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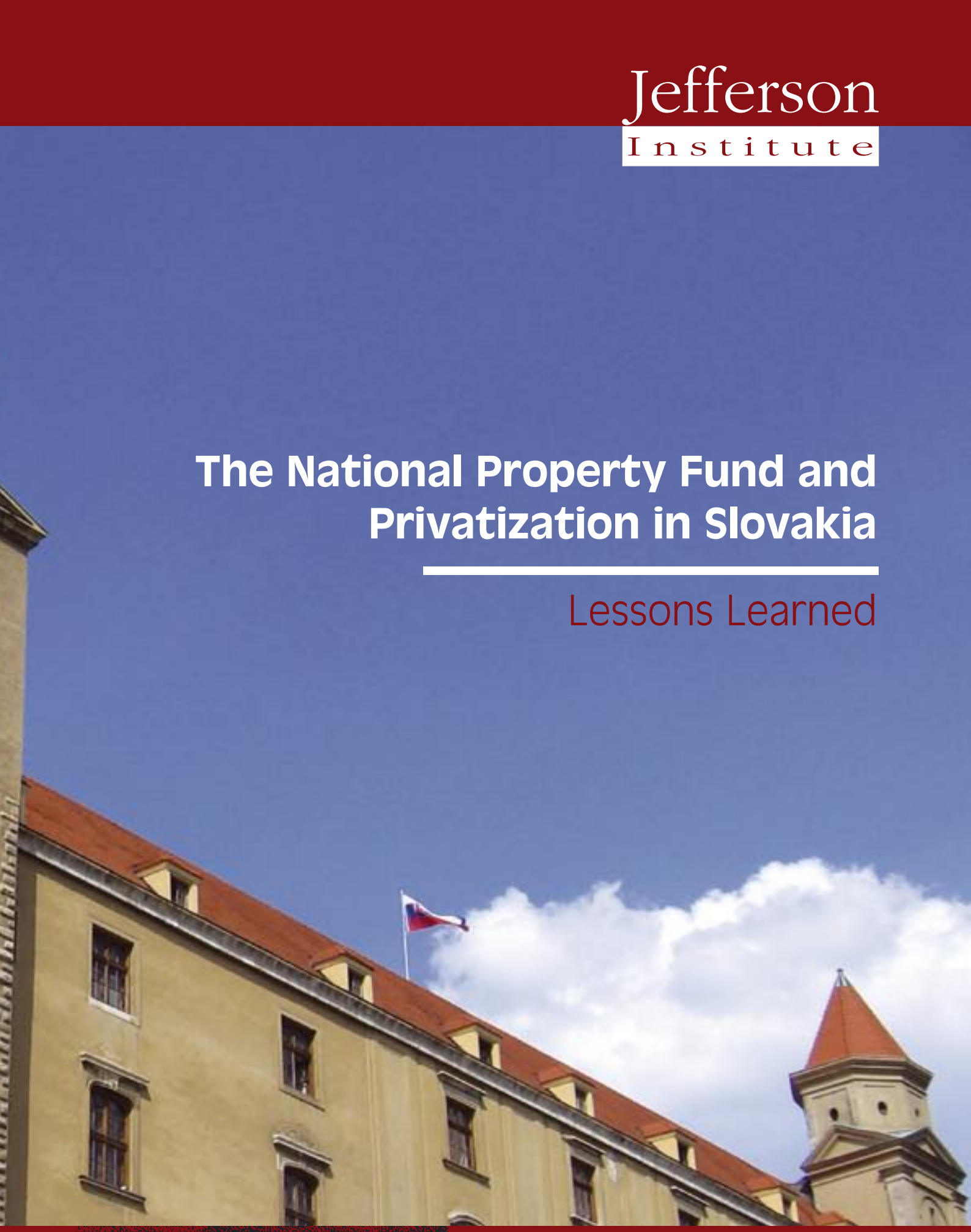
The National Property Fund and Privatization in Slovakia

Lessons Learned



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About the Author

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The National Property Fund and Privatization in Slovakia

Rudolf Autner

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Executive Summary

The National Property Fund represents a case of how to accomplish privatisation without derailment by scandals or other substantial problems. The Slovak case traces the evolution and environment of the National Property Fund (NPF), which was, and still is, the key element of the privatisation process in Slovakia.

The NPF is a legal entity, intended to last until privatisation is over in the short term, whose main role is to implement approved privatisation projects, conclude sales and purchase contracts in line with such projects, organise public tenders and auctions, and temporarily administer government stakes (in formal terms, those were NPF stakes) in corporatised or partially privatised business companies.

