had already been introduced in Estonia. The final and perhaps the most weighty inducement for starting the large-scale privatization was the introduction of the Estonian own currency, Estonian kroon, in June 1992, which eliminated the last obstacle in implementing the large-scale privatization program, namely the use of the 'hostile' inflationary rubles in the privatization process as a means of payment[6].

Besides, by that time the political consensus was achieved and organizers of privatization had already gained some experience (from the pilot privatization program) for privatizing large enterprises[7], and the corporatization of SOEs (launched in 1991) had been basically implemented in Estonia.

The initial large-scale privatization program was founded on two resolutions: "On Terms and Procedure of the Privatization of State and Municipal Property" and "On the Commencement of the Sale of Shares of State-Owned Joint-Stock Companies", approved by the Parliament in August 1992, which were adopted to regulate the privatization of objects with book value over EEK 600,000. These temporary resolutions enabled the Government to start the sale of shares of SOJSCs and privatize up to 30 large enterprises. The commercial privatization strategy was chosen, leaving enough flexibility also to the application of voucher privatization in case of SOEs. In order to carry out large-scale privatization a special body – the Estonian Privatization Enterprise (EPE) – was established in September 1992, which relied extensively on consultants and financial aid from the German Treuhandanstalt.

Still, the implementation of the large-scale privatization program started very slowly. Though the first international privatization tender of 38 large enterprises was announced in November 1992, the first sales contracts were concluded only in May 1993.

The reasons for the slow pace of privatization lay largely in the struggle between the economic approach and the political approach. The initial large-scale privatization program (legal framework) lacked clearness and sufficient unity as it was designed when the struggle between the priorities and methods of economic and political approaches was still going on and there were radical differences in the understanding about priorities and methods in large-scale privatization between the Parliament and the Government.

As after the parliamentary elections on 20 September 1992 a concord was achieved between the Parliament and the Government, the ground for more constructive cooperation in the field of privatization issues and consequently for significant acceleration of the privatization process was created. In 1992 also the post of a minister without portfolio – Minister of Reforms – was instituted for the coordination of ownership reform.

Thanks basically to the consensus achieved in 1992 between the Parliament and the Government, the year 1993 became a breakthrough in the privatization policies in Estonia. In summer/fall 1993 the large-scale privatization program underwent substantial improvements in its legal and institutional framework introduced basically by the Law on Privatization, adopted on 17 June 1993:

1) clearer but flexible procedures for the privatization of enterprises were stipulated by the Law on Privatization, the earlier numerous legal acts regulating privatization were replaced, the contradictions and inaccuracy within the legal framework of privatization liquidated, and the distinction of the small-scale and large-scale privatization programs finished;

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[6] As long as Estonia belonged to the ruble-zone, intermediate forms, such as leasing were preferred rather than radical changes in the ownership relations, i.e. privatization.

[7] The pilot privatization, involving seven large enterprises, was launched in the spring/summer of 1991 and completed by April 1992.

2) the Compensation Fund, which enabled the privatization of enterprises to continue for money without significant injustice to the voucher holders[8], was established in August 1993. This step was a solution (essential compromise) of the conflict in large-scale privatization issues between the supporters of the economic approach and the political approach;

3) in September 1993 the Estonian Privatization Agency (EPA) was founded as a result of merging the Department of State Property (DSP) and the Estonian Privatization Enterprise (EPE). This step strenghtened the organizational centralization of privatization and finished the ambiguity that existed in the division of tasks and competence between the DSP and EPE, which so far had hampered privatization. Besides, the EPA and its Board[9] were granted more authority than the EPE or DSP had in the process of carrying out privatization;

4) the order of payment by installments, which established for the Estonian residents and legal persons favorable conditions for participation in privatization, affording them to make an initial payment of only 20% from the sales price and to pay the remaining sum in the course of 10 years, was approved by the Government in September 1993.

