Restructuring Before Privatization—Putting the Cart Before the Horse: A Case Study of the Steel Industry in Romania

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The Eastern European countries have been going through a transition phase since the liberalization of their economies with the collapse of communist regimes in the early 1990s. The attempts at transition from a centrally planned economy to a market based one has provided a fascinating laboratory for research in both theory and practice. The problems of how to make the transition are not fully resolved. Economists are still debating various strategies. While the neoclassical economists focus on the macroeconomic issues of the transition process, the Austrian School puts the focus on the microeconomic issues.[1] Part of the ongoing debate among neoclassical economists is whether state owned industries need to be restructured before they can be privatized.

Romania is an interesting case that has not received much attention.[2] Among the Eastern bloc countries, Romania stands out as having been virtually gutted after forty-two years as a "people's republic." The terror and megalomania that characterized Ceausescu's regime since the early 1960s left the country completely unprepared for the transition to capitalism. This paper

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[1]Rothbard (1992) has provided insight into an Austrian perspective on these issues.

[2]Hefner and Woodward (1999) discuss the role of foreign direct investment in developing entrepreneurial activity and successful business practices in Romania. Coyne and Leeson (2004) more recently discuss the role of three types of entrepreneurship, productive, unproductive, and evasive, in underdeveloped countries using Romania as a case study.

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examines the progress of the Romanian economy during the decade of transition while focusing on the restructuring debate illustrated by the Romanian steel industry.[3] The steel industry is particularly interesting since it is often viewed as one of the major industries in centrally planned economies. The steel industry has been analyzed by Wagner (1998), Kotas and Markus (1999), and Kotas and Price (2000). All have argued that the Eastern European steel industry needs to reorganize and restructure before it privatizes to be successful in the transition.

In the next section we present an overview of what may be termed the "neoclassical approach" to the transition process. We then describe the history of the Romanian plan for transition that has been implemented. Section four uses Austrian theory to critique and offer an alternative approach. This section is followed with a case study of the Romanian steel industry during the transition. The last section offers concluding remarks on whether or not restructuring is a necessary condition for successful transition to a free market.

The Neoclassical Approach: The Road to Freedom?

According to Parker et al. (1997) the neoclassical transition process typically contains the following four reforms: macroeconomic stabilization, enterprise and price liberalization, elimination of foreign trade and investment barriers, and privatization of state-owned enterprises. Bruno (1994) suggests that in implementing these steps, there are several questions that neoclassical economists find themselves asking. Are initial price shocks necessary? Is an output collapse unavoidable? Can fiscal balance be achieved? How should large state-owned enterprises be privatized? "The problem is how to instill market-oriented behavior in management and workers without unduly delaying the privatization stage" (Bruno 1994, p. 45).[4]

Gradualism versus Shock Therapy

There are two main perspectives on how the transition process and privatization should occur: (1) a gradual process or (2) a "big-bang" or "shock-therapy" approach to the establishment of property rights. Bruno (1994, p. 27) states, "the key question to be asked at the outset of any major reform is whether to adopt the big bang approach or gradualism." He continues by claiming that "The answer to this question is not at all clear."

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[3]Moving from a soviet style command economy to a truly free-market is a complex process involving the establishment and evolution of institutional arrangements that support a private property rights system. The complete analysis of this process from the neoclassical or Austrian perspective is beyond the scope of this paper. Instead we focus our attention on one aspect of this process; namely the debate as to whether to restructure state run enterprises before they are made private.

[4]Hefner and Woodward (1997) present two case studies in Poland that analyze the managerial problems in the transition.

Cohen (1993) argues that gradualism is the key for the success of the transition process in Eastern Europe. He claims that a rapid transition will fail and the outcome will be massive unemployment, bankruptcies, and social distress, ultimately requiring the intervention of the state. In this view, the development of proper institutional structures, such as tax laws, financial intermediaries, and capital markets, must precede the formation of property rights.

