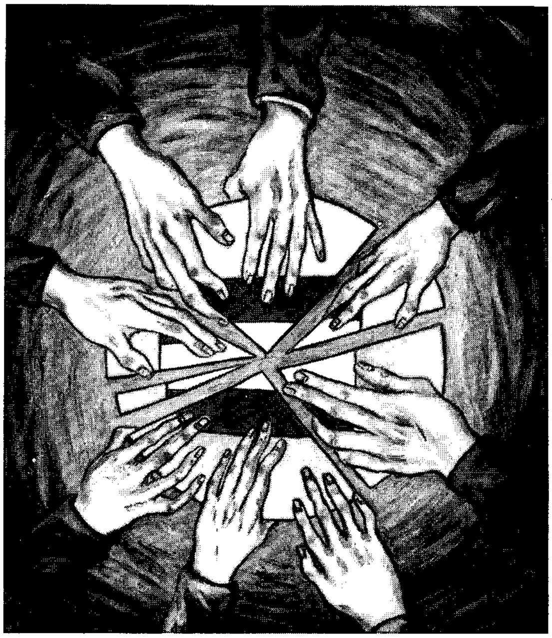
MANAGING THE MANAGERS

BY STEVEN CARLSON

Last year Hungarians were transfixed by drawn-out battles in the press over the dismantling of dictatorship. Even the new wave of porn publishers dignified their trade with titles like "Independent and Democratic Sexy Magazine." This year the buzzword is *privatization.* The coded language of post-Stalinist socialism is being replaced by a trendy vocabulary of commerce, although words like *profit* and *investment* still sound risqué to the Hungarian ear.



Private enterprise has existed in Hungary in a bastardized form since the Kádár regime began a series of stunted reforms in 1968, even if *businessman* was still a dirty word. But aside from the semantic problems, "goulash communism," as the Western media dubbed the program, has left the country with an uncertain model for economic restructuring. The two decades of reform have shifted power from the former state planning apparatus to the hands of managers, who are now dividing their little empires into private corporations, allotting company assets to themselves on highly favorable terms. Small wonder that "business" still has sleazy connotations.

Only about 10 percent of the national economy is privately owned. The current government hopes to bring that level to 70 percent or 80 percent within the next three years. This means privatizing 2,000 state-owned firms with combined assets estimated at $37 billion. Economists have proposed various methods of privatization, including open auction, employee ownership, and distribution of shares among the general population. Policymakers in Hungary are understandably reluctant to venture into such uncharted waters. But the longer the government delays and equivocates, the more opportunity it gives managers intent on looting state-owned enterprises.

In an interview in the *Hungarian Observer*, Tamás Schagrin, deputy state secretary for privatization, explains how this works: The manager of a state-owned firm establishes a joint stock company to which he transfers the firm's assets. The joint stock company essentially strips the original firm, leaving it with only an asset-management permit for the property. Schagrin says the prices paid for the assets of state-owned companies are often as much as 50 percent below market value.

This sort of maneuver is undermining the credibility of privatization in general and of foreign investment in particular.

For example, a scandal erupted last September over plans to convert a well-known downtown Budapest building, housing a popular café, into a hotel. The state-owned tenant, Gamszov, planned to turn over occupancy rights to the building, which is valued at $21.5 million, to a new private company formed by Gamszov and a German partner. A liberal member of parliament accused the Gamszov partnership of intending to raise the venture capital using the building as collateral, without formally purchasing the tenancy from the state-owned firm. The conflict remains unresolved.

The Gamszov affair is only one of a series of quarrels over privatization projects using foreign venture capital. Inevitably, the argument is that Hungarian assets are being sold far too cheaply. Because they have no responsibilities to shareholders or investors, Hungarian managers have little reason to worry about the undervaluation of state properties. Since nobody seems to know who the "state" is that owns these firms, managers make the decisions—often in their own interest. As the saying goes, possession is nine-tenths of the law.

But spontaneous privatization is not always a case of rape and pillage. The Alliance of Free Democrats, the parliamentary opposition, argues for rapid privatization to bring in capital, technology, and know-how. The Free Democrats argue that the actual price of state properties is not as critical as an immediate restructuring of the economy. Streamlined, private firms have a better chance of pulling themselves into the black by overhauling production, cutting staff, and attracting foreign partners. If management has its own interests in mind, the reasoning goes, so much the better.