The Slovak NPF is an example of how to balance interest group politics with professional management to the degree that a state privatisation agency can successfully complete its mission of privatizing all entrusted state assets, before closing down. The key is both the selection of highly qualified professional managers and especially the carefully defined inclusion in the political decision-making process of a wide array of competing interest groups.

In the Slovak experience, the political inclusion of wider interest group input improved the state's chances of preventing monopolization of, and minimizing rent-seeking within, the privatisation process by one or a few interest groups. With wider interest group support and excellent professional management as jointly necessary conditions, state privatisation agencies are able to survive to complete their institutional mission with strong results.

It is vital to adjust the privatization process already underway to subsequent legislation. The laws and regulations that were most wanting when reform and privatisation were launched included those on the procurement of investments, goods, and services (making it obligatory for state-owned enterprises and institutions to make procurements using tender procedures), regulations to prevent the conflict of interests, taxation regulations, and laws and regulations to prevent money laundering.

Corrupt behaviour may often be encountered in cases of defaulting on contracts concluded by buyers and the NPF. Most commonly, this concerns the failure to pay the purchase price of privatised property. The highest incidence of such behaviour is observed in instalment schemes.

Instalment plans are always associated with the risks of post-privatisation corruption. The problem is that the new owners acquire property and the ability to dispose of it before paying the full price. In some cases, real estate may be used as collateral pending the last payment; however, it is not possible to prevent, in the case of defaults or contract termination, some assets being stripped away from the enterprise to the buyer and to the detriment of the enterprise, i.e. of the state or the NPF.

Corruption cannot be avoided in the privatisation process. However, the degree of corruption is primarily determined by privatisation forms and methods that are employed, the pace of privatisation, and respect for the principle of equal opportunities.

Where privatization is concerned, an important danger of the post-communist interest lobby system is the very important influence of newly created interest groups on management boards that influence the real political and economic decision-making process in Slovakia.

The Fund is under direct control of the National Council of the Slovak Republic (i.e., the national parliament), to which the Fund submits its budgets, proposals of use of its property, and activity reports. Also, the top decision-making bodies of the Fund as an organization, i.e., its Presidium and Supervisory Board, are elected and recalled by the National Council of the Slovak Republic.

The organizational structure of the Fund and its activities are governed by Statutes approved, after discussion with the Government, by Parliament. The Statutes also define the scope of mutual co-operation between the Fund, the Ministry of Finance, the founders and the Government, as related to the activities of the Fund, especially concerning the founding of companies under Privatization Awards, among other activities.

The Executive Board of the NPF is where professional management capabilities interface with a small group of political representatives. This match is crucial for smooth operations of the NPF. It is also why an independent, professional management team is hired to help to mitigate potential influences which might lead to costly or damaging compromises affecting Board members' professionalism. The highly sensitive difficulty is to devise methods to constrain the rent-seeking or micro-managing influence of politicians, while allowing the

latter to exercise some measure of political oversight of transactions involving state assets. To ensure that this function is working properly, independent professionals have to be invited to run the day-to-day operations of the privatisation entity.

With the privatisation mission of the NPF deemed to be largely accomplished, the government of the Slovak Republic recently decided (November 2005) that the NPF's activities will be terminated by the end of 2006. All of the NPF's assets and liabilities will be taken over by the Ministry of Economy of the Slovak Republic as of January 1, 2007.

Introduction

In Czechoslovakia, decisions about the methods and procedures of economic transition were made in the first half of 1991, with the intent of pursuing a radical form of economic transformation. A rapid transition to a market economy was implicitly endorsed in the first free elections held in June 1990, appearing most concretely in the conceptual program entitled "Scenario of Economic Reform" that was approved by the federal parliament in September 1990.

From the beginning, promoters of rapid economic reform fully realised the daunting nature of swift and extensive privatisation, as well as the fact that it was absolutely essential to proceed with it. This led them to rely, in addition to well-known standard methods, on a non-standard procedure - the voucher scheme. As the voucher method of privatisation is rather complex, we do not go to details of it. This privatisation method is irrelevant for any kind of application for the Reform of the Defence System of the State Community of Serbia and Montenegro

Underlying systemic changes consisted of establishing economic conditions and an economic environment that would automatically maximise interests, primarily economic interests and incentives, and induce such behaviour by macroeconomic entities that would promote efficiency and competitiveness both of individual businesses and the economy as a whole. In other words, this meant replacing the salesman's market by the buyer's one. Such a substantial change as the shift to demand-driven markets immediately caused much deeper thought about current reforms being implemented in Slovakia, as well as anticipated reforms. This revised reform process was launched in the late 1990s and will finish over the next several years by reforming the tax code, pensions, and the health system. Incomplete reforms will probably jeopardize a solid base for real growth.

