State Enterprises Restructuring in Bulgaria, Albania and Romania

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SAUL ESTRIN, MITKO DIMITROV and XAVIER RICHET

ABSTRACT *The aim of the paper is to analysis, through a cross-sector and cross-country approach, the way in which firms in less-advanced transforming economies are restructured. Compared with more advanced economies, where different kind of privatisation schemes have been experienced, in Bulgaria, Albania and Romania, adjusting to the new market environment has followed different paths (weak macrostabilisation policies, lack of a comprehensive programme), which have led to a kind of defensive restructuring. In this paper, we look at the way in which firms in different sectors have reacted. The main economic and political factors that slow the process are analysed.*

1. Introduction

In this paper, we summarise the findings from a project about the restructuring of state enterprises in Albania, Bulgaria and Romania. The project brought together research teams from each of the three transitional economies, plus researchers from London and Paris with experience in addressing reform issues. The approach was to apply a common methodology in terms of case studies to a small sample of firms in each country. Important information was also gathered concerning the institutional arrangements in each country and the macroeconomic environment. We go on to outline the relevant economic environment in each country before considering a framework for analysing and measuring the degree of restructuring within firms.

The main finding of our study is that the degree of restructuring in state-owned firms in the three countries under consideration has been surprisingly modest. This is in sharp contrast to the significant pace of change noted in earlier studies by, for example, Belka *et al.* (1993) for Poland or Estrin *et al.* (1995) for the Czech Republic, Hungary, Poland and Slovakia. It is also surprising, given the length of time since the commencement of serious market-oriented reforms. The study suggests that this is in large part because the economic environment in these three countries is much less clearly a market one than in the Visegrad countries. The final section speculates on additional reasons, including the scale of the external shock in these countries and the less favourable pre-conditions to reform. Policy recommendations are deduced from the analysis.

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In the following section, we discuss project methodology and findings, before considering macroeconomic preconditions to reform and indicators of progress in reform. The third section is addressed to the issue of restructuring, defining the tasks to be undertaken by firms in the shift from planned to market environment. This framework formed the basis for the common questionnaire applied in all the case studies. In the fourth section, we enquire why progress in restructuring in state-owned firms, as indicated by the case studies, has been so much less than in the Visegrad countries. We also speculate on the reasons for differences between the three countries, before drawing policy conclusions.

2. Methodology and Background

The study comprises a parallel analysis of state enterprises restructuring in Bulgaria, Romania and Albania on the basis of unified research methodology applied to each of the countries, identical range of problems and comparable samples of enterprises. This has made possible not only the description of the processes of restructuring but also the comparison of their development in the three countries.

The first part of the study, which comprises the macroeconomic and institutional framework of the process of enterprises restructuring, is based on a quantitative and qualitative analysis of statistical data, review and analysis of relevant literature and normative documents.

The second part includes original studies of five to seven enterprises in each country using the ‘case study’ method. The questionnaire applied is identical for all countries, and the sample of enterprises is formed according to preliminary determined unified criteria.

The first part of the project comprises the study of four main issues in each of the countries. The first of them concerns the initial conditions at the start of the reform period, and includes a study of ownership structure, organisation and size structure, management principles and economic independence by the end of the 1980s.

Second, the macroeconomic changes since 1990 and the subsequent creation of a market environment for the functioning of enterprises are revealed. The main stages of the economic reform are analysed along with some basic problems related to financial stabilization, opening of the economy, development of the private sector, etc.

Third, the national policy and institutional framework of state enterprises restructuring is analysed. In the final chapter of this part, the structural changes in the system of state enterprises are studied as resulting from the on-going economic reforms. To this end, the same indicators are used as those characterising the economic structure by the end of the 1980s.

The second part of the project presents the results of 19 case studies of enterprises (seven case studies each in Bulgaria and Romania, and five case studies in Albania). Each of the reports comprises a short summary of the characteristics of the studied enterprise, determination of the intensity and importance of the main shocks accompanying the macroeconomic changes, and analysis of the short- and long-term responses of enterprises to the shock effects.

Table 1. Preconditions to reform, 1990

	Albania	Bulgaria	Romania
Population	12.6	8.7	23.2
Development level	Low	Medium	Low
External debt (|b)	0.09	9.9	0.6
Exports/GDP <%)	4.7	21.7	11.53
Share of industry/GDP (%)	37	51	48.2
Share of agriculture/GDP (%)	40	18	18
Natural resources	Medium	Low	High
Government deficit (%GDP)	- 3.7	- 12.9	1.2
Primary school enrolment rate	85	97.1	99.4
Infant mortality rate (< 5 years)	44.1	20.9	30.3

2.1. Preconditions to Reform

The three countries of our study belong to the second tier of reforming economies, clearly starting from a lower initial level of development than, for example, the Czech Republic or Hungary. As can be seen in Table 1, which brings together numerous indicators pre-reform, income per capita was well below $3000 in Albania, just below in Romania and just above in Bulgaria, using purchasing power parity measures for 1990. These levels of development are reflected in other social indicators, such as infant mortality rates and school enrolment ratios, notably for Albania. It is also reflected in the agriculture share, which is relatively high in all three countries, but notably Albania, where it was 40% in 1990. Of the countries, Bulgaria is the smallest but most developed while, by a considerable margin, Albania faces the greatest development challenge.