Besides the remarkable year 1993, also during 1994 the legal framework for the privatization of (large-scale) enterprises underwent substantial improvements in its integrity. In August 1994, the procedure for public offering of shares of SOEs and the Decree on Investment Funds were approved by the Government. The basis was created for practical implementation of the voucher privatization scheme aside from the commercial privatization.

As a consequence of these changes, the process of large-scale privatization improved significantly. However, the privatization of enterprises is not free from problems and still contains issues which are difficult to solve. Besides, due to the openness and flexibility with regard to the application of voucher privatization in case of SOEs, it has still remained the battleground of the conflicting interests between the supporters of the economic and the political approach.

2.2.3. Basic characteristics of the legal framework and the basic methods of large-scale privatization

The existing legal framework for privatization in Estonia is rather liberal and flexible. In order to encourage competition, practically no limitations are imposed on the participation in the privatization of enterprises. All domestic and foreign persons or private-property-based legal entities (state's or municipalities' share less than 1/3) can participate. Though in principle the EPA has the right to restrict the circle of entities entitled to participate in privatization, so far it has not used this right.

In general, the privatization process is based on equal competition for all participants. There are practically no prerogative rights for insiders, Estonian or foreign residents, or any other social or interest groups in the privatization of enterprises. The only exceptions are in case of:

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[8] Namely, the Compensation Fund (CF) issues in the extent of privatization proceeds received (50% from the privatization proceeds are allocated to the Compensation Fund) its bonds with the maturity of six years, selling these bonds for vouchers and converting these bonds into cash on the term of maturity. The guaranteed interest rate of the bonds is 7% plus additional percentage as an income from the activities of CF. The CF's resources received are temporarily invested in the finance-needing Estonian economy, preferably as long-term investments in bank deposits (2/3), bonds, shares, or real estate.

[9] The Board of the EPA consists of 11 members nominated by the Government, including the Minister of Reforms (Head of Board), the Minister of Economy, the Minister of Finance, a representative of the Bank of Estonia and five MPs, who represent different political parties (inc. those in opposition).

1) enterprises processing agricultural products, where the local producers' cooperatives can be granted prerogative rights;

2) the application of the payment by installments, where only local physical and legal persons (Estonian share more than 50%) enjoy the installment plans.

In the existing legal framework a rather wide range of privatization methods are possible in Estonia. According to the Law on Privatization, privatization can occur either in the form of:

1) the sale of property or shares of enterprises or their structural units by way of tender applying preliminary negotiations;

2) the sale of property on public or restricted auctions;

3) public sale (offering) of shares of SOEs; or

4) other forms established by the organizer of privatization if the application of the above-mentioned forms had not given any results (in case of so-called leftovers).

Privatization can be conditioned with additional requirements (e.g. employment and investment guarantees, environmental commitments, etc.), which, in addition to the price, can be also required to be backed by the bank guarantees in order to avoid 'empty bids'.

However, also alternative privatization methods are possible:

1) investment of state property as an equity into a newly established company (joint-venture method), which is regulated also by the Law on Privatization;

2) privatization through the bankruptcy procedure (regulated by the Law on Bankruptcy, adopted in June 1992).

Besides, privatization may also occur in an unsanctioned form, i.e. as spontaneous privatization in its various schemes.

2.2.3.1. Sale of property or shares of enterprises or their structural units by way of tender applying preliminary negotiations

Among the forms of privatization applied in case of large (and medium-sized) enterprises the tender applying preliminary negotiations has been the predominant one in Estonia. This form has been applied for whole enterprises, their majority shares, or only for structural units. The main idea of this method is to find a viable owner for the enterprise. As a rule, the core investor principle is followed, which means that the 'core stake' (often 100 per cent of votes) is offered for sale at the tender.

Bearing significant advantages basically due to its flexibility, which makes it possible to take into account the specific features of large enterprises and to select the buyer proceeding from the future prospects for the enterprise (property), this method also deserves criticism. As no a priori winner selection criteria are established in the tender[10] and the negotiations (bids) are confidential and their contents are not revealed to public or to other participants in public sale, this method bears the danger of subjectivity and corruption. Ultimately, such principles have already led to judicial disputing of sales contracts, which is a rather expensive and time-consuming process hampering essentially the activity of both the EPA and the privatized enterprise.