The centrally planned economy was riddled with deficiencies, with aggregate demand prevailing over aggregate supply. As a result, the problem was not of selling, but that of buying. At the same time, there existed no competitive environment, with imports being administratively limited and domestic producers facing virtually no competition. Manufacturers and salesmen did not

have to win buyers' trust because in a deficient economy, they were able to sell everything anyway. Even if manufacturers and salesmen found themselves in trouble, they were not threatened with going out of business because the government would usually bail them out in the form of soft budgetary restraints, i.e., grants, subsidies, soft loans, or tax waivers.

To achieve a successful transformation to a market economy, it was essential to impose a tight, criteria-driven economic environment, where a macroeconomic equilibrium could be reached through tight budgetary constraints, a uniform system of taxation, the minimisation of state grants and subsidies, and the liberalisation of foreign trade. All these measures were launched on 1 January 1995 with the commencement of the economic reform. The reform was assumed to evolve in the following stages.

The first stage, that of abrupt price increases, was projected to last 3 to 4 months. The second stage of adjustment was anticipated to produce economic decline as businesses adjusted to the new climate, and forecast to last one to one and a half years, followed by stage three, economic growth.

The stage of abrupt price increases evolved almost entirely as predicted, lasting three to four months during which the rate of inflation went up by about 55 per cent. However, price increases then levelled out, and the annual inflation rate was only 63 per cent. As of April to May 1991, a tough, criteria-driven macroeconomic environment was imposed on the Czechoslovak economy.

There is now a uniform taxation rate; subsidies and grants have been dramatically reduced compared to the early years of the transitional period; loans are only granted under commercial conditions, the sellers' market has been replaced by a buyers' market, and there is a macroeconomic equilibrium between aggregate demand and supply.

The adjustment stage commenced roughly in July 1991. This stage, however, did not progress as quickly as initially projected. In other words, many enterprises, their altered economic environments notwithstanding, persisted in displaying patterns of behaviour inherited from the centrally planned communist economy. The most typical examples included over-producing huge inventories for warehouses without secured sales, relying on the government to sort out sales problems. Another example was the insufficient use of company assets, such as commercial utilisation of recreational facilities.

A quick adjustment of individual businesses and the economy as a whole to market conditions is conditional on rapid changes in ownership. This applies both to individual firms and the economy as such. Inadequate or insufficiently

rapid adjustment of microeconomic units to changed conditions usually entails depreciation of enterprise property, among other consequences. Such long-standing depreciation without an adequate response is easily possible under state ownership when there is no concrete owner who will have to assume the risks of failing to respond to the problems posed by asset depreciation. Privatisation, understood as a process seeking to achieve a dominant share of the economy by the private sector, is an immensely necessary but insufficient condition for a rapid and successful adjustment and economic restructuring, and thereby the overall success of economic transition.

The National Property Fund and the Macroeconomic Framework of the Process of Restructuring of the Slovak Economy

The privatisation process in Slovakia was divided into two different frameworks: small-scale and large-scale. In the small-scale framework, the only privatisation method employed consisted of auctions where only those assets without entitlements and obligations were sold. These assets were primarily retail outlets, restaurants, smaller operations and factories, small hotels, etc. There was a restraint on foreign participation: only domestic natural persons and legal entities were eligible to bid in the first round. Foreign bidders were allowed to participate in a second round only when a business failed to be sold in the first one. Small-scale privatisation was supervised at the regional and district level by District Privatisation Commissions accountable to the Privatisation Ministry.

Because the pace and scope of privatisation were deemed to be important criteria, and given a lack of available funding as well as the generally long time needed for privatisation, a decision was taken to rely on, in addition to standard methods, a voucher scheme as a non-standard method.

Large-scale privatisation was divided into two waves, during which the intention was to privatise most of the assets that could be privatised. A decision was also taken to make the voucher scheme a component of each of the two privatisation waves (though the voucher scheme is not a subject of this paper).