Evidence for the severe excess development of industry typical of communist regimes can be seen in the extraordinary industrial shares in Bulgaria and Romania, reaching more than 50% of GDP in Bulgaria and only just below in Romania. Ironically, Albania may have some slight advantage in restructuring from being less developed, because so much of industrialisation in the other countries was misdirected according to market criteria. These levels of industrialisation are high, even by the standards of transitional economics: the share in Hungary in 1990, for example, was only 29%. The over-industrialisation was associated with almost total integration into the Council for Mutual Economic Assistance (CMEA), for Bulgaria at least. The figures are lower for Romania and especially for Albania, which had followed a more autarchic path. Taken together, these facts left Bulgaria particularly exposed to the trade shocks associated with the disintegration of CMEA and the Soviet Union. None of the countries had any great trade links to the West, and these have had to be built post-reform, even if Romania has tried to balance its foreign trade by becoming, since the early1960s, less dependent from the CMEA.

The countries also differed considerably in macroeconomic balance pre-reform. Bulgaria already had accumulated considerable foreign debt and had a large monetary overhang associated with a considerable budget deficit. Albania and Romania, for quite different reasons, had followed more controlled and autarchic policies, leaving them with better macroeconomic balance and much less international debt. Bulgaria decided in the early years of reform to default on much of its foreign debt, at considerable cost in terms of credibility on world capital markets.

2.2. *Progress in Reform*

Economic analysis of transitional economies (see, for example, Fischer and Gelb, 1991; Portes, 1993;, Estrin, 1994; Richet, 1992) argue that there are four distinct but interrelated elements to a transition process, namely:

— macroeconomic stabilisation;
— price liberalisation, including trade liberalisation and reintegration into the world economy;
— institution building, including capital markets;
— privatisation and restructuring of state-owned enterprises, creation of *de novo* companies, spin-off and unbundling of state assets.

Albania, Bulgaria and Romania were all placed by the 1996 World Bank Development Report into the second group of reforming economies in terms of the extent of liberalisation. The first group, including Poland, Slovenia, Hungary and the Czech Republic, had average 'scores' on liberalisation between 1989 and 1995, of around 0.65 on a scale from zero to unity. This compared with a value of around 0.5 in Bulgaria and 0.45 in Albania and Romania. The 1997 EBRD Transition Report also contains progress indicators in its Table 2.1, which confirm these economies' comparable and middle-ranking position in the transition process.

The attainment of macroeconomic stabilisation following the traumas associated with price liberalisation in situations of severe macroeconomic imbalance has led to large declines in output across the region. The situation in our three countries is summarised in Table 2. Interestingly, the output drop was largest in Albania, but there have since been 3 years of steady growth, restoring the initial position somewhat. The output drop has also been partially recovered by recent growth in Romania, which is beginning to creep towards 1989 output levels. However, it continues in Bulgaria, whose relative position is now slightly worse than that of Albania compared with 1989. The decline of industrial production is more dramatic and gives a good idea of the shock experienced by the distorted industrial structure of theses economies (Fig. 1). Albania was also performing well on the inflation front, with initially high levels being brought under control and 1995 results being close to OECD standards. Nevertheless, the collapse of the financial schemes has totally ruined theses positive results in a couple of weeks. Inflation has been much higher in Bulgaria and Romania, but there is some evidence that control is being reasserted in at least Romania. In summary, the macroeconomic situation, at least up to January 1997, was at best moderate in all three countries, but perhaps surprisingly was clearly best in Albania in terms of both growth and inflation, and worst in Bulgaria.

Progress in the process of privatisation in the three countries is summarised in Table 3. Progress has been modest in all countries, though arguably more advanced in Romania in terms of formal procedures, especially for small firms and in Albania in terms of GDP shares (probably because of the emergence of private agriculture).

Turning finally to institution building, the World Bank Development Report produces indicators across three variables—laws and legal institutions, the banking sector and the role and management of government. These are reproduced for the three countries

Table 2. Output and inflation

		Albania	Bulgaria	Romania
Real GDP in 1995 as % 1989		75	75	81
(% Output drop 1989-93		63	83	73
Inflation (CPI) (%)	91	104	339	223
	92	237	79	199
	93	31	64	296
	94	16	122	62
	95	6	32	28
	96	17	165	57
	91[a]	41	311	116

[a] Estimate, Source: EBRD.

in Table 4, with the variables moving on a scale from 1 to 4. In these deeper areas of reform, the more developed economies of Bulgaria and Romania have established a lead over Albania, especially with respect to the banking and financial sector.