Economists who favor rapid transition are concerned with many of the same problems, but claim the key is macroeconomic stability. Macroeconomic stability for them consists of low inflation, economic growth, low unemployment, and stable fiscal and monetary policy. Sachs (1997) argues that monetary growth, due to budget deficits, additional government spending, and credit expansion, is the main cause of inflation. He favors the elimination of fiscal deficits and the creation of a tax base, which promotes monetary stability and confidence in the currency and the government. Although he does not favor price controls, he argues that wage controls can be useful in short-run for state-owned enterprises. Bruno (1994) on the other hand, argues that the monetary overhang and price liberalization that resulted in unstable prices throughout Eastern Europe could have been less severe, had price controls been left in place longer and the monetary devaluation smaller. He further argues that the declines in output should be gradual to reduce the harm to firms and employees. He suggests that the state offer subsidies and loans to weak firms.[5]

According to Sachs (1992), privatization of enterprises is important for a successful transition. However, due to a process he refers to as spontaneous privatization, whereby managers liquidate assets, citizens have been left with a negative impression of privatization. Thus, he claims that commercialization should be the first step toward privatization. Commercialization converts the enterprise into a treasury owned joint-stock company.[6] While Lipton and Sachs (1990) favor a rapid approach they doubt that it will produce immediate increases in productivity or managerial efficiency.

After commercialization, the next step requires the restructuring of the enterprises. Although a logical course of action, this policy prevents the rapid implementation of reforms within individual enterprises. Boycko and Shleifer (1993) argue that the prerequisite for this step is the depoliticization of firms.

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[5]It is worth noting that social spending, such as unemployment benefits and the design of programs that soften the negative impact of economic reform, is a recurring issue in the neoclassical literature. See Milner (1991), Sachs (1997), and Bruno (1994); however, they all argue that state intervention in social protection programs should be limited.

[6]Lipton and Sachs (1990, p. 294) define privatization as “the creation anew of the basic institutions of a market financial system, including corporate governance of managers, equity ownership, stock exchanges, and a variety of financial intermediaries, such as pension funds, mutual funds, and investment trusts.”

The firms must change their objective from meeting the desires of politicians to maximizing profits. They argue that restructuring reduces the amount of inefficiency, creates product competition, improves corporate governance, and eliminates political control of capital allocation. Their claim is that restructuring is a critical strategy of depoliticization, and hence privatization.

In contrast, Blanchard et al. (1994) question whether traditional Western stabilization methods can be effective in an economy where state ownership prevails. They raise the question of whether or not the lessons of the West can be directly translated to the Eastern bloc countries. In addition, they question the logic of the stages of transformation inquiring whether privatization should come first.

The neoclassical view of transition involves stabilizing the macroeconomy and attempting to liberalize foreign and domestic markets before addressing the issue of private property rights. In the neoclassical paradigm, the establishment of private property involves three major steps in the following order: commercialization, restructuring, and privatization.[7] The main difference between the gradual and rapid approach in the neoclassical transition process is not the agenda of issues, but the pace at which this process is implemented. With the gradual approach everything is done in stages, the "big-bang" approach attempts to address these issues simultaneously. However, with the logical order suggested by neoclassicals both processes would be gradual. The gradual and big bang approach under the neoclassical paradigm involves the state directing the process at every stage, which from an Austrian perspective is the fatal flaw in this policy. While the neoclassicals focus on the macroeconomic issues and debate the timing of the process they miss the larger implication that the logic of their steps to establish private property rights and attain a market is at best backwards.

The New Romanian "Plan"

During the socialist era, Eastern Europeans were denied political and economic freedoms. The "parasitic mentality" that ruined the civil society and crippled economic life, was a result of the lack of separation between individuals and the state, since "all economic and social decisions became political decisions and everybody became a ward of the state" (Dorn 1994, p. 440). The Communist Party in Romania maintained the tightest control over the

[7]An issue of taxonomy may be of use here. The terms commercialization and restructuring are noted above and the neoclassical definition of privatization, at least according to Lipton and Sachs, is explained in the previous footnote. We accept the neoclassical definition of commercialization and restructuring, throughout this paper. However, the definition of privatization does not conform with the Austrian notion of private capital or factors of production remaining in the hands of capitalists (see Mises 1998). Therefore, when comparing and contrasting these positions we will use the Austrian definition of privatization.

economy and did not realize the impossibility of regaining tight control after moving towards freedom.[8] The population could no longer tolerate the deteriorating condition of their lives, which lead to the revolution of December 1989 and the overthrow of communism to adopt democracy.[9]

Examining Romania's transition process reveals that the new government has followed the neoclassical paradigm. It is also clear that after a decade of reform Romania's attempt at a big bang approach has, as predicted, evolved into gradualism. The concept of planning in this context is important, because after years of central planning, the Romanian government is still planning. Only now the government is trying to plan a free market. What follows is a description of the legislation and government intervention that has occurred, and the neoclassical explanation as to why this process has been so slow.