Parliament, acting on a governmental initiative, set up a specialised institution to handle privatization of large-scale state enterprises, namely the National Property Fund (NPF). This NPF was and still is a distinct legal entity whose main role was and is to implement approved privatisation projects, conclude sale and purchase contracts in line with such projects, organise public tenders and auctions and temporarily administer government stakes (in formal terms, those were NPF stakes) in corporatised or partially privatised business companies. There were three National Property Funds, one at the federal level

and two in the constituent republics (the Czech Republic and Slovakia). A Presidium and Supervisory Board were the supreme bodies of these NPFs, their members being elected by respective parliaments by secret vote.

Interests that Influenced the Process of Privatisation

Even with socio-economic developments monitored by relevant statistical and informational services, for the time being it is impossible to draw a complete picture of all participants and their specific interests and attitudes involved in the privatisation process in Slovak society. However, it is quite possible to describe interests which existed before the privatisation process began. These interests changed to some degree over time, as the positions of particular groups towards privatised property evolved throughout the shaping of the privatisation process.

One can understand that we are describing legal groups and people as well as some set of semi-legal and even illegal groups of people. Of course, such groups try to play a role in the transition and privatization process everywhere in the world. Our meaning of the expression "interest group" refers to all privatisation process stakeholders, starting with managers of state-owned companies, and including groups of individuals trying to privatise the company under the best possible conditions for narrower group or individual interests that deviate from the interest of the state as represented by the NPF. All these groups use a range of available tactics (lobbying, blackmail, and biased media communication) to influence every privatisation transaction. A part of the privatisation process includes the hidden fight against each others' interests, a subterranean competition and conflict of interests which, strikingly enough, promoted the values of efficiency and net economic benefit to the state as a trustee for the general public in the case of Slovakia.

Factors in Privatisation

Various groups within Slovak society differed from one another with regard to property, methods, and consequences (e.g., the fate of pension funds) of privatisation. Not all citizens were or are equally interested in the privatisation process, which is why they did not show the same interest in obtaining privatisation-related ownership rights, though there was no official and/or formal reason why some groups of citizens should be excluded from privatisation. Practice has also shown that the intensity of privatisation-driven interests and activities of different groups varies significantly.

The differences in interests and activities of actors result from the following factors:

1. The natural form of the property privatized in direct relation to the information costs, know-how, and network support needed to exploit that type of property: certain types of property can be used effectively only if an owner possesses some combination of certain skills, expert knowledge, experience, business contacts with suppliers and customers, etc. Of course, not every citizen is able to meet such criteria. Nor could everyone become a manager in a limited number of enterprises.

2. Different degrees of real power and control of assets delineated for privatisation: in practice, certain groups (managers or officials) manipulating state property had various kinds of control over assets before privatisation was formally launched. Such control originated in the authorization those people were given to administer economic, managerial and production activities in state-owned enterprises, central state administrative bodies or the political institutions on which the whole state system was based.

3. Assets available before privatisation and opportunities to acquire necessary capital through loans, joint ventures, or other approaches: the acquisition of such assets and capital at the outset of privatisation was obviously not evenly distributed through the entire citizenry.

4. Political decisions about the mode and conditions of the privatisation process. Those decisions significantly influenced citizens' self-evaluation, along with the conditions described in paragraphs 1-3 above. Evidently, these antecedent political decisions shaped the effective execution of managerial and ownership rights and the distribution of real power in the society, and thus played a crucial role in citizens' decision-making and in forming their attitudes towards privatisation.

Based on the above four factors, an active interest in privatised property could be expected from those who either had at least the minimum cash necessary, or were able to get the cash through loans or joint ventures with foreign or domestic entities. Primarily this meant executive managers of state-owned companies, members of top management, employees together with managers, or owners of already privatised firms who could meet those conditions at the appropriate time. In addition only a very few individuals, either holding important positions in central state administrative bodies, or having strong political ties, could join the narrow group of potential privatisation participants.

Taking into account the situation of the Slovak cash deposits market and the so-called "pre-privatisation positions," which were based on real control of administered state-owned enterprises, it was no surprise that groups, rather than individual bidders, were able to succeed in privatisation. Those interest groups fought each other, as demonstrated by numerous scandals and controversies published in the press almost daily. Media accounts, however, do not allow us to determine the structure of the interest groups more precisely, to the extent that important actors remained behind the scenes.