In summary, Albania was a significantly less developed economy pre-reform than the other two, was also less integrated within the CMEЛ system and less industrialised. Bulgaria was particularly integrated into the Soviet bloc and highly over-industrialised in sectors supplying the Former Soviet Union (FSU), while Romania had pursued an expensive policy of debt repayment at the heavy cost of contracting the internal demand and worsening supply conditions following the credit squeeze and the ban put on most input imports. Given these preconditions, reform has arguably been most rapid in Albania, especially on the macroeconomic side. However the low level of development has meant that Albania has made less progress in deeper reforms related to, for example the legal system and the capital market. We will see below that progress also appears less in restructuring, based on the findings from our cases.

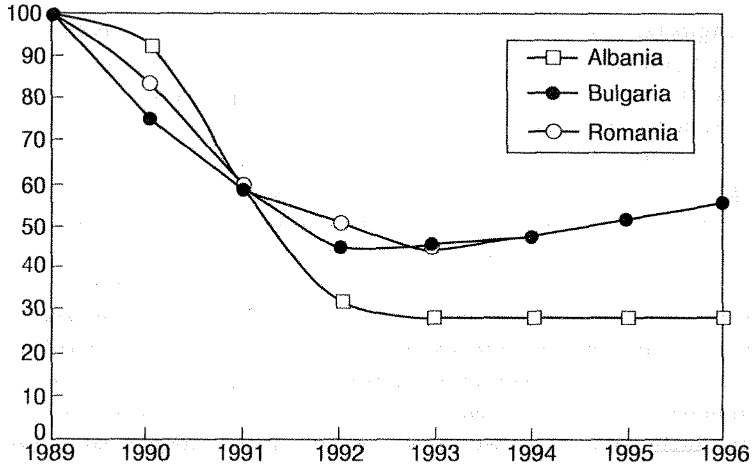

Figure 1. Industrial production in Albania, Bulgaria and Romania (1989 = 100).

Table 3. Progress in privatisation

	Albania	Bulgaria	Romania
% Employment in private sector, 1997	77	50	60
Private sectors share in GDP, 1997	75	50	60
Progress indicators			
large firms [a]	2	2	3
small firms [a]	4	3	3

Sources.EBRD Transition Report, 1997. World Bank Development Report, 1996.
[a]1 = little or no privatisation
2 = a significant short at privatisation
3 = substantial progress in privatisation (> 50% privatised)
4 = privatisation nearly complete.

3. Enterprise Restructuring in Transition

This project has focused towards measuring the extent of restructuring of state- owned firms in Albania, Bulgaria and Romania, using the case study approach. In developing a common analytical framework, the key issue is therefore to define restructuring in the transition context, and to find indicators of progress. The obvious starting point is an understanding of the socialist enterprise in the planned economy, in contrast to capitalist firms operating in a competitive environment. We can then categorise the changes that must take place in the firm in a number of ways. In what follows, we employ the following categories:

— enterprise objectives and constraints
— organisational restructuring
— ‘unbundling’
— product market restructuring
— input restructuring, notably of capital, labour and energy.

The most important point to stress is that restructuring in a transitional context is a multifaceted phenomenon. Firms have to restructure their products, production methods, quality control, stock systems and accounting systems, not to mention their organisational structures and the balance between the ‘make or buy’ decision. Firms can be making progress in some dimensions but not in others. An obvious reason might be differences in the costs of restructuring. Changes in energy use, production layouts, or quality of supplies purchased (made available by liberalization of foreign trade) might be virtually costless or even cost saving, while the purchase of new equipment or information technology might entail capital expenditures, which firms would not be in a position to finance. But restructuring may also depend on governance mechanisms. Firms effectively controlled by their labour force or by local government authorities might be much less willing to reduce employment or to cut back on social assets than managerially controlled firms with docile labour forces. Thus, restructuring cannot be regarded in a unidimensional way, and progress in a particular direction need not necessarily be associated with progress in other areas.

3.1. The Socialist Firm

As is well known in the literature on central planning (see, for example, Gregory and Stuart, 1989; Ellman, 1989), the socialist enterprise could be viewed effectively as merely a production unit. The central planning apparatus operative in most communist countries (Yugoslavia, Hungary and, in the 1980s, Poland were exceptions) arranged for the bulk of material inputs to be delivered, and for the disposal of most production, whether as inputs to further down the value chain, to domestic consumers or for export. Money was passive and while formal accounts were kept, positive or negative financial balances had little decision-making role in a system controlled by quantitative allocation of inputs and outputs. Investments were largely decided at the centre, and funded by direct grant.

Managers were put under considerable pressure to achieve quantitative output targets, upon which their considerable bonuses largely depended. At the same lime, informational deficiencies in the planning system itself and the desire by the Centre to use pressure on managers to motivate plan fulfilment meant that the plans themselves were often infeasible and typically very hard to achieve. This gave every incentive for managers to cut comers in the attainment of current production goals; quality, planning, husbandry of capital and human capital, careful input management, energy and resources control were all sacrificed in the search for higher output.