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[10] According to the present procedure of preliminary negotiations the sales contract is concluded with the person offering the best bid taking into consideration the purchase price, business plan, employment guarantees, investment guarantees, etc. The weight of these factors in the decision-making may vary in every single case, depending on the specific conditions (e.g. the situation of the enterprise). Thus, the price offered may not to be the determinative factor in the process of selecting the winner.

Since the decision about the winner of the tender is not always made on the basis of price, but on the basis of the amount of investments guaranteed (promised), there arises also the issue whether these promises will be actually fulfilled and whether the EPA has surveillance capacity to monitor the fulfillment of additional requirements and apply sanctions.

2.2.3.2. Sale of property on a public or restricted auction

Public auctions, either in oral or since August 1994 also in written form, are applied as extensively as possible in case of small and medium-sized enterprises, as well as in case of buildings and constructions detached from the whole property of an enterprise. Though the Law on Privatization allows also a restricted auction, it has not been used in practice.

2.2.3.3. Public sale (offering) of shares

Envisaged by the Law on Privatization from June 1993, the procedure of public offering of shares of SOEs was adopted only in August 1994. According to it the public offering of shares can take place either as a:

1) fixed price offering, where after a 30–90' days subscription period special adjustment schemes, usually favouring small investors in case of over-subscription, will be used;

2) public competitive bidding.

This form of privatization is envisaged primarily as a part of the voucher privatization program. Following the strategic 'core investor' principle, the public offering is applied as a rule only for minority shares, usually only in case of viable enterprises and after the determination of the core investor.

While the reservation of minority shares for public offering for vouchers started already in May 1994, the first public offering (49% of the shares of the Tallinn Department Store) was announced in the beginning of November 1994. By November 1995 the minority share had been reserved for public offering in 22 enterprises privatized. At the same time the public offering had been applied with regard to the state-owned share in 13 enterprises. This form should become the predominant one besides the tender applying preliminary negotiations. It should contribute to the formation of a securities market and its infrastructure as well as the investment funds industry.

2.2.3.4. Investment of state property as equity in newly established companies (joint-venture method)

Though this method has been in use in Estonia since 1988 with the establishment of joint ventures (JVs) with foreign partners, it has been again topical since fall 1994 in connection with the reorganization of lease enterprises into joint-stock companies, where the state's and lessee's 'contribution' should be identified and fixed.

However, this method of privatization, besides having advantages, such as the accompanying attraction of fresh capital, know-how, and managerial knowledge into JVs, bears also significant dangers. Practice has shown that the use of the joint-venture method has often led to a significant lessening or disappearance of the state's effective role in JVs and contributed to the spontaneous privatization of its state-owned share. Besides, due to the current procedure where the decision regarding the inclusion of state property into JVs is made by the Government (on the approval of EPA) without preliminary use of any competitive bidding or

tender procedures, this method can often be regarded as rather suspect of subjectivity and possible corruptive elements and consequently it can bring up disputes about the adequacy of the shares determined.

2.2.3.5. Privatization through the procedure of bankruptcy

In June 1992 the Law on Bankruptcy was adopted, which created the possibility for a new way of privatization – through bankruptcy. By the beginning of 1995 about 10 larger SOEs had been privatized via bankruptcy.

However, in Estonia this method of privatization is sometimes suspected to be the consequence of the 'criminal' artificial bankruptcy which has been purposefully created by the enterprise management and/or creditors and/or potential buyers.

Often the bankruptcy procedure is preferred by the buyers interested in the enterprise. The reasons for that lie in the fact that the present bankruptcy procedure, giving large authorities to the trustee appointed by court, allows the interested party to obtain properties more 'easily' and at relatively lower prices, avoiding also other potential competitors. At the same time the Law on Bankruptcy does not envisage any sanctions with regard to the creators of artificial bankruptcy.