Daianu (2001), Stan (1995), Earle and Sapatoru (1993), and Demekas and Kahn (1991) all claim that the Romanian economy, under the rule of Ceausescu, was the most Stalinist regime in Eastern Europe. The inheritance left by Ceausescu's regime was one of central planning, strict autarky, isolationism, and industrial policy choices that ignored comparative advantages making reform a difficult process (Stan 1995). Therefore, the Romanian economy had more to overcome than other Eastern European countries.

The 1990 interim government's main economic goal was improving living standards. Populist measures were taken that resulted in a boom in consumption, a dramatic decrease in industrial production and investment, and a rise in imports, all of which were financed by foreign exchange reserves. In May 1990, the interim government won the general elections and began to implement its transition plan.

The issue of stabilizing the macroeconomy took precedence. Controlling inflation, unemployment, and output were all primary concerns. Daianu (1994) discusses the disequilibria in the Romanian economy and argues that the proper use of macroeconomic tools would reduce both the external and internal imbalance in Romania's command economy. Consequently, the changes in unemployment, inflation, and output that occurred, led some economists to push for a more gradual approach. Van Frausum and Gehman (1994) and Bruno (1994) note that among the previously centrally planned economies, the decline in output and increase in unemployment were among

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[8]The Soviet leader, Mikhail Gorbachev realized the need for reform, and his policies of *glasnost* and *perestroika* reveals the intention to allow for greater personal, economic, and political freedom, and encouraged the surrounding communist countries to adopt such reforms. The reforms of the 1980s, as presented above, reveal Nicolae Ceausescu's intention to follow the path of openness started by the Russian leader. For a detailed analysis of these Soviet reforms, see Boettke (1993).

[9]Boettke (1994a) argues that democracy is neither a necessary nor a sufficient condition of economic reform. However, democracy in the sense of an electoral process was viewed as the first step to transformation in all of these countries. Similarly, Dorn (1991) warns that democracy could turn Russia into a large welfare state.

the greatest in Romania. Various fiscal and monetary policies were initiated to stabilize the economy. A period of high inflation 1990–1993 occurred during, which Daianu (2001, p. 449) attributes to the destruction of the old institutional framework "without a rapid build up of market-based institutions." The period 1993–1994 was characterized by an interest rate shock. The banking system attempted to control inflation by trying to raise real interest rates to positive levels. Inflation returned during the 1995–1996 period due to government budget deficits. As of 1999, the Romanian economy still had not achieved macroeconomic stability.

The government's inability to accomplish macroeconomic stability led the government to turn to the International Monetary Fund (IMF) and the World Bank for financial support of its economic reform program. With the pledge of $1 billion from the IMF to promote macroeconomic stability in Romania, the Romanian government agreed to the unrealistic standards of the IMF (Gregory 1999). As Gregory argues, even though the Romanian government did not always agree with the IMF's macroeconomic conditions, they had to follow the IMF's recommendations, which follow the neoclassical paradigm, in order to obtain the promised financial support. In addition, in 1999 the World Bank approved a $550 million loan package, which gives them the power to control the decisions of the government (Gregory 1999). This aid created a new level of bureaucracy, which continued to distort the situation. The plans of the IMF and the World Bank failed to improve the transition and were simply a bailout at the national level.

In July 1990, Law No. 15/90 recognized state-owned enterprises as commercial companies. Initial price liberalization occurred in three rounds: November 1990, April 1991, and July 1991 and removed price controls from approximately 80 percent of goods and services. In July 1991, new legislation was adopted on the privatization of commercial companies. The new government envisioned a two-stage process of reform: first a reform of the existing economic entities and second a modernization phase. The government's report stated, "the period of transition should be reduced to the possible minimum" (Demekas and Kahn 1991, p. 15). Thus, the idea of a rapid transformation appeared to be the favored point of view. Enterprises in strategic sectors, such as mining, defense, or transportation were to become *regies autonomies* (RA), and later transformed in whole or in part into commercial companies allowing them to be privatized at a later date (Earle and Sapatoru 1993).