The fast-track argument is compelling. The state economy is being rocked by cutbacks in military orders, loss of business from COMECON markets, the withdrawal of subsidies, and the radical decontrol of prices. Furthermore, firms still face the chronic problems of a socialist economy: Investment funds are short; producers are at the mercy of their suppliers; and, in a phenomenon called "debt queuing," firms often delay payments to other companies while waiting for their own debtors to settle up. The

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economy has also been hit by rising oil prices and a summer drought that withered the nation's corn crop and reduced hydroelectric energy potential.

The Free Democrats argue that a productive economy will generate tax revenue to service the $20-billion national debt and deal with the rising social problems of unemployment and homelessness. The ruling Hungarian Democratic Forum (MDF) would rather see that money coming in immediately, from the sales of state assets.

The MDF and others who argue for slow-track privatization disregard the issue of asset grabbing by managers, focusing instead on the perceived sellout of the country to foreign interests. Last May the State Property Agency (SPA), official watchdog of privatization, blocked the takeover of Vegytek, a chemical trading company, by an American firm, EIA Acquisition Corp. SPA objected that the majority-share price of $10 million was insufficient for a company with an annual turnover of $7 million. Moreover, the price did not include the value of Vegytek's personnel or market connections.

Whatever the weight of these accusations, the Americans were not the only side vulnerable to criticism. Vegytek's management, bargaining from weakness, seemed ready to accept any offer to gain liquidity, pleading that capital was necessary to forestall bankruptcy. Furthermore, the managers had seen fit to negotiate with only one firm. Few foreign investors are willing to expend the energy of sizing up a minor Hungarian partner like Vegytek without some assurance that the deal will go through.

Coming up with a fair price for state properties is nearly impossible without accurate value assessments, Western accounting methods, and a viable stock market. One Austrian banker quoted in *Newsweek* claimed that he looked at the value of similar assets in the West and divided by five. No wonder, then, that disagreements are frequent.

The foreigners appear undaunted, however. According to the Hungarian Court of Registration, the number of foreign joint ventures jumped from 184 in 1988 to 4,429 in late August 1990, with estimated capital of $1 billion to $1.5 billion. At present, individual Hungarians have little opportunity to get in on the action. A private sector has been developing for the last decade or so, but it consists mostly of small operators with little capital.

SPA seems to be taking a cautious approach. The so-called First Privatization Program focuses on the hotel trade and commerce, areas in which disagreements are hoped to be few. But SPA has no means to oversee the entire economy. Spontaneous privatization has been halted for the moment, but no real program is on the horizon. The MDF government has tried to instill confidence by issuing an "Economic Program For National Renewal," but critics say the document is merely a rehash of previous vague statements.

The cost of subsidizing inefficient industries may force the government to allow free-style privatization. Another consequence of the 1968 reform package was that increased autonomy in fiscal and production planning gave state enterprise managers economic bargaining power. With the demise of planning, the many larger firms that held monopolies in key markets were left with a vague responsibility to supply the nation. Thus managers could be mildly criticized for shortages, but if they pleaded insolvency the Finance Ministry had little choice other than to offer cheap credits, forgive debts, or waive taxes.

Finance Ministry figures in 1989 counted more than $1 billion in supports to the state economy, including farm subsidies and COMECON trade. Company lobbies are steadily building influence with the year-old MDF government; if their demands are met, higher budget deficits are inevitable. Meanwhile, the International Monetary Fund is pressing for cuts in government spending. With the overall downturn in Eastern European economic figures this year, investor confidence is flagging. Unless the government comes up with a systematic plan for privatization, the managers may have their way in the end.