In order to protect the privatization procedure from artificial bankruptcies, a moratorium on starting bankruptcy procedures during 9 months following the announcement of the privatization of an enterprise was approved as amendments to the Law on Privatization in June 1994.

2.2.3.6. Spontaneous privatization

As elsewhere in the post-socialist countries, also in Estonia various schemes for the spontaneous transfer of state property into private hands have occurred (e.g. take-over of state assets at book value by the managers, profit transfer schemes to 'satellite' companies, illegal direct sales of state assets, lease of state property at evidently disadvantageous conditions for the State, mortgage deeds of the state property, etc.). This has been facilitated by the deficiency of the legal framework as well as by the State's inadequate control over the SOEs and encouraged by the delay of privatization.

2.2.4. Results of large-scale privatization

The main method of privatization of large-scale (and medium-sized) enterprises in Estonia is the tender with preliminary negotiations. The implementation of the large-scale privatization program in Estonia began on 17 November 1992, when the first international tender for the sale of 38 enterprises was announced in world business media. By 1 January 1995, eight privatization tenders had been announced already. More than 300 enterprises representing different branches of the economy have been offered in these privatization tenders (see also Table 1).

The tenders have demonstrated rather great interest towards privatization of enterprises: for the privatization of more than 300 enterprises included in the tenders, a total of 831 bids were received. Besides local investors, also foreign investors show significant interest: 22 per cent of the bids received have been made by foreign investors (see also Table 1).

The first sales contracts were concluded in May 1993. While during 1993 only 54 sales contracts were concluded, then during 1994 the privatization process accelerated significantly: that year 213 sales contracts were concluded. As of

Table 1

Privatization tenders in Estonia

Tender	Deadline for applications	Number of enterprises listed	Number of bids received (total/Estonian/foreign)
I	22.12.1992	38	103/50/53
II	08.07.1993	52	180/103/77
III	16.12.1993	40	109/97/12
IV	16.12.1993	25	48/48/0
V	26.05.1994	49	142/117/25
VI	22.06.1994	56	108/102/6
VII	18.08.1994	14	26/23/3
VIII	22.12.1994	42	115/106/9

SOURCE: Estonian Privatization Agency

1 January 1995, a total of 267 sales contracts had been concluded (either for the entire enterprise or its structural units) through the tenders with preliminary negotiations (see Table 2). The total sales price of enterprises privatized through tender with preliminary negotiations reached EEK 1662 million (ca DM 208 million), whereas the buyers had taken the obligation to guarantee investments worth EEK 885 million (ca DM 111 million) and roughly 34.8 thousand jobs (see Table 2).

Table 2

Sales contracts concluded through tender with preliminary negotiations

	1993	1994	Total by 01.01.1995
Number of sales contracts concluded	54	213	267
Total sales price, million EEK	353.2	1308.8	1662
Total investments guaranteed, million EEK	236.8	828.9	1065.7
Associated debts, million EEK	195.6	690	885.6
Total employment guaranteed (thousand jobs)	9.1	25.7	34.8

SOURCE: Estonian Privatization Agency

According to estimations, the foreign investors (capital) played an important role in the privatization of enterprises in Estonia. The EPA has estimated that, taking into account joint ventures as well as the use of 'dummies', the total share of foreign capital in acquiring privatized property is roughly 40 per cent in terms of sales price.

By 1 January 1995, a total of 369 objects had been sold by way of open auctions by the EPA. The total sales price of these objects reached EEK 192.9 million (ca DM 24 million) (see Table 3).

Privatization via public auction

	1993	1994	Total by 01.01.1995
Number of objects sold	243	126	369
of which: number of objects sold at initial bidding price	169	51	220
Total sales price (million EEK)	124.7	68.2	192.9

SOURCE: Estonian Privatization Agency

The number of objects offered in open auctions diminished in 1994 as compared to 1993. There are basically two reasons for that:

1) the privatization of the objects that can be regarded as subjects of small-scale privatization, and thus require public auction, has been practically completed;

2) since the fall of 1993 the SOEs were granted the right to sell single objects on the approval of the EPA, whereas the sales proceeds remain in the enterprise. Thus, instead of being organized by the EPA, the sale of single objects (things) is organized by enterprises themselves through public auction.