The National Agency for Privatization (NAP) became the government body in charge of the privatization process (commercialization). In 1991 the Romanian government created five Private Ownership Funds (POF) and one State Ownership Fund (SOF). The POFs were established in August 1992 and functioned as the holders of equity shares equivalent to 30 percent in the newly formed commercial companies. One of the goals of the POFs was to accelerate the commercialization of shares from the SOF by allocating them to the POFs. The SOF was established to transfer into private ownership the

70 percent of shares it had in each commercial company. The SOF was to create a commercialization program to sell 10 percent of the shares each year. Stan (1995) states, in the first five years of Romania's transition that the "mass privatization" process failed to occur, since the NAP and the SOF "privatized" only 8 percent of the enterprises planned. There exists confusion over whether these institutions are controlled by the state or private sector. Earle and Sapatoru (1993, p. 158) emphasize "the lack of understanding of the proper boundary between state and private." Political appointees govern these funds showing the continuity of a command system rather than a system that relies on market-type mechanisms (Earle and Sapatoru 1993).

Following commercialization, the Romanian government implemented restructuring of the state owned enterprises (SOE).[10] Ianos (2001) confirms that the dominant view of economic reform was that industrial restructuring should precede privatization. In 1993, the Agency of Restructuring was created with the objective of reorganizing unprofitable enterprises through technical and financial support. Political pressure caused the program to yield no improvements in the performance of these companies, and only further delayed the privatization process. This program's failure leads one to further question the feasibility of designing successful restructuring programs under the auspices of the government. Ianos (2001, p. 194) states, "the involvement of the state in this process followed a classical path of subsidizing domestic and export items, supporting loss-making industrial activities, and setting prices by overrating the exchange value of the national currency."

In June 1995 the government attempted another fast paced commercialization process, and in September began the Mass Privatization Process (MPP). More legislation followed in December 1995 designed to accelerate the restructuring of RA and SOE. In 1997 the government made still another attempt at a rapid commercialization. The results were, as expected, more declines in output and rising unemployment. The 1995 laws and the creation of the Ministry of Privatization in December 1997 demonstrate the failure to increase the pace of the commercialization process and the government's intention to continue planning.

Bilsen and Konings (1998) assess the restructuring process in terms of job creation, destruction, and firm level growth in Romania. They conclude that employment growth is lowest in the SOE, slightly higher in private enterprises, and is higher still in the *de novo* private firms, firms created after December 1989. The successes of these firms demonstrate the importance of entrepreneurship and establishing property rights. Daianu (1994, 2001), van Frausum and Gehman (1994), and Stan (1995) all acknowledge that institutional fragility and undefined property rights have combined to discourage

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[10]The commercialization and the restructuring processes overlap, since the process initiated by the POFs converting ownership certificated into shares for more than 100 commercial companies was not finalized until April, 1995.

foreign investment in SOEs and thus contributed to the delay of private ownership. It is clear from the information presented that even Romanian neoclassical economists realize that their "plan" has failed to achieve its desired goal. The next section evaluates the logical progression to a market economy using Austrian theory.

The Austrian Approach to Privatization

While neoclassical economists debate the merits of a gradual versus a rapid approach to transition, Austrian economists agree on a quick transformation. In fact, if an Austrian approach is followed, the transformation can only be quick. It should be noted that the use of the term shock therapy is somewhat misleading. The goal is not to shock the economy, but rather move it forward as quickly as possible. A rapid transition will result in shocks to the economy, but these shocks are necessary.[11]

In justifying a rapid transformation to a free market economy it is helpful to examine the Austrian arguments for transforming former socialist states. Boettke (1994b) explains that there is more to the transformation process than speed. The neoclassical arguments for rapid versus gradual transformation are not all right or wrong. He explains that Sachs is correct in stating that incentives matter and providing the correct incentives quickly is important, but Cohen (1993) is also correct in stating that culture and history matter. According to Boettke, the error is in thinking that these arguments are mutually exclusive.

One approach is to treat Romania as a developing economy rather than an emerging market. Bauer (1957) argues that the first function of government in a developing country is the maintenance of law and order. Governments have to safeguard the lives and property of their citizens. This type of government structure did not exist in Romania during the socialist regime. The drastic changes in laws, governmental structure, and development of resources are therefore in many ways closer to a developing country. Bauer warns that in a developing country resistance to economic change will exist and governments need to avoid monopolization of resources and power to implement these

[11]The shock approach has yet to be attempted in Eastern Europe. The Czech Republic has come the closest to using shock therapy and one can see the influence of the Austrian method in its transition (see Hazelett 1995). Several historical examples of successful rapid transformations exist. One such case is the German miracle from 1948 to 1961, under the influence of Ludwig Erhard, the German economy made a drastic improvement. Erhard started with a currency reform and moved to a market reform; he abolished all price and wage controls and allowed almost complete freedom of movement, trade, and occupation, thus radically expanding the rights of private-property owners (Hoppe 1991). Robert Higgs (1977) notes that in the U.S. the federal government did not institute new policies to aid the newly emancipated slaves; however, property rights were upheld and blacks were able to achieve economic success.