Here we can only speculate on possible combinations. Fights between old communists and new management interest groups have been frequently mentioned. This simplistic dichotomy of interest group competition is not at all exhaustive. Participants in the privatisation process represent a wide range of individuals who differ from each other in political background and professional career history. Managers in old state-owned enterprises came from different professional environments. The break-down of huge state organizations and conglomerates resulted in a significant migration of managers. Officials from former general headquarters, managers in particular enterprises, and some employees from smaller operational units and distribution outlets all knew the real value of privatised property and all had approximately the same potential to meet the formal privatisation criteria.

Moreover, managerial and other interest groups broadened their networks on the basis of family ties, as well as through local and regional contacts among network members. All groups were trying to build solid political support through alliances with various political parties. However, their interests did not have common ideological (or any other) grounds. In all cases, it was a marriage of convenience, or in other words a temporary alliance based on expected support in asserting managerial rights and ownership rights related to privatisation, and to help resolve resulting problems with the help of political patrons.

Regardless of the real buyers' economic interests that were shaping the privatisation process, official privatisation decisions usually stressed productive development of privatised enterprises as the top priority.

The same was true in all cases when a sufficiently strong "pre-privatisation position" combined with a real economic interest in the development of the enterprise in question. On the other hand, there is a long list of recorded transactions where new owners of privatized companies did have just one simple interest: to sell their influence to third party investors eager and ready to run the business. These "transient owners" had no interest to run the business in many cases: their real interest was just to re-sell the company quickly for a

large profit. That is why wealthy foreign investors were and are often welcomed.

The ESOP Approach

Proposals dealing with the new structure of ownership relations differed from each other significantly, especially in the early stages of transformation. They were based on voucher schemes where the vouchers were distributed to all citizens (older 18 years) and on direct sales methods. Sporadically, other proposals were introduced: ESOP (Employee Stock Ownership Plans, or ESOP), privatisation through the establishment of cooperatives, preferential rights for employees in the privatisation of the relevant facility, the regular sale of shares, and other modifications. Some proposals connecting the interests of employees, employers, and owners in Slovakia were inspired by ESOP plans implemented in the USA and other countries.

The object of the ESOP alternative (which has sizeable support in Slovakia) was to overcome certain limitations stemming from collective ownership, and to make it possible for individual representatives of employees to own part of their particular enterprise. The solution depended on creating special shares through which both capital expansion and rapid workforce development could allegedly be reached at the same time. However, the authors of such proposals in Slovakia overestimated the strength and intensity of the employees' interests. Such interests could have been successfully enforced in practice only with sufficient organizational strength of employee groups. Had a sufficient employee interest existed, even in latent form, it would have been possible to form strong collective interest groups of employees. That, however, did not happen.

In enterprises with employee ownership participation, respective employees either put coupons into that enterprise, or bought its shares. Both alternatives resulted from (and were only a supplement to) the activities of management, which frequently had obtained decisive stakes in advance.7 Employee interest in ownership was strong, especially in regions where privatised facilities represented the only job opportunities or where employees felt that their job status was being threatened. Such activities were similar to pre-war movements enforcing the establishment of cooperatives or other societies supportive of employees.

For the most part, employee interests were strictly individual in nature. No wonder that such individual interest, when competing with the interests of

potential external bidders, has proven to be insufficient and weak. The basic reason was that representatives of employees were not always sophisticated enough to compete with outside groups, who in many cases misused those employee representatives to play a hidden role on behalf of other investors.

Employee ownership of shares did not secure employee jobs. One way or the other, selling the shares was often the only alternative offered to the employees, and it is hard to say whether their choice would be the same if they had another alternative available. Such ownership and employee-employer relations might be consistent with the development needs of the respective enterprise, but definitely does not create the strong collective entrepreneurial awareness that is the basis of all ESOP models.

The interests of pensioners, medical beneficiaries, and other groups of the population are much like those expressed by employees. If not organized, such groups, though numerically large, tend to be relatively marginal actors whose interests are relevant only when some more powerful group needs them in order to satisfy its own ambitions. That explains why legal amendments proposing that part of pension funds should be covered by privatised property, or more precisely, by money gained from privatisation, were not introduced into Slovakia's legislation, although such amendments were prepared in Slovakia, the Czech Republic, and other countries.

Besides the aforementioned groups, political parties played and still play a crucial role in the privatisation process, since their representatives hold important positions in government bodies and take part in privatisation decision-making.

Last but not least, foreign bidders also shape the process by their close relationship with some government representatives.

Those are the groups whose interests are at play in privatization, or act on behalf of some other group which does not directly participate in privatisation.