It is also significant that among the 369 objects sold, 220 have been sold at the initial bidding price. It has been generally accepted that this figure reflects the lack of competition within the public auctions rather than the high initial bidding prices. Still, during 1994 the competition in public auctions increased.

2.2.5. Basic issues in large-scale privatization

Privatization of large-scale enterprises is a rather complicated activity involving problems related to the shortcomings of the principal concept of ownership reform as well as those in the methods of privatization. Besides the problems already discussed, several others have emerged in the course of large-scale privatization in Estonia.

2.2.5.1. Restitution

The restitution issues belong, without doubt, among the most important and acute problems of the ownership reform in Estonia. The unsolved restitution issues affect also the privatization of SOEs. Basically, the problems spring from the a priori treatment of restitution issues under the conditions where the former owners (inheritors) have been given an option to choose between the physical restitution and compensation. Thus, as long as all applications have not been looked through, and as long as the final restitution/compensation decision has been made by the local government, it will often not be clear whether there exists a claim for the property and whether the property will be restituted or compensated. For this reason the speed of the restitution is important for the overall development and activization of the economy. The uncertainties with regard to the ownership rights ensuing from the delay of the restitution process have evidently a negative impact on an efficient use of properties (mainly land and buildings) under discussion. Besides the fact that properties are out of

circulation in the potential markets (e.g., privatization market, real estate market, credit market), the important economic (especially investment) decisions related to the properties are hampered, being basically postponed until the ownership rights have been settled.

However, it is evident that the settlement of restitution issues is inevitably a lengthy process due to the complicated and bureaucratic character of the clarification of ownership rights (the verification of claims) as well as due to the need to reduce as much as possible the potential conflicts between former owners and present users (especially of land and buildings) in case physical restitution is applied. The Estonian experience confirms it. Besides the extensiveness of restitution[11] resulting from the broad interpretation of both the property subject to restitution or compensation and the circle of persons entitled to claim restitution or compensation of property by the laws, the speed of the restitution/ compensation process has suffered in Estonia also from the repeatedly extended and protracted deadlines for the submission of restitution/compensation applications (see Kein & Tali, 1993).

Despite its decentralization, the process of restitution/compensation, which was principally launched in summer 1991, progressed very slowly until 1994. The basic reasons were the overall complicacy of the process (e.g. the verification of claims), rigid procedures, and lack of integrity of the legal framework. A significant acceleration of the restitution/compensation process has been achieved since the second half of 1994, after the integrity of the legal framework had been improved and the restitution/compensation process specified and simplified (especially with regard to land) during 1993–94. However, the process is far from being accomplished. As of January 1995, roughly 1/3 of the claims were still unsolved. According to the preliminary data from the Ministry of Finance, as of 25 January 1995 only roughly 15,000 properties had been restituted and roughly 15,000 properties compensated, while restitution/compensation claims with regard to more than 150,000 properties had been made.

2.2.5.2. The use of vouchers in the privatization of SOEs

Though the use of vouchers in the privatization process was principally agreed upon in summer 1991 (taking account of the existing economic, political, and social conditions), the basic concept regarding the use of vouchers in the process of privatization was approved in Estonia only in the beginning of 1993. According to this concept the use of vouchers is rather wide in Estonia. The vouchers (existing in dematerialized form, so-called privatization securities accounts)[12], can be used in the process of the privatization of state- (or municipally) owned dwellings, land, shares, and also assets of enterprises, either through financial intermediaries (investment funds) or directly, or for buying bonds of the Compensation Fund, until 31 December 1998.

However, the basic concept left open the extent of the application of voucher privatization in case of SOEs. Hence, the proportion of property privatized for money and for vouchers as well as the extent of the application of public offering of shares for vouchers, have remained a continuously disputed issue within the implementation of large-scale privatization.