changes. Strong government involvement in these facets of the economy is likely to retard economic growth.[12]

Boettke (1994b) reveals that the neoclassical methodology of development theory explains why Romania and other former socialist states are not treated as developing countries. The formalist and positivist revolution in neoclassical economics undermined the emphasis on institutional infrastructure. The rise of socialism, and the Keynesian revolution in macroeconomics changed government's focus from designing rules to directing the economy. With the development of modern macroeconomics capital theory was removed, and the underpinnings of microeconomics in macroeconomic theory were lost. According to Garrison (2001), this left two points of view in mainstream macroeconomics: the Walrasian world of general equilibrium with no market complications and the Keynesian view that markets cannot generate solutions. Austrian economics relies heavily upon capital theory in its macroeconomic analysis acknowledging that markets experience disruptions, but maintains the microeconomic foundations of market analysis.

The Austrians however place more emphasis on the elements of market process, exploring the ways in which the discoordination of markets occurs and how markets respond. Gallaway and Vedder (2000) claim that at the macroeconomic level discoordination among wages, prices, and the average product of labor is common, and that the macroeconomy is in a continual state of flux. Thus, creating economic policies that generate macrostability in the neoclassical sense is extremely difficult. They propose that the most appropriate short-run macroeconomic stabilization policy is to give entrepreneurs and workers maximum freedom to adjust to potentially discoordinating shocks to the macroeconomy.

Rothbard (1992) touches upon an important issue in recognizing the struggles associated with desocialization and the establishment of free markets. He makes several recommendations on how not to desocialize and emphasizes that markets cannot be planned. First, governments should not phase in free markets. Second, underground markets should not be illegal. The third recommendation is do not inflate the money supply. Finally, do not raise taxes. Neoclassical economists have ignored all of these recommendations in the policies advocated in the transition process, and it is clear from the earlier section that the Romanian politicians favored the neoclassical view.

The Austrian perspective on the privatization process opposes the neoclassical view by emphasizing the establishment of property rights for state-owned resources as the primary step. Only after property rights have been realized can successful commercialization and restructuring occur. Boettke (1993) argues that difficulties in economic policies are not unique to Eastern countries. Western democracies have been faced with difficult economic problems as well. Austrian economics has shown that while socialism will always

[12]One could argue that the political interference noted in the last section could be used as evidence of government hampering economic development.

lead to chaos, capitalism is an economic possibility. Today Eastern and Western economies are quasi-mercantilist, rent-seeking societies. The problems and paradoxes of reform all revolve around the nature and logic of economic institutions and the vested interests of the old regime. The basis of economic reform is private property rights that are protected by a rule of law (Boettke, 1994b).

> Rather than command and control, the agenda for studying economic development that I have alluded to appears to suggest that state action be limited to the establishment of rules which cultivate economic experimentation and competition. Property rights need to be clearly defined and strictly enforced. Economic progress is a function of the "rules of the game." Legal, political and cultural institutions combine to provide the effective rules within any society, and as such determine whether that society will progress or stagnate. (Boettke 1994b, p. 18)

Furthermore, Boettke (1994a) warns that conventional neoclassical models of politics and economics can result in two traps that can stall real reform. Neoclassical theory is preoccupied with (1) "getting the price right" and (2) maintaining economic stability in these transition economies.[13] Boettke (1994b) explains that Mises and Hayek, in their critiques of socialism, outlined why the institutional requirements of private property rights are essential for a free market economy. Property rights create: (1) A legal environment that provides credibility and certainty that encourages investment. (2) The right incentives for responsible decision making on behalf of property owners. (3) An environment of social experimentation that spurs progress. (4) The means for economic calculation, which allows the formulation of price, profit and loss signals, that can reasonably guide resources. Boettke and Leeson (2003) argue that in the former soviet states that if property rights are correctly established entrepreneurship will lead to new industry and competition. Entrepreneurs involved in the market process will be able to evaluate prices, and create a dynamic market economy. Restructuring existing industries will only retard this transformation.