The Process of Privatisation and Conflict of Interests

The restructuring process had decisive impact on the management of state-owned enterprises.

The means for restructuring enterprises not destined for privatisation include legal restructuring (providing enterprises with a new juridical identity and access to credit and foreign exchange), commercialization (cutting off subsidies but allowing public enterprises to act as private commercial enterprises in pricing and capital-raising activities), and rehabilitation (giving public enterprises new loans for equipment and debt restructuring, as well as engaging in debt-equity conversion).

Here, we are interested in the other means of restructuring: the privatisation process. As part of privatisation, different interest groups substantially influenced the management of enterprises at the top level in Slovakia. This privatisation process, especially at the top level of management, reveals the socioeconomic and ethical problems linked with the emergence of new owners of enterprises and consequently new managers.

The goal of the privatisation process in Slovakia is the transformation of state property into private property with different private owners. This process concerns also the problems of restructuring the economy in Slovakia. Authors distinguish two different types of restructuring through privatisation: a reactive, passive-type struggle for survival under the pressure of strict budgetary limitations, versus an active type of restructuring by seeking major changes and active adaptation. The first type is characteristic mostly of enterprises dominated by insiders, managers and employees. The second type is associated with foreign ownership of former state enterprises. All these entrepreneurs bring new capital and managerial know-how, and consequently have preconditions for active restructuring linked with new investments and a new managerial approach. This type also seeks new approaches to property, control in privatised enterprises, and management.

The results of the privatisation process in the transfer of state property to foreign owners and the share of foreign investment and capital in such types of companies and enterprises in Slovakia are the following: in September 1996, the

volume of foreign investment capital in the Slovak Republic was 845 million USD (equivalent at the time to 25,3 billion Slovak Crowns).

The Privatisation Process in Slovakia

The results of the privatisation process in Slovakia former Czechoslovakia are found in the following figures, which show the percentage of privatised property:

Year	1989	1990	1991	1992	1993	1994	1995
%	17,5	20,0	25,8	30,8	38,6	44,6	60,2

The privatisation process has proceeded very quickly since 1995. Consequently, as a general matter, we can say that privatised and private enterprises are dominant in the Slovak economy, with the exception of banking and some infrastructural sectors. For instance, in Slovakia there are 48,520 profit-oriented organizations and of these, only 1,558 or 3.2 percent belong to the public sector, while 46,962 or 96.8 percent belong to the private sector. The situation in large enterprises is similar, such that the ratio between the public and private sector favoured the private sector by 143 to 174 in 1997; in middle-sized enterprises, the ratio was 1,540 to 395; and in small enterprises the ratio was 3,152 to 308 in the same year. These large enterprises have very strong and influential lobbying groups working to ensure they receive good credit from banks or other financial institutions.

A special characteristic of the situation in Slovakia is the formation of a class of new economic owners of big enterprises after the first and second wave of privatisation, and the new economic lobby connected with its interests. These new owners strongly influence the strategy of enterprises, not only at the level of top management of subsidiary enterprises and factories, but also as members of interest groups embedded on management boards of newly privatized companies, who shape much of the real decision-making process in Slovakia. Outside the respective firms, some of the newly founded large privatised enterprises have their own influential contacts in strategic posts in government. Consequently, if broad state policy on privatisation is dominated by the influence of lobbying groups that bridge the state and particular enterprises, it may not reflect the real economic interests of many other enterprises.

In Slovakia, there is a real danger of too few lobbying groups that collude, possibly to the point of domination of policy decision-making by powerful lobbying groups of some of the most important Slovak enterprises. This corporatist situation may also influence interventionist fiscal policy on a broad scale, and consequently the decision-making process at all levels of government.

It may influence also the management in different kinds of enterprises, which in this sense is not dictated by pure economic reasons such as profit maximization and the promotion of real market, but by different political reasons.

If we compare this type of management with the type of management in OECD countries, we can see the difference. Corporatism in post-communist countries raises the possibility that particular large enterprises, recognized or licensed by the state, are thus privileged and granted a deliberate monopoly within their respective categories in exchange for careful selection of enterprise leaders, distribution of political support to ruling parties, and perhaps moderation of some social demands. Corporatism also often involves a production and distribution system intended in part to benefit family and friendship connections, with less attention to the interests of the state (i.e., taxpayers).