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[11] A total of 206,275 restitution/compensation claims, concerning 157,959 properties, have been made.

[12] There are two types of vouchers in Estonia, which form the source for the so-called privatization securities accounts: 1) national capital vouchers based on the years of employment, and 2) compensation vouchers based on the value of the property expropriated.

Until May 1994 the use of vouchers in the privatization of enterprises was totally ignored in practice, but since spring/summer 1994, due to an increased political and social pressure to find cover for the vouchers[13], a shift towards the implementation of voucher privatization of enterprises has occurred:

1) since May 1994 the minority capital stock (usually 20, 33, or 49 per cent) in the SOEs to be privatized started to be reserved for public offering for vouchers. During 1994, this practice was applied with regard to 18 enterprises privatized;

2) since June 1994, according to the decision of the Government and the Board of the EPA, the vouchers can be used as a means of payment in the extent of up to 50 per cent of the sales price of the privatized property[14].

In order to diminish the possible harmful economic consequences, such as the ownership diffusion based insufficient control ensuing from the application of voucher privatization, in August 1994 the trade of the privatization securities (accounts) was released[15] and the legal basis for the development of investment funds adopted, which envisaged the inclusion of the investment funds (including a special type of investment funds – privatization investment funds with some prerogatives) into the process of voucher privatization.

Such decisions reflect the increasing importance of vouchers in large-scale privatization. However, despite these considerable changes it can be said that though vouchers may become in Estonia the major means of payment in the process of large-scale privatization, there is still no radical shift towards the voucher-based mass privatization, since only minority shares in a limited number of enterprises are offered publicly for vouchers.

2.2.5.3. Investor issue in the large-scale privatization

The investor issue has become topical due to the overall aim of privatization, i.e. improvement of the economic efficiency and performance of enterprises through privatization, as well as due to the existing situation where most SOEs are in urgent need of restructuring.

It is clear that different privatization strategies and tactics may result in different owners who may have different capabilities to undertake the restructuring and hence improve the efficiency of enterprises involved. Such issues as the investors' motivation, ability and a wish to exercise control over the enterprise, their active attitude and long-term orientation, should be regarded as critical for the new investments and restructuring.

The investor issue is closely related to the principal privatization approach. It is evident that the mass privatization and commercial privatization lead (at least initially) to the emergence of different ownership structures. The mass privatization will result in wide share-ownership, while the commercial privatization will result in core investor ownership.

It can be argued that under the conditions where most of the SOEs require considerable restructuring, it would be expedient to follow the core investor

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[13] As the preparations for launching voucher privatization had been successful (in May 1994 the opening of privatization securities accounts had started and the legal framework for launching the public offering of shares of SOEs for vouchers was already gaining its integrity), the need to find real cover for roughly 14–18 billion voucher kroons became topical and consequently increased political and social pressure.

[14] The precondition for such decision was the gradual release of the tradeability of vouchers. The decision basically proceeded from the aim to absorb vouchers as well as to rise their market value, the low level of which had caused social tensions.

[15] Because of the fear of possible inflationary pressure and for political motives vouchers were declared to be non-tradeable in the beginning, but as of spring 1994 the trade of vouchers was gradually approved and as of August 1994 the privatization securities (accounts) are freely tradeable among Estonian residents and legal persons registered in Estonia.

principle in order to create active and motivated owners able to accomplish control over their enterprise and carry out its restructuring. It is rather obvious that the diffusion of ownership rights would make the restructuring of enterprises more difficult. There is little incentive for a dispersed group of small share owners to participate in the control and restructuring of firms. Their interests lie in the development of liquid secondary markets that permit them to exit at low cost rather than in exercising their rights to intervene (Corbett & Mayer, 1991). The institution of privatization investment funds into the mass privatization schemes may not significantly reduce the impacts of the diffused ownership structure.

