

INHIBITORS AND ENHANCERS: THE ROLE OF INTERNAL AND EXTERNAL STAKEHOLDERS IN THE TRANSITION PROCESS

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ABSTRACT

Since several transition economies faltered after promising starts in the early 1990s, researchers should consider the role of inhibiting and enhancing stakeholders in relation to a developing nation's political and economic ideologies. We suggest that the role of stakeholders, specifically internal stakeholders, have largely been ignored in the privatization and economic liberalization processes involved in transition economies. These stakeholders should be examined further, as they often act as inhibitors to economic progress rather than enhancers in countries attempting to move from command to market economies.

Keywords: transition economies, internal stakeholders, privatization, liberalization,

INTRODUCTION

As once protected markets are opening to international competition and increasing consumer expectations, privatization and economic liberalization have become a focal area of attention in many national markets (Business Week 1997, Cavusgil 1997). Privatization is an important restructuring tool that is being utilized by governments in state-owned enterprises (SOEs) by their governments to compete more effectively.

Unfortunately, many nations have lagged consistently behind that of other industrialized nations in privatizing SOEs, as demonstrated in India and China. From 1988 to 1993, there were about 2,700 SOE privatizations across the world. India did not join in any of these transactions (Goulding 1997). It has been suggested that, "in India... there are political, cultural, and unfathomable reasons why some

nations simply fail to create or attract a lot of industry” (Fortune 1992, 52). However, in 1991, India pledged to open up their economy through greater privatization and economic liberalization through the selling off of SOEs and removal of economic constraints (Goulding 1997). Yet, the SOEs and economic constraints are still highly visible in the Indian economy (Majumdar 1998).

China has taken a similar road as India, as there are an estimated 118,000 SOEs in China that generate approximately three-fourths of all of China’s industrial output (China Statistical Yearbook 2000). The Chinese government has attempted to make their SOEs more efficient through leasing of the smaller SOEs to private individuals and through transfer of ownership from the central state to local collectives. In essence, the Chinese government has identified this policy as retaining the large and releasing the small and has met with some success by allowing private individuals and collectives the autonomy to run these firms (Saez and Yang 2001). For both India and China, the move from a command economy to a market oriented economy has been exceptionally slow and has met with mixed results.

An antithesis to India and China’s transition process is Poland. Since the end of communism and the adoption of a democratic political system and market economic system, Poland has made a dramatic transition from an impoverished nation to one of the leading economic revival nations in Eastern Europe (Economist 2000). The Polish government has been able to create an environment that is conducive to economic growth through extensive privatization and economic liberalization policies (Goldman 1999, Rondinelli 1994). Moreover, the creation of viable small businesses is growing, as the people are allowed greater freedoms to use their entrepreneurial ability in the freer economy, which has led to a more robust economy (Collins 2000, Wasilczuk 2000).

These different transition experiences provide the basis for the following research questions. Why are some countries able to make the transition from highly regulated, nationalized or command economies to a market economy more effectively than other nations? What role do internal and external stakeholders play in the transition process? To address these questions, the paper is organized into three sections. The first section consists of an overview of privatization and economic liberalization literature. The second section identifies and examines the role of external and internal stakeholders in the transition process. The last section concludes with implications for researchers, national policy-makers and managers.

PRIVATIZATION AND ECONOMIC LIBERALIZATION

There are many definitions or elements of privatization. For example, Heald and Steel (1981) delineate three components of privatization that include: 1) the privatization of financing a service which is still being provided by the public sector, 2) the

privatization of production which continues to be financed by the public sector and, 3) transfer and purchase of property and financing rights from the public sector to the private sector. A basic definition of privatization is “transferring productive industries out of the public sector and into private ownership” (Ricupero 1997) or the transfer of public assets to the private sector (Park 1998). Similarly for this paper, privatization is viewed as the transferring of production and purchasing of 51% of a state-owned industry from the public sector to the private sector.