Managers understood that the profitability of production was, at best, a secondary issue for planners. Indeed, if the ‘value’ of planned output at centrally determined prices exceeded the ‘value’ of inputs, also at centrally determined prices, this was of little or no consequence. Budget constraints on firms were therefore soft. Even in decentralised economies such as Hungary, where output and supply planning had been abolished, managers could rely on subsidy virtually without limit to finance production. Managers also quickly learnt that it was often easier to achieve plan targets by getting their targets softened, or by getting special favours or grants from the Centre in supply allocation, than by improving technical efficiency or company performance. The motivation structure favoured systematic rent seeking amongst managers.

3.2. Reform and the Firm

As we noted above, a full transition reform programme would involve macro- economic stabilisation, price and trade liberalisation, the formation of market based institutions and laws, and privatisation. The three countries in our study have made moderate progress in all of these areas, though notably less has been achieved than in the Visegrad countries, for example. If we presume that a total transition reform programme had been introduced, one can categorise the resulting ‘restructuring’ at the enterprise level in the five areas noted above.

3.2.1. Enterprise Objectives and Constraints. The collapse of the planning system will deprive the socialist managers of the traditional incentives to maximise production to the detriment of costs and quality control. However, it is unclear what incentives it will put in their place. This depends upon two factors. The first is the governance system, which emerges with the decentralisation of decisionmaking authority to the firm consequential upon the formation of markets. For example, the state as owner could create a governance system to reward managers for progress in attaining profit maximisation, and to penalise alternative objectives such as employment maintenance. Another possibility is that the collapse of the communist party at the time of reform so weakens the apparatus of the state that governance is effectively non-existent, and state-owned firms are controlled by their employees—either managers or workers, or both together. The objective of the firm would in this situation depend on the balance of power between groups within the enterprise itself, and on the objectives of the constituent groups. It seems likely that managerial control would emerge, but managerial objectives are not simple in the transition context. One possibility might be a strong concern for employment and local social issues; another could be a gradual looting of state assets into 'private hands', with massive growth in the unofficial economy.

The second important factor in the objectives of the organisation post-reform is the softness of budget constraints. Whatever the governance mechanism, there will be little incentive for managers and workers to undertake complex and potentially painful restructuring in situations where the status quo is effectively underwritten by the state. Earle and Estrin (1995) have argued that there will be clear interactions between these two factors; the impact of manager versus employee ownership on restructuring, for example, will depend on whether budget constraints on the firm are hard.

The authorities may manage to reduce government subsidy, thereby introducing some crack into the walls of government regulations and bureaucracy surrounding enterprise decisions, in which case competitive pressures can be brought to bear. Then enterprises will be forced to take some account of their market situation, regardless of the governance and motivation structure. In the limit, if the firm is subject to full competitive market pressures, rents will have been eradicated, so even if insiders do control decision-making, they will have to respond to market pressures.

This implies that, even in state-owned firms that are not yet being privatised, the governance system will be very important. Moreover, the process of 'depoliticisation'—breaking the links between the enterprise and the state—will be crucial. There are a large number of indicators of this relationship, from the scale of direct subsidy or sales through the state to the extent of special licenses, regulations or quotas for inputs, outputs or other aspects of the production process. The extent of depoliticisation therefore represents a crucial dimension of enterprise restructuring in transition.

3.2.2. Organisational Restructuring. The remaining elements of restructuring are perhaps more straightforward and conventional. At its simplest level, the socialist firm will have to create new divisions to take on new functions previously undertaken centrally. These will almost certainly include finance, marketing and human resource management. In some organisations, they might also include R&D. The board structure will have to be changed and new personnel recruited to fill these crucial new slots. At a deeper level, multiproduct firms may seek to change organisational structure in favour of profit centres, divisions and subsidiaries. The potential role of joint ventures and strategic alliances fits here also. Many of these changes can be measured directly in terms of organisational and employment changes.

3.2.3. 'Unbundling'. Because of the pressures and uncertainties of planning, combined with the great rewards to plan fulfilment, incentives were skewed in favour of vertical integration, particularly in the manufacture of material inputs. Large socialist firms, therefore, often maintained their own foundries, machine shops, generators and repair units. Moreover, the enterprise also undertook important social welfare functions, notably in the areas of housing, childcare and health, but to some extent also as a retail outlet. These social assets often absorbed a significant proportion of enterprise turnover.

The emergence of a market system also seems likely to lead to a completely different balance on the 'make or buy' spectrum for most firms. Clearly, scale economies and experience benefits were being lost by firms supplying their own inputs separately, and once the market has eradicated shortages and queuing, there is little logic in disproportionate reliance on internal supply. The rapid growth of specialised SME eases the externalisation of activities for which they have no competitive advantages left in the new market environment. This is particularly the case with the set-up of joint-ventures or the acquisition of assets by foreign owners, where the speed of restructuring is made easier and contributes directly to the mushrooming of many new external businesses (Estrin and Richet, 1996). Similarly, in a market economy the role of the state—both central and local—*vis à vis* enterprises will shift, and the firm will need to divest many of its social assets, perhaps to local government.