Consequently, in order to establish a market economic system, there are certain steps that have to be taken. Boettke (1993b), Mises (1998), and Rothbard (1956, 1977) argue that market competition requires the separation of economic forces from political forces. Governments cannot understand the data of economics within the context of the chooser. Preferences and value scales cannot exist separate from the action of the individual. Coyne and Leeson (2004) demonstrate how entrepreneurship has been perverted by Romanian officials.

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[13]A third trap could be noted which is to favor the creation of democracy over markets (see footnote 9). Also Zakaria (2003) explains that democracy will not necessarily generate a desirable outcome. We are thankful to an anonymous referee for this point.

Praxeology explains why privatization schemes such as vouchers or auction models (commercialization) cannot value assets without a market, and a reliable market cannot exist without private property. However, if government manages the reform process the outcome will be one of economic distortions and political instability. Boettke (1994a) emphasizes that Austrians understand that economic and political freedoms are intertwined and that institutions are important.

Planned economic reform is not distinctly different from the communist system of monopoly that removed individuals from the decision making process of public life. Zygmont (1994) explains that privatization can be viewed as a threat when citizens depend on a single enterprise for their livelihoods. Gradualism and government restructuring is favored by many, because citizens think the state can minimize failures. The neoclassical approach delays the privatization process and does not result in the liquidation and reallocation of assets that is necessary to create capitalism.

If establishing property rights is the first logical step what is the best process? Rothbard (1992) recommends returning property to the original owners or their heirs when possible. In lieu of this possibility he argues for a homesteading approach.[14] Consistent with the homestead approach is Zygmont's (1994) view of liquidation or spontaneous privatization, Boettke (1994), and Boettke and Leeson's (2004) concept of *de facto* property rights. The argument is that in former communist countries, the business executives and factory managers seek to retain control through privatization of what they have already laid claim to as their *de facto* property. These individuals have been responsible for this property and have placed a value upon it establishing implicit property rights that should now be recognized.

Boettke (1994) argues that Hayekian economics and politics provides the most viable answer to the neoclassical traps by offering an alternative perspective that respects cultural traditions and institutions, while providing a methodology for critical analysis. Information under liberalization can freely flow to provide the incentives that neoclassical economists desire so that individuals can best discover and use the information. This information will then develop and emerge within the institutional arrangements of the economy rather than being imposed. The concept of *de facto* property rights, if established with certainty and credibility that these property rights will be protected, will necessarily lead to a commercialization and restructuring process that is based on entrepreneurial expectations. Boettke and Leeson (2003, p. 36) note that as important as the successful privatization of former state owned firms may be, the real test of a successful reform is marked by "the

[14]Homesteading is the act of mixing one's labor with land and capital that is otherwise unclaimed and thereby creating private property. For a detailed discussion of the homesteading principle see Rothbard's *Man, Economy, and State* (1993) and *The Ethics of Liberty* (1998).

establishment of institutional conditions such that private newly created firms come to dominate the economic scene."

The idea of commercialization and restructuring being the result of a private property system is lost in the neoclassical theory because of their frictionless models of economics and politics. The frictionless model of competition in neoclassical theory is the outcome and not the process. It is an ending, and not an explanation of how markets function. Traditional neoclassical arguments use the competitive model to avoid the problems of cost and uncertainty. The arguments of Mises (1975, 1998) and Hayek (1945, 1984), which incorporate private property, the rule of law, and uncertainty into their theory are the most appropriate for these former soviet states. Western advisors approach commercialization and restructuring with a careful and detailed plan and envision a process of phasing in reforms. Even if one claims that these reforms are no longer a socialist system, the mere act of government establishing institutions to encourage successful business practices, without first privatizing the property, is at best a major government intervention in the economy.

Austrians focus on liberalism and the power of social cooperation, thus arguing against interventionist attempts by the government to improve the economic order. Mises extended his work on the calculation debate to the theory of interventionism. Ikeda (1994) explains that Mises's and Hayek's arguments establish a theory of interventionism by connecting the impossibility of economic calculation and use of knowledge, to demonstrate how interventionism is inherently related to the centrally planned economy. Rothbard (1993) extended this work explaining that social utility can never be improved for a society when government intervenes.[15]

The Austrian perspective of privatization opposes the neoclassical view by emphasizing the establishment of property rights for state-owned resources as the primary step. Only after property rights have been realized can institutions, entrepreneurship, market prices, and profit and loss signal emerge all of which are necessary for successful commercialization and restructuring to occur. Finally, Austrian economists realize that planned economic reform, even if done in the name of markets, is still economic planning.