Often researchers group privatization and economic liberalization together. For example, Feigenbaum and Henig (1997) believe that deregulation and contracting-out of public services to private providers should be studied together; whereas, other researchers believe that economic liberalization should be a separate element (Brysk and Wise 1997, McKinnon 1991). One meaning of liberalization is the relaxing of governmental regulations, which prevents private firms from entering into a market (Heald and Steel 1981). Likewise, Kay, Mayer, and Thompson (1986) argue that economic liberalization is the removal of regulations to increase competition in monopolistic industries. This paper treats economic liberalization as the removal of internal and external governmental barriers to competitive trade within industries and markets and should be viewed as a necessary but not sufficient condition along with privatization in the process of creating more competitive national markets. Governments have attempted to implement privatization and economic liberalization strategies through two approaches.

Gradual and market shocks are the two primary approaches to implementing privatization and economic liberalization. A gradual approach is an incremental approach by governments to slowly and steadily make reforms while learning from their own mistakes and mistakes made by other nations (Park 1998). It is the approach taken by such countries as India, China, and Hungary (Hall and Elliot 1999). Conversely, market shock is the immediate introduction of vast privatizations of SOEs and economic liberalization of markets. Market shock is an immediate jolt to a national economy that is felt throughout an entire nation. This approach often results in short-term unemployment, increased taxes and bankruptcy (Park 1998). Additionally, this approach often results in social unrest, especially when the SOEs are located in highly inefficient and closed markets.

The gradual approach alleviates much of the social strife associated with the market shock privatization and economic liberalization strategies. There are several reasons for this gradualist approach that stem from the general motives of privatization and economic liberalization. Vickers and Wright (1989) propose that there are five primary motivations for privatization and economic liberalization that are 1) ideological, 2) economic, 3) managerial, 4) party politics, and, 5) financial reasons. The gradual approach has many limitations including a longer time horizon for the implementation of privatization and economic liberalization that could lead to

a lower level of perseverance in administering these policies by the government. Indeed, Rondinelli (1994, 1997) notes that Federal Prime Minister Vaclav Klaus of the CSFR (later Czech Republic and Slovenia) argued for a more rapid than incremental change, "When we stress a comprehensive reform, it doesn't mean that we must wait for an all-embracing blueprint...In my opinion, waiting for an ambitious, intellectually perfect, all-details-elaborated reform project is a suggestion to start the reform in the year 2057...It means postponing the reform process to eternity; there will never be a reform." Additionally, countries utilizing the gradual approach may find that the social problems such as unemployment, crime and low wages will continue due to the ineffectiveness and slowness of the transition (Park 1998). A critical point implicit in either the gradualist or implicit approach is that the key motive of privatizing and liberalizing the economy is to increase the overall competitiveness of a nation's firms both domestically and globally with a rising standard of living for the majority of its citizens.

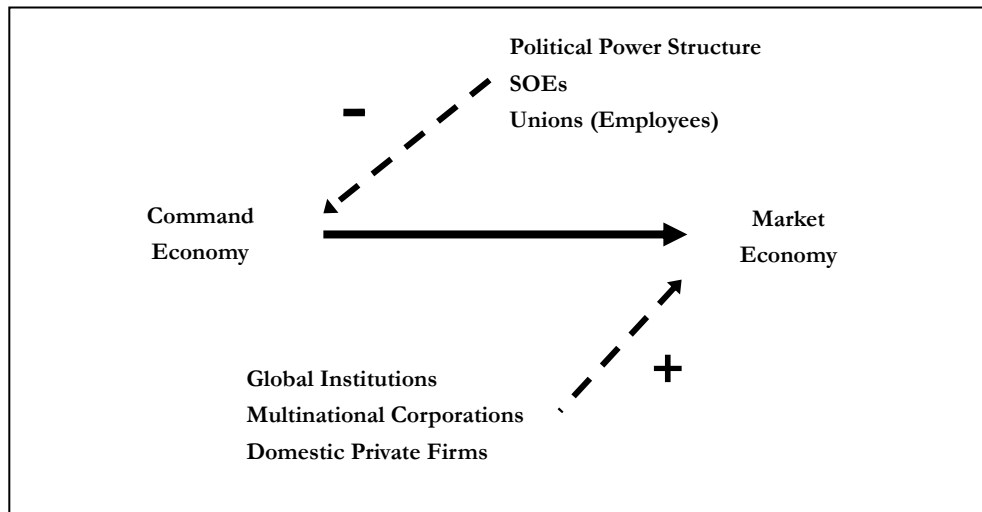
Privatization and economic liberalization have been discussed previously as providing vital contributions to national economic change. However, there are more than these two dimensions to the metamorphic process. Developing and sustaining a stable macroeconomic environment influences the transition process greatly. A stable macroeconomic environment consists of a government's ability to maintain a consistent economic macro-fiscal policy that focuses on the continual implementation of privatization and economic liberalization strategies.