Strategically the Estonian Government has proceeded in the privatization of large enterprises from the core investor principle assuming that the core investor is most capable of carrying out the restructuring of the enterprise. Thus, as a rule, in each enterprise a priori the 'core stake', often 100 per cent of votes (the exact stake is decided by the EPA Board), is offered for privatization, mainly on the tender with preliminary negotiations. This principle is followed also in implementing the voucher privatization. Thus, only the minority shares are usually offered at public offerings (for vouchers), and, as a rule, only after the sales contract with the 'core investor' has been concluded. There are no fixed criteria for the selection of the 'core stake'. The right to decide to what extent to follow the core investor principle has been left in the competence of the EPA Board, which makes the decision in every single privatization case, taking into account the specific features of enterprise, interests of the potential core investor, and the political considerations to meet the voucher-holders' expectations.

However, the combination of public offerings for minority shares and the a priori conclusion of the sales contract with the core investor has brought up several issues:

1) It has been argued that the practice where the core investor obtains a priori the majority of shares leads actually to the reduction of the value as well as liquidity of the enterprise's minority shares remaining in the state's possession;

2) The application of the core investor principle in the process of privatization brings up also the minority shareholders issue. Large-block ownership may give rise to expropriation of corporate resources and exploitation of small shareholders (Ognedal, 1992). Hence, there are fears that different profit transfer schemes, similar to those applied in the process of spontaneous privatization of state-owned property, may occur. Therefore, certain safeguard mechanisms for the protection of minority shareholders' interests and rights should be included in the shareholders' agreement (statute of the company) of enterprises subject to partial privatization via public offering of shares (see for instance Rojec et al., 1994). This must be assured by the organizer of privatization, i.e. EPA, prior to the conclusion of sales contracts with the core investor. However, it is rather difficult to implement such safeguard instruments as these reduce or even eliminate the core investor's interest in the 'core stake'. So far, such safeguard instruments have not been widely used in privatization.

Privatization brings up also several other important issues, such as the corporate governance issue and the owner–manager issue in general (see for instance Frydman & Rapaczynski, 1994). Although these issues are not acute yet, it is also rather obvious that after a while they will become into the fore, especially in the enterprises privatized applying public offering of shares.

2.2.5.4. Leased property

The Law on Leasing from September 1990 established a ground for extensive leasing of SOEs (structural units) in Estonia between 1991 and spring 1992. As a result approximately 300 leased enterprises and structural units emerged in Estonia.

Since the very beginning, the leased enterprises have been considered as a temporary (intermediary) form to fill the gap in ownership relations until privatization. However, the conversion of these leased enterprises (units) into private enterprises through privatization has proven a difficult and complicated task.

In most cases the lease contracts have been negotiated for 5–7 years at evidently favorable terms for the lessees and evidently unfavorable terms to the lessor, i.e. the State (Kein & Tali, 1994). It has become evident that there will be no interest in the privatization of leased property as long as the buyer is obliged to continue the lease with the existing lessee without having the possibility to change the terms stipulated in the existing lease contract. The lessees, as long as they continue to have a favorable lease contract, are not interested in privatization either.

Basically two solutions for the problem have been offered: first, to sell the leased assets at auction (in such case, the sole buyer will most likely be the lessee), and second, to convert leased companies into joint-stock companies (giving to the lessee the shares representing the value of leasehold improvements). However, in both cases the valuation of both the initial price and governmental share will be complicated.

2.2.5.5. Splitting of assets ('leftovers')

As the privatization procedure allows the splitting of property, the sale of enterprises in separate units has become a widespread practice. On the one hand such splitting is justified as often the existing enterprises include structural units which cannot be regarded as integral parts of the enterprise (auxiliary services, boiler houses, holiday homes, kindergartens, etc.). On the other hand, such practice has created the situation where often only the most valuable and promising parts of the enterprise's property have been sold. Therefore, it has proved to be difficult to sell later the 'leftovers'. At present the Government considers it neccessary to restrain such spontaneous restructuring of enterprises and has decided to apply more widely the sale of enterprises as a whole[16].