The process of unbundling will not necessarily all be one way, however. Socialist enterprises previously had little concern with supply quality or delivery standards. These might become major elements of competitive advantage in a reformed market system, and lead firms to develop or acquire new capacity up or down stream to their production process.

In summary, therefore, restructuring should include divestment of non-core activities, both productive and social, as well perhaps as some acquisition in new areas. Divestment may also have financial benefits for enterprises undertaking restructuring in other areas.

3.2.4. Product Market Restructuring. Reforms should lead to major changes in what firms produce, how they produce it and to whom the output is sold. Restructuring might include a shift to the production of consumer goods, to an increase in production differentiation, and to major improvements in quality control and standards of production. The key factors will be for firms to begin to understand their markets, and to shift supply so as to satisfy demand. In terms of supply channels, firms should begin to develop new distribution mechanisms to replace centralised purchase, and to focus more on delivery standards and pricing. There should also be a major reorientation of customer base, from the state and other central buyers in CMEA to consumers and other firms domestically and internationally, especially in the West. Once again, it is straightforward to find indicators of progress in these areas.

3.2.5. Input Restructuring. One can here separate out five main areas for restructuring activity, in capital, labour, material inputs and energy. In all, the key element will be efforts to minimise costs, and to maximise profits.

On the capital side, firms in the region—especially those outside the priority defence and space sectors—often possess antiquated equipment. Restructuring in products and quality may well require major investment in new equipment, both fixed assets and information technology. Such changes have major financial implications because socialist firms typically had little or no financial assets (or what they had was eradicated by inflation) and the banking systems in these countries remain severely important. Investment will, therefore, have to be financed largely from firms' own resources in the short run, and this requires either current profitability or asset sales. Financial restructuring is therefore a key element in enterprise turn around, and will depend crucially on improved accountancy standards.

Overmanning was typical in socialist economies, partly as slack to ensure that output plans could be attained in huge production bursts at the end of each plan period, and partly as a full employment policy subsidised by soft budget constrained. This problem has been exacerbated in socialist countries by the large output drop associated with reform. A key indicator of restructuring, therefore, is performance with respect to labour productivity, and in the reduction of the labour force. However, while gross employment will typically have to fall, the other aspects of restructuring noted above may also imply significant labour recruitment, mainly of white-collar staff in finance and marketing. These will be in contrast to the sharp declines in blue-collar employment. Training will also be important, for example in changing employee attitude towards absenteeism or quality control. On the material input side, reform offers enterprises opportunities to change their suppliers, and perhaps to buy higher quality inputs from abroad. Information technology will also be important in stock control.

Finally, socialist firms were traditionally highly wasteful of energy, which was traditionally provided very cheaply within CMEA. The cost implications are now serious, not only at the enterprise level but for the balance of payment in countries where energy resources need to be imported. This is a major and fairly easy area for market restructuring, though investment will typically be required for fundamental shifts in energy usage. The serious environmental problems caused by poor standards and emission controls are also typical of socialist enterprises, and are an area in which restructuring yields social but not necessarily private benefit.

The questionnaires employed in our cases attempted to quantity or qualify developments in all these areas of restructuring. They also attempted to capture the impact of changing macroeconomic conditions, notably the decline in demand, the shifting terms of trade, the increase in certain costs, notably capital and energy and the developing nature of the relationship between the state and state-owned enterprises.

4. Assessing the Findings

4.1. Assessing the Findings

A careful reading of the cases reveals that, at least for the sample of state-owned firms in our study, the pace of restructuring in all the dimensions under consideration has been very modest. In this section, we seek to explain why this might be the case, and to deduce policy conclusions.

We can summarise the findings across the cases in the five main areas of restructuring according to a scale from 1 (minimal restructuring) to 5 (maximal restructuring) for each of the cases. This is attempted using our own judgement in Table 5. It can be seen that, in general, the pace of restructuring has been very modest.

Table 4. Institutional reform

	Albania	Bulgaria	Romania
Laws	2	3	3
Banking sector	1	3	3
Role and management of government	4	2	2

Source: World Bank Development Report, 1996,

In terms of country, Bulgaria appears to have made the most progress, and Albania the least. Progress has been greatest in input restructuring on average, and least in unbundling and organisational restructuring. There appear to be limited sectoral differences in the pattern of restructuring.

4.2. *Explaining the Findings*

The first major issue concerns why restructuring in state-owned firms in Albania, Bulgaria and Romania appears to be so much less than has been, found in previous studies for the Visegrad countries. The reasons are probably largely to be found in Tables 1-4 above. First, the preconditions to reform in these three countries was significantly worse than in the Visegrad countries: the level of development was lower, the degree of integration into CMEA for Bulgaria at least was higher, the extent of over-industrialisation was greater, the involvement in Western trade was less. There had been almost no decentralisation of the planning system, in any of these countries, in sharp contrast to Poland or Hungary. Moreover, unlike in the Czech Republic, the low level of international debt in Albania and Romania had been bought at the price of autarchy and improvement. Reform, therefore, involved a much greater institutional shock than in most of the Visegrad countries, in economic conditions that were inherently poorer.