THE ROLE OF INTERNAL AND EXTERNAL STAKEHOLDERS IN THE TRANSITION PROCESS

The privatization and economic liberalization literature is fairly clear on the potential paths (i.e., market shock or gradual approach) that a government may choose to take. However, the extant literature has overlooked the role of internal and external stakeholders with few exceptions (i.e., DeCastro, Meyer, Strong and Uhlenbruck 1996). It is proposed that these two groups of stakeholders have a powerful impact on the transition process, as drawn in Figure 1.

In Figure 1, inhibiting factors include the political power structure, SOEs, unions, while the identified external stakeholders are global institutions, multinational corporations, and domestic private firms. A key assumption to this paradigm is that members of these two groups primarily act as an inhibitor and enhancer. However, these stakeholders sometimes act in the opposite way. For instance, the Polish government has consistently been an enhancer of the transition process. However, the Indian and Chinese governments are more representative on a global scale of how governments in developing countries tend to perform, that most countries adopt the gradualist approach to economic reform.

Figure 1. The Relationship of Inhibiting and Constraining Factors in Economic Transition



The political power structure is often a function of the form of democracy and capitalism that a country accepts. All democracies are not created equally. Zakaria (1997) suggests that democracies range from liberal to illiberal democracies. Liberal democracies can be characterized as being ruled not only by a president, but also by the rule of law, a separation of powers, and the protection of basic liberties. At the opposing end of the continuum, illiberal democracies can be qualified as elected top leaders ignoring constitutional limits on their power and depriving their citizens of basic rights and freedoms (Zakaria 1997). An example of an illiberal democracy is Russia's present form of government or many sub-Saharan African nations. For instance, Kenya has recently moved to a multi-party democracy but the ruling party continues to draw criticism from international agencies concerning the lack of free and fair elections and the forced movement of non-supporting constituents from their homes (Africa News 1998). This may be due in part to the cultural embedded tribal system inherent in Kenya which acts an inhibitor in the adoption of a multi-party democracy.

Attributes of the political factors of development include the capitalistic orientation and the degree of democracy. Capitalistic orientation can be further delineated into the two sub-attributes of communitarian capitalism and individualistic capitalism. George Lodge (1976, 1983) coined the phrase communitarian capitalism, which implies that society works together as a group in order to achieve greater overall success (Thurow 1992). Communitarian capitalism is active in nations such as Germany and Japan. Values of communitarian capitalism include firm loyalty, social responsibility for skills, government and business working together to promote

growth, teamwork, and industry strategies (Thurow 1992). Thurow (1992) argues that American and British capitalism is based on individualistic capitalism, and values that are demonstrated through individual achievement. These values include ease of firing and quitting, profit maximization, the entrepreneur, individual responsibility for skills, and large wage differentials. In addition, Thurow makes this comparison:

The profit maximizing Anglo-Saxon business firm is based on the idea that more consumption and more leisure are the sole economic elements of human satisfaction. Higher productivity at work is desirable because it gives individuals higher incomes to buy more goods and the ability to obtain more leisure without sacrificing consumption. Conversely communitarian capitalism focuses on individuals as being social builders who want to belong to empires that expand, and firms can be based on that need (Thurow 1992, 1998).