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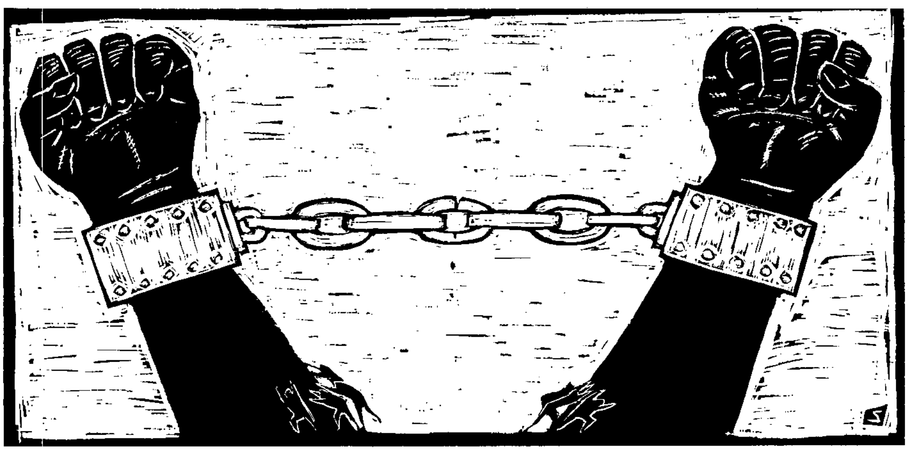
THE**BOOK**CASE

The Persistence of *Plessy*

BY CAROLYN LOCHHEAD

Unfinished Business: A Civil Rights Strategy for America's Third Century
By Clint Bolick, San Francisco: Pacific Research Institute, 180 pages, $24.95/12.95 paper



KEN SIEGEL

The modern civil rights movement began at the turn of the century as a struggle for equal opportunity and equal protection, girded by the principles of the nation's founding. A primary aim: to overturn the pernicious separate-but-equal doctrine established in 1896 by the Supreme Court in *Plessy v. Ferguson.* After half a century, success finally arrived with the 1954 case *Brown v. Board of Education.* Ten years later, the civil rights movement achieved another dazzling success with passage of the Civil Rights Act of 1964. In the words of William B. Allen, former chairman of the U.S. Commission on Civil Rights, "petty apartheid was swept from American life with the stroke of a pen."

Then, having achieved its initial goals, the movement quite suddenly changed course. The drive to eradicate discrimination was succeeded by a quest for group preferences and entitlements. During the past 25 years, such "affirmative action" has become the doctrine of the civil rights movement and has been written into state and federal law. The struggle for racial justice has become a conflict—among minorities and between minority and majority—over group privilege.

Into this arena steps Clint Bolick, a Washington, D.C., civil rights activist. In an imaginative frontal attack on establishment doctrine, Bolick declares current thinking on civil rights to be wrongheaded, unprincipled, and ultimately destructive, especially to those it purports to help. A young radical and unabashed idealist, Bolick quotes Thomas Paine, champions the poor and oppressed, and offers not just a new vision of civil rights but a practical strategy to return America to her first principles: inalienable natural rights and equality before the law.

Bolick spells out his manifesto in a slim volume called *Unfinished Business: A Civil Rights Strategy for America's Third Century*, published by the Pacific Research Institute. As the director of the Landmark Legal Foundation for Civil Rights, Bolick represents mainly poor black and Latino individuals in lawsuits that raise constitutional issues. Imbued with optimism and a sense of mission, he offers a striking alternative to standard prescriptions for preferences and entitlements: economic freedom.

Decades of laws and regulations, Bolick argues, severely constrain entrepeneurship, freedom of contract, and entry into occupations, among other things. Many of these laws—not least the 1931 Davis-Bacon Act, which requires government contractors to pay "prevailing" wages—were promulgated with the transparent purpose of stifling economic competition from blacks. Moreover, the state has consigned poor minorities to the failed public school monopoly, diminishing their chances of obtaining an education.

Through such measures, Bolick writes, government has slowly "cut off the bottom rungs of the economic ladder, leaving those outside the economic mainstream to argue their case for quotas and set-asides or join the welfare rolls." He builds a careful framework for his ideas, ranging over broad historical, philosophical, and legal territory with surprising depth and ease. His penetrating and highly readable discussion of natural rights clarifies their deep relevance to the ongoing civil rights struggle. *Unfinished Business* offers far more than a litigation strategy; it is a compelling argument crafted to move public opinion.

For Bolick, civil rights are natural rights, as conceived by the classical liberals of the Enlightenment and embodied in the common law, the Declaration of Independence, the Constitution, and the 14th Amendment. It was this original vision of civil rights as the natural and inalienable rights to life, liberty, and the pursuit of happiness—protected by law in equal measure for all—that propelled the nation to independence and informed its greatest triumphs. And it has been the denial of these principles, Bolick reminds us, that has consistently led the nation to its most