Restructuring the Steel Industry

The steel industry provides a case study of the neoclassical view of restructuring. The steel industry in Romania was developed during the industrialization of the 1960s. In 1989, the industry consisted of thirty-three enterprises.[16] The

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[15]For a detailed analysis of the categories of intervention and the theory of social utility see Rothbard *Man, Economy, and State* (1993). Also, see Salerno (1993) for the further development of this theory suggesting that government intervention can reduce social utility.

[16]In addition, four research and development institutes exist in the steel industry.

Romanian steel industry was a large exporter of steel products in the Council of Mutual Economic Assistance (CMEA), always registering positive net exports.[17]

The attempt at commercialization and restructuring has not resulted in the anticipated economic benefit, primarily because the policies outlined for eliminating the SOE failed to occur. Many of the steel companies continue to be state-owned, and as of 2002, all thirty-three enterprises are still in existence.

Since 1989, steel output has continuously declined due to the fall in internal consumption of steel, reaching a low 4.5 million tons per year in 2000. The decline in output has also decreased employment. In 1989, 207,856 people were employed in the steel industry. In 2000, 77,000 people were employed in the industry. According to the restructuring strategy, developed by the Ministry of Industry, the number of steel workers is expected to decrease to approximately 54,000 by 2010. Net exports are another indication of macrostability in the neoclassical model. Exports of steel products have declined from 1,069 thousands tons in 1989 to 505 thousand tons in 1999, while imports have fallen from 844.5 thousand tons to 487 thousand tons during the same period. Net exports remained positive, but are decreasing.[18]

The first stage in Romania's efforts to transfer the state-owned enterprises into "private ownership" was the process of commercialization, initiated in July 1990. Enterprises were to be transformed of into either joint-stock or limited liability companies that were to be subsequently privatized. Shares of steel companies were to be divided into the POF and SOF. Over a decade later the SOF has not accomplished its stated goal still holding large percentages of steel enterprises. The SOF eventually changed its name to the Authority for Privatization and Management of State Ownership. The main objectives of the "new" institution are the restructuring of enterprises, providing financial assistance as needed in the revamping, managing the companies' portfolio, and the sale of the state's shares to the private sector. These objectives are "following the governmental strategy," which reveals the continuity of a command system with constant political intervention in the economic realm.

The restructuring strategy of the Romanian steel industry for the years 2002 to 2005 focuses mainly on the industrial segment. The government plan recommends: specialization in each enterprise in order to avoid competition as much as possible at the national level, maintaining the internal market demand, maintaining and developing the export markets, development of intermediate products, and investments in technology. The restructuring program concentrates on increasing the economic efficiency of enterprises by

[17]The Council of Mutual Economic Assistance (CMEA) was a trading bloc consisting of Communist bloc countries.

[18]Government of Romania (2002).

trying to increase productivity, reduce input consumption, and increase quality to achieve European Union standards. The total explicit cost of the industrial and social restructuring of the steel industry amounts to 590 million dollars. These funds are being supplied from governmental resources, strategic investors, and external sources.[19]

The Romanian government is not alone in favoring restructuring before privatizing. Kotas and Markus (1999) argue that the objective of the restructuring process in Romania and Central Europe is necessary for the long term viability of the steel industry. They define viability as business profitability, the ability to fully meet customer needs, and the ability to compete with international steel manufacturers. They argue that privatizing first involves the risk that the new shareholders will not restructure plants. If the government continues to privatize first and restructure subsequently, there is a high risk of viability never occurring (Kotas and Markus 1999). The Austrian perspective argues if these entities, which are the result of planning, should even continue to exist; it can only be decided under private ownership. Although modernization of some plants has occurred, there is no guarantee of viability, and cannot be as long as the steel industry continues to be operated by the government. The investments in restructuring have been funded by loans from state-owned banks without consideration for the business strategy, which has left steel firms with large debts (p. 7). This outcome should not be surprising as it is understood that economic calculation by the government cannot occur, so no "business strategy" could possibly occur. Kotas and Markus claim that the privatization of Romanian banks would lead to investment decision makers placing a greater emphasis on business viability. While the banking industry being completely private is a worthwhile goal it is not enough to generate true entrepreneurial decision making for the resources of the steel industry.

One problem with obtaining viability in the steel industry is the source of inputs. Kotas and Price (2000) urge the Romanian government to exploit its domestic resources rather than to import materials, even if the costs of production are higher and mining operations are not viable.[20] The steel industry cannot obtain any kind of meaningful viability or success if the government continues to control and intervene directly in these companies, and indirectly through input markets. This results in the steel industry continuing to operate without economic calculation. Specifically, it is the lack of market prices in the input markets, such as mining and financial markets, that prevent economic calculation.