For example in the case of Korea or the other Asian tigers, they would be more probable to adopt a model that reflects their social desire for community as demonstrated by the industrial conglomerate Daewoo. The deliberate creation of chaebols, large private conglomerates, has been a mainstay of Korea's privatization and development strategy. The Korean government handpicked successful exporters, gave them a wide range of subsidies, restricted MNE entry. In return, the Korean government expected that the chaebols pursue the governments' industrial strategy of setting up capital and technology intensive activities geared for export markets (Lall 1997). Chaebols faced pressure to localize supplier networks and government supplied financing created huge networks of firms. This strategy has been particularly successful for a number of chaebols including Samsung and Daewoo. The relationship between the different types of democracy and capitalism is further explored in Figure 2.

As suggested in Figure 2, the most conducive cell for a country involved in the transition process is through a liberal democracy and individualistic capitalism. The liberal democracy is critical as it takes potentially authoritarian control, as found in the illiberal democracy, and places it in the hands of its citizens. Moreover, individualistic capitalism provides the foundation for entrepreneurs to take root. Conversely, communitarian capitalism can be effective, as demonstrated through Japan and Germany. However, it often has a heavier reliance on the government to make non-partisan and un-biased decisions. For the most part, Poland has been able to accomplish this paramount task with the assistance of external stakeholders such as the International Monetary Fund (IMF) (Goldman 1999, Rondinelli 1994).

Figure 2. Political Factors of National Capacity

Degree of Economic Democracy (Zakaria, 1997)	Liberal Democracy	Moderately conducive to economic liberalization & privatization.	Highly conducive to economic liberalization & privatization
	Illiberal Democracy	Non-conducive to economic liberalization &	Slightly to moderately conducive to economic liberalization & privatization
		Communitarian	Individualistic
		Capitalistic Orientation (Thurrow, 1992)	

Unfortunately, many national governments in developing countries have been unable to achieve this goal, as the power of internal stakeholders has swayed their perspectives toward inhibiting economic policies.

Inhibiting Stakeholders

The SOEs are primarily considered as inhibitors to privatization and economic liberalization progress (Wellisz and Iwanek 1993). The basic reason is that they are loath to have strong government subsidization removed, while being forced to adapt to an increasingly competitive marketplace through the introduction of multinational corporations and local entrepreneurs.

With governmental support, SOEs do not have to attempt to become more efficient or effective. SOEs consistently argue that they provide a critical and valuable service at a “reasonable” price that serves the national economy and should not be left to private companies. For example, the argument against multinationals such as AT&T taking over state-owned telecommunication centers is due to nations wanting to avoid becoming dependent upon a multinational corporation (Lerner 1999). Additionally, SOEs often serve as a governmental employment service for a variety of groups that often pay homage to the national government, and if they were privatized, then they would be forced to become more efficient which could lead to greater unemployment in hurting transition economies (Chanda 1995).

Regarding increased economic privatization, SOEs believe that this would lead to greater competition from both within the country and from outside of the country. Within the country, competition would be felt from domestic companies that would be forced to be more efficient and innovative than the SOEs, as they would not have the governmental support to assist them. Competition from outside of the country would be felt through market entry of multinational corporations. Multinational corporations would be able to utilize their global economies of scale, economies of scope, cross-subsidization and assets to compete more efficiently and effectively than SOEs (Lall 1997). Similarly, SOEs have an ally with the trade unions.

The unions can be considered to be inhibitors of the transition process. For the most part, unions do not want privatization or economic liberalization, as it may increase local competition, which could result in the loss of jobs for its union employees that are employed at inefficient SOEs. In India, for example, "unions have been vociferously opposed to any reduction in government shareholdings." (Goulding 1997, 585) Likewise in China, there were internal obstacles to passing the necessary reforms in the National People's Congress. Specifically, the Chinese government feared large layoffs of ineffective employees that could result under the reorganization of SOEs from being state controlled to being privately held. Likewise, they were concerned about the potential social unrest and instability that could result from the transfer of ownership (Saez and Yang 2001). Conversely in countries such as Poland where privatization and economic liberalization have occurred with some success, unions have been a critical part of the success (Thirkell, Scase, and Vicerstaff 1994). Unfortunately, on the whole in many transition economies, unions do not advocate the rewards of privatization and economic liberalization, but rather they espouse the negative views of higher unemployment and a loss of services to customers, which places these transition processes in a negative public light.