It is sometimes argued that the degree of responsiveness of an economic system is positively related to the scale of the shock that it faces. Arguments of this sort underlie the case for 'big bang' as against gradualist reform packages. However, once one begins to look in detail at the macroeconomic level, it becomes clear that very large exogenous shocks—the loss of markets, the collapse of supply systems; the inability to secure inputs or to pay for labour and energy—effectively paralyse enterprises, which become unable to make even modest changes. This is partly an incentive problem—the situation appears irretrievable which mitigates against undertaking minor restructuring—and partly a matter of soft budget constraints. The authorities in such a situation are aware that they cannot let all firms go under, and hence permit continued subsidy, which itself demotivates restructuring.

The three countries in our study, as noted earlier, have made significantly less progress in the introduction of a market economy than the Visegrad countries. Though the extent of reform is considerable, given the initial statutory conditions, the degree of price and trade liberalisation remains modest, leaving considerable scope for bureaucratic intervention, rent seeking and the insulation of firms from market forces.

The pace of development of the private sector, both *de novo* and through privatisation, also leaves much to be desired, and this affects detrimentally the competitive pressures under which the firm operates. Capital market development has been particularly weak—and in the context of a recession, which has severely strained enterprise resources, funds are simply not available for the more costly aspects of restructuring or used for speculative purposes as in Albania. Perhaps most significantly, the patchy evolution of the state apparatus has left governance of state-owned firms largely under the control of managers, and to a lesser extent workers. Managers have had only limited incentives to undertake profit-maximising restructuring because the personal benefits to them will be modest, the effort considerable and the process will be unsettling and perhaps painful. Moreover, in none of these countries has a management market been established, in which managerial performance in state-owned firms can be viewed as a signal of likely performance post-privatisation, thus giving managers incentives to restructure in order to enhance their own marketability.

As the State in these countries has limited resources to allocate and bureaucratic competences to control and restructure SOE is short, *de facto,* SOE firms have loose links with supervisers on the board, allowing managers to develop either positive or defensive adjustement policies, according to the competitive environment. By positive adjustment, we mean the application of strategic policies aiming at reshaping the boundaries of the firm around its core business. This policy encompass such measures as externalisation, liquidation (giving away, sale at discounted price) of assets, investments. Defensive adjustment, on the other hand, means policies providing enough room to avoid undertaking deep structural changes that are needed.

The erratic and sometimes half-hearted approach to reform taken in these countries is also a reflection of political realities. In all three, communist or post-communist parties play an important political role, and either share in power or retain a significant prospect of returning to power. This is in part because income levels are low, distributional iniquities are great and the threat of high unemployment is considerable. All of these act to slow reform. They also discourage direct foreign investment, which has been very low in all three countries compared with Visegrad country members (Table 6). It is arguable that foreign direct investment can play a particularly important role in the transition process by unleashing competition based on quality, brand and price on hitherto closed markets, as well as by disseminating improved know-how, labour practices, training and production methods through the economy.

When one looks at differences in terms of progress in restructuring between countries, it seems likely that these can best be explained by preconditions rather than current progress in reforms. We saw earlier that it is arguable, especially on the macroeconomic front, that Albania leads the way in this group, with Bulgaria lagging. From our cases, the order seems to be reversed at the enterprise level; progress in restructuring in our Bulgarian sample is somewhat more advanced and broader-ranging than in Albania, with Romania in the middle. These differences probably derive from initial levels of development; despite the worse macroeconomic performance, underlying human capital and other long run supply characteristics are probably superior in Bulgaria, leading to greater responsiveness. The gap between macro- and microeconomic performance should warn against excessive reliance on the former as an indicator of progress.

4.3. Policy Conclusions

We have argued that to some extent the relatively less satisfactory restructuring performance in Albania, Bulgaria and Romania compared with the Visegrad countries

Table 5.

Cases	'Depoliticisation'	Organisational restructuring	Unbundling	Product restructuring	Input restructuring
Albania					
MCPE (Wool)	2	2	1	1	2
Profarma (drugs)	2	2	1	2	3
Woollen textile	2	1	1	1	2
Bread factory	2	1	1	1	2
Bulgaria					
Electronics	4	4	2	3	3
Machine-building	4	4	3	3	3
Pharmacy	4	2	2	2	2
Electrical	4	2	2	2	2
T extile	4	3	2	4	3
Tailoring	4	3	2	3	2
Foods	4	3	2	4	3
Romania					
IRIS (porcelain)	3	2	1	2	2
Sicomed (drugs)	3	2	1	1	3
Libertatea (wool)	3	2	1	3	2
Steana Electrica (lamps)	3	2	1	2	3

is inevitable, deriving from worse preconditions, less progress in reform for real political and institutional reasons, and lower levels of development. But some of the wounds are also self-inflicted, and these can be addressed by policy measures.