Corruption Risks in Privatisation

For analytical purposes, corruption – whether viewed from moral, ethical, or legal standpoints – originates in large part as a set of legal, social, and economic legacies bequeathed by the communist period to popular mentalities and values across a broad swath of post-communist society. The illegal or immoral transfer of public resources to private use was endemic not just for communist-era elites, but also ordinary employees in state enterprises and other average citizens. Such widespread transfer was both rational and logical at a systemic level for individuals and families grappling with pressures on daily economic and political survival as well as for those seeking upward social mobility. Values and attitudes towards commonly tolerated, informal practices of commandeering publicly-owned assets for private ends directly shape post-communist behaviour for elites and ordinary citizens, and cannot be erased so easily.

For Slovakia and its neighbours undergoing post-communist transformations, privatisation in particular offers a tempting environment in which to exercise old habits. Legislation from the communist era is often understandably silent on the rules of private investment and asset transfer, while new rules on taxation and attempts to monitor income and declarations of assets have struggled to catch up to a privatisation process already well underway. Though officially egalitarian, communist societies contained a significant minority of people with business experience and information, illicit or otherwise, who operated in the grey and black economies or in state enterprises, and who were thus better positioned than others to locate and acquire publicly-owned assets before their fellow citizens. And popular frustration among Slovaks, as captured in opinion polls, has grown with the consistent failure of political and administrative authorities to punish and redress what ordinary citizens see as the unfair and immoral redistribution of public wealth for private gains for a narrow layer of citizens.

That said, this analysis will briefly survey a few of the larger opportunities for corruption in the privatisation process.

Types of Corruption: Pre-privatisation Corruption (Spontaneous Privatisation)

Spontaneous privatisation is a term that describes the securing and distribution of assets in the period between the start of economic transition or economic liberalisation, and the completion of the privatisation of a given enterprise. Primarily, this refers to asset acquisition and disposal pursued by the management of state-owned enterprises (or parts or individuals thereof) and people close to them.

The scope and intensity of spontaneous privatisation is directly proportional to the length of the time that elapses between the start of economic transition (liberalisation) and completion of the privatisation of a given enterprise: the slower overall privatisation is, the more extensive spontaneous privatisation tends to be.

It should be emphasised that spontaneous privatisation is observed to some degree in all economies in transition.

The prolonged nature of the privatisation process was aggravated by the degree of dominance of state ownership and great confusion and lack of transparency in cadastre records. To ensure that emerging private property is not compromised, it is essential that only state-owned assets be privatised. At the same time, the privatisation process should be used to increase the measure of ownership transparency. Therefore, a clause with a full and clear description of how the state has acquired the property should be a feature of each base privatisation project, as well as proof of the fact that the state has been entrusted with the property for management purposes. Such evidence should be clear and available for every land allotment and other real estate.

Restitution to pre-communist property owners was another reason for privatisation being time-consuming. Public opinion and governmental authorities deemed it essential to rectify past injustices and return nationalised or otherwise expropriated assets to their original owners or their heirs. As stipulated by restitution laws, a certain period should be set aside for filing and proving restitution claims.

A lack of political consensus concerning the methods and concepts of privatisation is another frequent reason for procrastination. This lack of consensus is often aggravated by the strong pressures of interest groups, political, professional and other forces.

Soon after the November 1989 political transition in Czechoslovakia, pro-reform political forces realised the need for rapid privatisation, namely because they viewed privatisation as an essential prerequisite of successful transition. However, state authorities expressed the intention to avoid spontaneous privatisation if possible.

Section 45 of the Large-scale Privatisation Act (No. 92/1991) illustrated concern regarding spontaneous privatisation. This paragraph was designed to prevent the management of state-owned enterprises, in the period leading up to enterprise privatisation, from engaging in transactions beyond the scope of routine management that would depreciate enterprise value and result in material gains for management. At the same time, it was essential to ensure that such constraints on asset management should be as brief as possible, because otherwise the risk was that managers would have their hands tied, unable to accomplish those changes in asset structures that were important and necessary for the enterprise.

After June 1992, the pace of privatisation in Slovakia slowed down. Before June 1992, the progress of privatisation in the Czech and Slovak Republics were roughly equal, such that by the end of 1992, approximately 30 per cent of overall property in each republic was privatised. However, by the end of 1994, the Czech Republic had about 80 per cent of its property already privatised, and Slovakia had a mere 37 per cent. In Slovakia, the period after June 1992 offered enormous opportunities for blossoming spontaneous privatisation.