Another key inhibitor to the transition process is often the government. The government has a considerable amount of vested interest in SOEs and unions, in relation to the control of these organizations. This control or power over these organizations often is translated into greater personal rewards through graft or other corruptive practices, which reduces the political will of the national government to act in favor of economic reform. Countries often attempt to deal with corruptive practices through internal purges such as in China. Unfortunately these governments (e.g., China) often fail to enact corporate ethics initiatives such as formalized ethics trainings for managers and government officials (Schlegelmilch and Robertson 1995). This lack of appropriate ethical behavior reinforcement prevents these governments from realizing the benefits of a non-corrupt government. Such benefits would aid in dissolving resistance to economic liberalization and privatization from internal inhibitors of the transition process. De Castro, Meyer, Strong and Uhnlenbruck (1996) note that the effectiveness of privatization of transforming a government agency

historically controlled and financed via the government and political hierarchy is generally low. However, they also note that once SOEs have access to external capital markets and market-based human resource practices, the likelihood of an effective transformation is much higher. However, politicians rarely advocate a course of action that usually has negative short-term changes on the economy, as demonstrated in the market shock approach with the exception of Russia.

For Russia, the market shock approach emanated both short- and long-term negative effects on the Russian economy (Goldman 1999). This is in contrast to the successful market shock implementation and successful transition processes in Poland (Hall and Elliot 1999). The prolonged negative outcomes on the Russian economy can be attributed, at least in part, to the illiberal democracy (Lynch 2002, McFau, 1999) and communitarian capitalism (Thurow 1992) that Russia has institutionalized in their present economic system. As illustrated in Figure 2, these two components are not conducive to privatization and economic liberalization. Without these changes, the market shock approach in Russia was doomed to be unsuccessful.

In order to avoid many of the short-term hardships that countries such as Russia have faced, many countries have adopted a gradualistic approach that is often easier in the short-term. This ease in the short-term provides national governments with the ability to gradually lose control of power vested in the SOEs and the economy over an extended duration of time. China has adopted this policy with the outcome of some economic liberalization and privatization keeping the external stakeholders somewhat frustrated, while keeping their internal constituents somewhat satisfied by the slow pace of transition (Lee and Peterson 2000).

Enhancing Stakeholders

Stakeholders that wish to enhance the transition process include global institutions such as the International Monetary Fund (IMF), World Trade Organization (WTO), World Bank, European Union (EU), multinational firms, and domestic private firms. Each group represents a different set of stakeholders; however, each group benefits from increased privatization and economic liberalization of transition economies.

Global aid institutions such as the IMF and the World Bank are institutions that provide capital and guidance to help stabilize national economies. For instance, the IMF was instrumental in assisting countries in the recent Asian devaluation crisis by loaning them capital to shore up their currencies (Warner 1997) and was very involved in the privatization of several central European countries (i.e., Czech Republic, Hungary, Poland, and Slovenia) (Rondinelli 1994). In order for countries to gain access to external capital markets, they often have to make fundamental changes to their economies. For instance from 1950-1989, Argentina was politically indecisive on what economic policy would most effectively handle their economy (Hall and Elliot 1999). The IMF stepped in with financial assistance which aided in stabilizing the

country's economy through most of the 90s, but forced them to make structural changes to their economy through greater economic liberalization and privatization (Weisbrot 2001). Recently, though, the Argentine government relented to pressure from the internal stakeholders such as the trade unions and moved away from what the IMF suggested (The Economist 2002). This policy movement has led to both the collapse of their national economy and to the destabilization of the national government. Each of these global institutions strives to provide freer access to all markets with the lessening of subsidies through increased privatization and economic liberalization.