The key problem is that in all these countries, the governance of state-owned firms is inadequate; the extent of 'depoliticisation' is insufficient and the development of competitive market forces is, at best, partial. Concerning governance, the state must either exert greater authority over firms to ensure profit maximisation, or must dramatically accelerate privatisation. The latter policy would provide clear managerial incentives to restructure while firms were still in state hands, as well as through the changes in ownership and control. The state also clearly has much work to do in all three countries in eradicating subsidy and other government controls, and in withdrawing the state as an economic actor. Finally, faster progress towards liberalisation, freezing prices, opening trade and building market institutions, including a capital framework and a capitalist legal system are clearly crucial elements in ensuring more rapid restructuring.

Note

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Appendix A: Adjusting Firms to the New Environment

Background of the Reform of Enterprises

Bulgaria. At the end of the 1980s, a rejection of the strict centralism in the management of the economy has been declared. The Planning committee and Branch Ministries were removed. Centralism remained through the so-called state orders, which embraced different parts of the enterprise capacities. Enterprise management, for a short time, allowed the experiment of self-management, which was introduced from above, including the choice of directors by the employees. This reform did not succeed, and a kind of contract relation between the supervision structure and directors of firms was set up. This was followed by the disinterest of the government both in the management and the capitalisation of state-owned firms.

Romania. Before systemic changes in this country took place, the control of firms was characterised by the combination of hypercentralised planning, strong budget constraint and interference of the Party apparatus with quasi-autonomy of firm, allowing companies to retain some part of profits and turning workers into some kind of shareholder of their company.

Albania. The control of firms was characterised by hypercentralisation and command management with strict hierarchy structure, including State Planning Commission, Branch Ministries and municipalities. At the end of the period, the director had limited rights combined with decreasing subsidies that the government was no longer able to provide to loss-making enterprises. The government, in fact, had no means of undertaking some kind of decentralisation as in the other countries.

Reforming State-owned Enterprises

The reform led not only too a change in the macroeconomics conditions for functioning of the firms but also to a change in the firm organisation and the firm structure. In all transition economies, including Bulgaria, Romania and Albania, evidence for executed decentralisation, change of the juridical status of firms and diversifying of the size structure of the enterprises can be seen.

Bulgaria. In Bulgaria, the decentralisation of state-owned enterprises and the changes in their juridical status were executed considerably early—in the first half of 1991. The newly accepted Trade Law has the aim of equalising the main economic legislation with that of developed western countries and the special law for creation of trade companies laid the base for the corporatisation of state enterprises. The majority of these enterprises were restructured the very same year in joint-stock companies and limited-liability companies.

By this time the decentralisation and the demonopolisation of the big state unions were launched with the exception of firms from seven branches—electronics, telecommunications, energy industry, metallurgy, military industry, etc., for which decentralisation was to be realised with a special decision from the government.

The measures mentioned led not only to diversifying of the organisational forms of state enterprises, but also to a sharp increase in their number. The total number of municipal and state enterprises, including *de novo,* increased more than 22 times in the period of 4 years. The increase in the number of new enterprises was particularly high in 1991. In industry, the increase in the number of state enterprises was more than seven times. The increased number of independent enterprises as a whole and in their branches should have a positive impact in term of competition and for eliminating monopoly positions. Inmost branch demonopolising measures have been achieved. Some enterprises still take advantage of monopoly positions in production, following their organisation and specialisation under the former CAEM structure (Balkankar, Bulgartabak, for instance), but even these complexes differ very much from their condition before 1989, since a partial decentralisation has taken place. In the last years, the competition through imports had a strong influence in entailing or eliminating monopoly position on the domestic market of both mentioned groups.

One of the most important fields of influence of the reform is the change in the control and the management of state enterprises. Property rights have been sharpened and the unclear combination of workers' self-management, technocratism and government interference was eliminated. The Council of Ministers was chosen as the body in charge of monitoring of state enterprises. Rules for selecting managers were also established. Unfortunately, these contests were held very quickly and quite formally and did not led to the expected results.

As a whole, decentralisation has been realised to a large extent and very diversified forms of organisation of enterprises were set up. In spite of these positive changes, we still cannot say that state enterprises function as normal institutions of the market economy. The development of this process depends on the implementation of other market institution, the creation of a sound market environment and, finally, the privatisation of the main assets of these enterprises.

Romania. In the first years of the reform, the adoption of a set of laws has created different types of ownership. As far as state enterprises are concerned, they have fallen under public property but have been given operative independence and have the right to implement their policy under market principles. Strategic enterprises are kept under supervision from the state, even if private mangers can ran these enterprises either under leasing condition or through management contracts. This can be done by public auction on the condition that the government be paid an annual sum representing the average profit of the enterprise in the last 5 years.

Commercial companies, which represent the biggest share in the economy, have a mixed ownership with the state controlling almost 70% of the current assets, while 30% are distributed by ownership certificates through the population. The State Ownership Fund has a decisive influence. The adoption and implementation of these new laws, up to now, has had a limited impact on decentralisation and the creation of new enterprises; on the contrary, the government, arguing the breaking of some technological links, has proceeded to the merging of some state enterprises.