The privatization in the Romanian steel industry has been extremely slow. More than a decade after the fall of the Communist regime, there still exist 14 enterprises that are SOE's. A true market process that signals profits and

[19]Government of Romania (2002).

[20]Kotas and Markus fail to consider the theory of comparative advantage and the law of association in this analysis.

losses has yet to be realized. Furthermore, many of these companies have been incurring major losses on a yearly basis, and yet none of the 33 companies have been liquidated (Government of Romania, 2002). Kotas and Price (2000) think that the costs to turn these enterprises into profitable businesses may run into billions of dollars per company; however, the likelihood of funding these turnarounds from the state and private sectors is small. Some of these companies have to be liquidated; however, as long as the government owns both the banking system and these companies, the liquidation process is not likely to occur. It is in the interest of politically appointed managers in these companies, to follow the government imposed strategy. This restructuring strategy offers the government complete control over the economic situation of these enterprises. Furthermore, it is important to highlight the impact of unions on the steel industry transition. According to Aurel Radi President of the "METAROM" National Trade Union, unions are independent from the management of the enterprises, as well as the political power.[21] However, due to the legislation passed in 2002, unions are consulted in the commercialization process, and a social contract will be drawn between the union and the buyer; disregarding this contract represents a clause to annul the contract.

Further compounding the difficulties of establishing a private property based market economy, the Authority for Privatization and Management of State Ownership nationalized (i.e., reverted ownership to the state) of two previously commercialized steel companies (Ciobanui, June 2002). This sudden reversal of property rights raises the issue of the government's credibility of protecting private property. The investors' property rights are being taken away at governmental discretion. Private investors run a great deal of risk when investing in the Romanian steel industry. The fragility of private property rights retards the market process, which leaves enterprises in the possession of the government. Wagner (1998) underlines the importance of having a successful steel industry rather than a Romanian owned steel industry. To the extent that markets dictate the profitability of this industry this can only be accomplished by the establishment of true property rights based on sound legal foundations.

Conclusion

With the collapse of the Soviet System in 1989 many envisioned economic and political innovations in the former communist countries. Western economic advisors rushed to aid in the development of these new institutions, but a lack of understanding of economics and history has stalled this process to date.

Neoclassical economists did not understand the significance of economic calculation as developed by the Austrian School. With their concern for establishing equilibrium prices and macrostability they ignored underlying

[21]Reported to one of the authors in an interview with Aurel Radi in July 2002.

principles: the macro economy is always in a state of flux and prices can only emerge under a private property rights order. The result has been a slow process with a mix of government relinquishing and re-taking control.

The Austrian insights lie in the understanding that private property rights in all aspects of a market are what allow individuals to evaluate resources. Furthermore, the Austrians understand the important role of institutions and that they cannot be planned. Privatization will be a shock, but there is a lot to be corrected from years of misallocation. New institutions must emerge and not be forced.

The steel industry is a microcosm of the attempt at transition by neoclassical economists and Romanian officials. Property rights have not been established in the industry or its resource markets. Despite the attempts to stabilize the economy the industry has experienced all the negative shocks that economists are trying to minimize. The key to the restructuring of the steel industry, in Romania from the Austrian perspective relies upon the important role that the Austrians place on the entrepreneur. The entrepreneur must assess the market and the resources available to him to determine which industries he expects to yield profit. However, entrepreneurship in and of itself is not sufficient. As Coyne and Leeson (2004) note, destructive forms of entrepreneurship may develop depending on the institutional structures in place.

Notions of restructuring prior to privatization are merely delaying the process of sorting out resources and the necessary liquidation and reorganization of assets. If central planning failed then why do we continue to witness politicians and economists continue to advocate centralized decision making in the transition process? Finally, it is worth noting that Lange (1937, p. 134) argues that most socialists preferred a gradual transition to a socialist state, but he claims that a swift change is best any time you have a radical change. "The very existence of a government bent on introducing socialism is a constant threat to this security. Therefore, the capitalist economy cannot function under a socialist government unless the government is socialist in name only." We claim the same argument can be made in reverse, that a radical change to capitalism should be rapid, and that the neoclassical gradualist approach toward capitalism that has been visible in Romania is one in which the government is capitalist in name only.

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