Multinationals press for greater privatization and economic liberalization as they search for new markets in which to compete and to set up production facilities. These highly competitive companies look to Big Emerging Markets such as India and China and see large potential markets that have until recently been closed to most external trade. Yet, they find it difficult to compete in these markets, as they are faced with free trade obstacles including high tariffs, indirect trade barriers or subsidized local companies.

The domestic private firm pushes for greater privatization and economic liberalization, as do the other enhancing stakeholders. These companies face the most difficult task of often being small with little capital, while have to compete against SOEs and being mired in bureaucracy. With increased competition allowed through greater privatization and economic liberalization these firms would be able to compete on their cost or differentiation qualities more effectively. A caveat to this point is that domestic private firms would possibly resist the complete economic liberalization of the economy that would allow multinationals to enter and to compete in the market freely, as this would more than likely put their firms at a competitive disadvantage.

Figure 3 is a graphical representation of how these enhancing external and internal stakeholders strive for similar goals of increased competitiveness through greater privatization and economic liberalization. Though the three enhancing stakeholders have different motivations, each stakeholder wishes to see increased competition, which would result in a freer market-oriented economy.

DISCUSSION

Drawing from the different political and economic ideologies along with the inclusion of inhibiting and enhancing stakeholders Figure 4 is presented. Figure 4 represents two schemas: the status quo and the desired status. The status quo will not be changed until there is a need for change. Essentially, (1) the dynamics of economic control by the political system; (2) under what conditions controls are relaxed; and, (3) the premiums that may be extracted to release these controls are the drivers of the status quo or the desired status. As Figure 4 indicates, there are two separate self-

reinforcing systems that come into play under differing situations. The command economy status continues to exist till domestic and/or international necessities compel the nation to seek a desired status, that of a market economy.

Figure 3. External & Internal Stakeholders in the Economic Transition Process

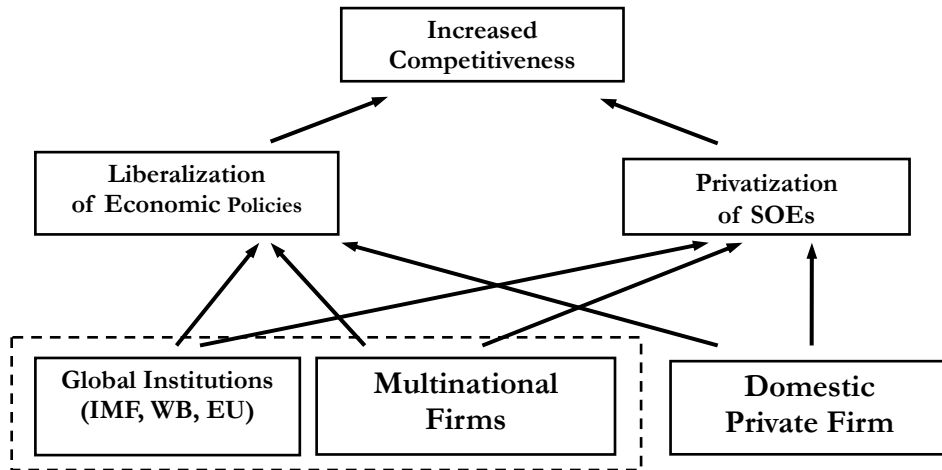
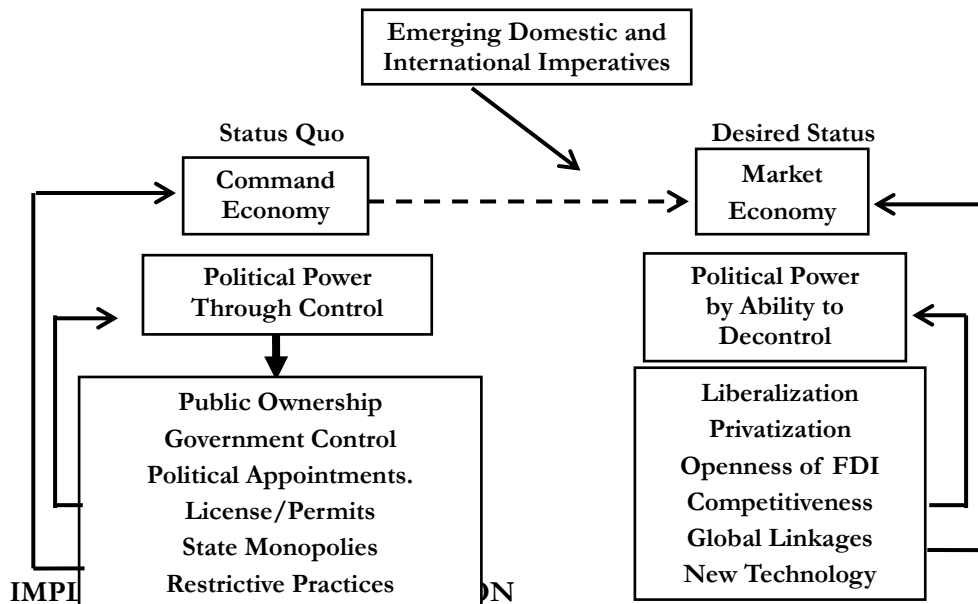