In both Bulgaria and in Romania, the recent adoption of comprehensive reform plans following the last elections should accelerate the restructuring of firms and the tightening of external control on firms not yet privatised.

Albania. The corporatisation of state enterprises in Albania has been only formal. State enterprises have gained some managerial independence and financial autonomy. An Enterprise Restructuring Agency has been set up to supervise the restructuring of the 30 biggest state enterprises. In terms of control, state enterprises are subordinated to Branch ministries or to municipalities. In the latest case, in the condition of undeveloped markets, unclear status and lack of managerial traditions, many contradictions arise between the management and the municipal bodies, which often interfere in the production and financial activities of firms.

Appendix B. Short Characteristics of the Sample of Firms

The Bulgarian enterprises are from seven branches of industry (Table A1). Three of the enterprises are big (2000-4000 employees), three are middle-sized and one is small (120 employees). All enterprises are state-owned, but two of them have privatisation projects and there is an application for part restitution for one. Five companies are joint-stock companies with 100% state ownership.

The Romanian enterprises also represent the main branches of its industry (Table A2). Ail enterprises, with the exception of one, are big, which is not surprising as a large scale decentralisation and deconcentration of state enterprises has not yet taken place. Enterprises investigated have the same ownership structure; 70% belong to the state (SOF) and 30% to Private Ownership Funds (POF). All seven companies are commercial companies, which is the most popular form of organisation in the Romanian industry.

The Albanian enterprises (Table A3) are all state enterprises, one of them being under the double submission of a municipality and the Ministry of Agriculture, another one is under the supervision of the State Agency for Restructuring. One enterprise is partly privatised, another has prepared privatisation projects.

Table A1. Bulgarian enterprises

Sector, product, group	Enterprise characteristics
➢ Electronics components: consumer goods	State, joint-stock company, plan for privatisation, large—4000, main producer, export, competitive market
➢ Machine-buildig: food machines	State, joint-stock company, plan for privatisation, large— 3800, final products, main producer, domestic/export, monopoly/competitive market
➢ Electrical industry: illuminants	State, limited liability company, no plan for privatisation, middle-sized—400, final products, only producer, domestic, competitive market from import
➢ Chemistry: harmaceutics, cosmetics	State, joint-stock company, no plan for privatisation, middle- sized—4-500, final/intermediate products, a few producers, domestic/export, competitive market
➢ Textile: cloths, yarns	State, joint-stock company, no plan for privatisation, large— 2000, intermediate products, many producers, domestic/export, competitive market
➢ Sewing industry: knitwear, store clothes	State, joint-stock company, application for partly restitution, middle-sized—800, final products, many producers, domestic, competitive market
➢ Food industry: flours	State, limited liability company, no plan for privatisation, middle-sized—120, intermediate products, many producers, domestic, competitive market

Table A2. Romanian enterprises

Sector, product, group	Enterprise characteristics
1. Manufacturing: mining and oil equipment, reducers	SOF/POF 70-30%, trading company, large—2600, final products, main producer, export/domestic
2. Machine-building: buses, trolleys, special vehicles	SOF/POF 70-30%, trading company, large—4200, final products, main producer, domestic, monopolist
3. Electrical industry: lamps, glass, semiproducts for lamps	SOF/POF 70-30%, trading company, preparation for privatisation, large, final/intermediate products, one of the three producers of lamps, 50-50% export/domestic, the only supplier
4. Chemistry (pharmaceutics): drugs, medicaments	SOF/POF 70-30%, trading company, preparation for privatisation, large, final/intermediate products, 50% main producer, domestic/export (10% of the production), main supplier
5. Textile: wool tissues	SOF/POF 70-30%i, trading company, preparation for privatisation, large, intermediate products, one of the five producers, domestic/export 55^15%, many suppliers
6. Light industry: leather, shoes	SOF/POF, trading company, large—9000, final products and semiproducts, many producers, domestic/export (10% of the production), many suppliers
7. Light industry: porcelain	SOF/POF 70-30%, trading company, preparation for privatisation, final products, many producers, domestic/export 2:1, many suppliers

Table A3. Albanian enterprises

Sector, product, group	Enterprise characteristics
1. Electric industry: electric energy	State, electro-energic corporation, no plan for privatisation, middle-sized, final products, one of many, domestic, natural monopoly
2. Chemistry (pharmaceutics): medicaments	State, no plan for privatisation, middle-sized—200-300, final/intermediate products, the only in Albania, domestic, competitive from import
3. Textile: cloths	State, Enterprise Restructuring Agency, plan for privatisation (close and sell), middle-sized—200-300 now 40, intermediate products, many producers, domestic (army), competitive from import
4. Textile: clothes, shoes, tents	State, no plan for privatisation, large—10 branches (factories), final products, the only military enterprise, domestic, monopoly for the army
5. Food industry: bread	State, depends on municipality and ministry of agriculture, partly privatisation, middle-sized—100-400, final products, 18% of the bread production in Albania, domestic (regional), 20% from Tirana, competitive from new private firms