2.2.5.6. Deterioration of decision-making during the pre-privatization period

The uncertainty with regard to the future has often hampered the economic activity of SOEs expecting privatization. Their investment activity is extremely restrained, there is insufficient reorientation towards a market economy (either in products, technology, marketing, and/or management methods). Often the major decisions are postponed. Ultimately this will lead to a loss in the value of state-owned assets.

2.2.5.7. Uncertainties with regard to plots (land)

Although the Government favors selling land into private ownership, the procedure of selling (commercial) land to legal persons and foreigners is not entirely settled. Currently the Government is the decision-maker regarding single cases of selling land. Long-term rent (building license) already functions. Simultaneously with the privatization of enterprises, the clarification of the legal status of the land belonging to the enterprise, is necessary.

[16] Since 1994 the 'leftovers' of partial sales are permanently in the tender process. Every month the EPA makes a local advertising campaign, and allows anyone, anytime, to make an offer for these 'leftovers'.

SUMMARY

Estonia made considerable progress in ownership reform and the privatization of SOEs in 1991–95. However, the privatization of SOEs has proven more complicated and time-consuming than originally expected. During the implementation of privatization policies, several shortcomings of the fundamental concept of the overall ownership reform, as well as strategies and tactics for privatization of SOEs, have become evident.

Since neither the economic approach nor the political approach can be ignored in privatization policies, the privatization scheme and methods applied in Estonia often involve complex elements, which have come into being as a compromise between the priorities of the political approach and the objectives of the economic approach. Based on a mixture of political and economic considerations, the ownership reform in Estonia is a process involving contradictions and complications. The privatization of SOEs in Estonia has continuously been the battleground of the conflicting interests between the supporters of the economic approach and the political approach.

It is clear that privatization should be regarded only as a means to transform inefficient economic enterprises into efficient ones. The replacement of state ownership by private ownership should eliminate (reduce) the conflict of interests, insert active owner-motivation, as well as bring competition into economy, and thus improve the efficiency of enterprises. It is the understanding of the author that it is too early to give a more fundamental evaluation of the privatization policies undertaken. Besides visible quantitative results and some short-term effects there exist also long-term effects which need not follow exactly the same trend as the former. Hence, time will show which privatization policies have been the most effective in achieving the overall aim of privatization – an efficient economy.

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RIIGIETTEVÕTETE ERASTAMINE EESTIS: POLIITIKA JA ELLUVIIMINE

Alar KEIN

On käsitletud riigiettevõtete, eelkõige riiklike suurettevõtete erastamist Eestis ning antud ülevaade erastamispoliitika kujunemisest (analüüsitud on ka erastamispoliitikat kujundanud tegureid) ja praegusest erastamispoliitikast Eestis. Pikemalt on peatutud erastamismeetoditel ja nende kriitikal, samuti erastamise elluviimisel ja suurettevõtete erastamisel esilekerkinud probleemidel.

On eristatud kaht põhimõttelist võimalust läheneda erastamisele, nimelt majanduslikku ning poliitilist. Autor on püüdnud näidata, et erastamispoliitika ning selle tegelik elluviimine riiklike (suur)ettevõtete puhul on Eestis läbi põimunud mõlema lähenemisviisi seisukohtadest, olles seega kompromisslahendus.

ПРИВАТИЗАЦИЯ ГОСУДАРСТВЕННЫХ ПРЕДПРИЯТИЙ В ЭСТОНИИ: ПОЛИТИКА И ЕЕ ПРЕТВОРЕНИЕ В ЖИЗНЬ

Алар КЕЙН

В статье рассматривается ход приватизации крупных государственных предприятий в Эстонии. Дается обзор формирования политики приватизации (анализируются составляющие ее факторы) и положение дел в этой области на сегодня. Особое место уделяется методам приватизации, их критической оценке. Разграничиваются два подхода к приватизации – экономический и политический. Автор находит, что лишь сочетание этих подходов, т. е. компромиссное решение, позволит избежать проблем в случае приватизации крупных государственных предприятий в Эстонии.