Figure 4. Governmental Issues of Control Involved in Transition



There are many implications for researchers, national policy-makers and managers. The paper has attempted to demonstrate that countries involved in transition

economies face a far more difficult time than previously believed, as many transition economies find that they lack the appropriate forms of democracy and capitalism which directly lead to the coalescence of the inhibiting stakeholders in slowing or preventing the privatization and economic liberalization practices. Regardless of whether a country attempts a market shock or gradual approach to the transition process, the political will to progress will be lacking. Economic progress from a command to a market economy will occur only when it is necessitated by disruptive change. External or internal stakeholders can then have an opportunity to provide enhancing services to the transition economies as controls are lessened from the inhibiting stakeholders. Researchers should continue to explore the role of stakeholders as facilitators and inhibitors of the transition process. We believe that there are many fruitful avenues for exploration given the changing dynamics of transition economies. Further studies may wish to more closely examine the role of political status and economic liberality dimensions more closely. As suggested in this paper, we believe that some combinations are more conducive to transition than others. Additional factors have also been omitted due to the limited scope of this paper. Other scholars may wish to examine the role of culture as an inhibitor or facilitator in the transition process. For instance, the caste system in India is reflective of a culturally embedded system that may affect the transition process. Similarly, countries such as Kenya have culturally embedded tribal systems that also may affect the willingness of Kenyans to adopt multi-party political systems.

There are several implications for policy-makers and private managers. They need to push for greater privatization and economic liberalization of a nation's economy. The benefits to a society are greater than the long-term costs of continuing to operate in a relatively state-controlled economy. Goulding believes that academia and editorial writers "fail to recognize that the returns from selling the enterprise and reinvesting in social items like universal elementary education have far higher returns than are being made by these companies" (1997). Policy-makers and private managers must attempt to demonstrate to their constituents that increased levels of privatization and economic liberalization will be beneficial to all of society in the long run, and warrant short-term sacrifice. We believe that stakeholder involvement is critical. For instance, including small businesses and employees of former SOEs in the transition process creates defenders of privatization and may reduce some inherent political problems (De Castro, Meyer, Strong and Uhlenbruck 1996).

In conclusion, the purpose of this paper was to provide a greater understanding to national policy-makers and managers of firms concerning the potential constraints and catalysts involved in progressing to a market economy. Each nation involved in this process must be willing to make sacrifices in order to reap the long-term benefits associated with a market economy. The process of privatization and economic liberalization is dynamic and complex. It takes a great deal of commitment from many

stakeholders both internally and externally to reap the rewards of the transition process.

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