This assumption is confirmed by 1994 data, according to which prosecutors carried out inquiries into 271 state-owned enterprises, checking on the legality of state asset transfers made under exemptions from § 45 of the Large-scale Privatisation Act. Prosecutors found that 242 transfers had been made contrary to existing regulations.

In essence, spontaneous privatisation can be viewed as unfair material gains for private natural persons and legal entities at the expense of the state (whether via state-owned enterprises or joint-stock companies). Such activities are mostly organised, promoted or facilitated by the management that runs state property and the material gains are either directly or indirectly for the benefit of the same persons.

Spontaneous privatisation is multifaceted, with methods determined by human ingenuity stimulated by prospective selfish gains.

The most common method of spontaneous privatisation is the existence of two entities – a state-owned enterprise or state-owned joint-stock company, on the

one hand, and on the other hand, a private individual or legal entity with whom the management of the former is somehow linked. The form of connection may differ, ranging from explicit involvement to quiet partnership or the participation of relatives and friends, or hidden action in return. Most frequently, management teams incorporate limited liability companies in which they act as quiet partners.

A second, sometimes related, method of spontaneous privatisation is the deliberate deterioration of the economic position of an enterprise, depreciating its value with a subsequent purchase at a low price. However, such instances are not as common as those that rely on unbalanced transactions between state-owned and private entities as described above – in other words, transactions that deliberately fail to compensate fully a state enterprise while resulting in great benefits for a private company.

It is more than evident that almost all forms of spontaneous privatisation are facilitated by the clash between two types of entities with two types of incentives and, in particular, two types of controls. These are private entities with the clear incentive of maximising performance and profit, and state-owned entities without genuine owners, but with their representatives or at least managers supervised by genuine (state) owners. Under spontaneous privatization, managers routinely subordinate their trusteeship of the state's interest to their individual interest in private firms. It is understandable that state-owned enterprises are the losers in this uneven battle, with state property being dissipated and depreciated.

Another typical feature relating to spontaneous privatisation is the absence of competitive methods of selecting partners and concluding contracts, since the Public Procurements Act (No. 263/1993) only came into effect on 1 January 1994. However, this form of spontaneous privatisation is of secondary importance, the primary factors being the absence of private ownership, private supervision and private incentives for state enterprises.

Post-privatisation Corruption

Corrupt behaviour also appears in cases of defaulting on contracts concluded by buyers and the NPF. Most commonly, the problem is failure to pay the purchase price of privatised property. The highest incidence of such behaviour is observed in instalment schemes.

This phenomenon has become rather common since 1993. However, defaulting contractual parties should be divided into two groups. The first would include

those who do not pay for "objective reasons;" the other one comprises those who do not pay largely for speculative reasons.

After 1992, a variety of influences resulted in deterioration of economic conditions for business activity. This was primarily caused by the dissolution of Czechoslovakia and a slowdown of the transition process in Slovakia. Changes in economic conditions facing firms included:

- shrinking markets, including new difficulties in selling to the Czech Republic after 1992;
- decreasing domestic demand, primarily resulting from economic decline, i.e., decline in the consumption of households, government and lower fixed capital formation;
- greater challenges after the implementation of new schemes of pension, sickness and social insurance;
- the initial total absence of lending funds, followed by a growing supply of such funds, albeit at high rates of interest, and aggravated by the persistent shortage of medium- and long-term loans;
- deteriorating insolvency.

In other words, conditions had changed significantly compared to the assumptions of prospective buyers at the time when the latter were formulating privatisation projects and proposing payment terms. The conditions deteriorated to an unexpected extent. Some new owners of privatised assets found themselves unable to make payments according to the schedules to which they had committed themselves in the contracts.

The other group includes such owners of newly privatised assets who, although economically in a position to pay, do not, relying on loopholes in the contracts, the large backlog of work at commercial courts, or political lobbying to let them get away scot-free or to help modify the contracts to reduce prices or to waive payments. Attempts to distinguish between these two groups and get the NPF to apply a differentiated approach in terms of collecting due payments or terminating purchase contracts would establish a vast area for discretion in subjective decisions and, thus, corruption. Therefore, one should either clearly define objective, discerning criteria (which is extremely difficult) or treat all delinquent buyers uniformly, insisting on compliance or contract termination by a court. The problem is that since the prevailing approach has been too soft so far, new owners have been disposing of their assets for quite some time and, if threatened with contract termination, would be able to enter into such equity and financial transactions that would reduce the value of eventually recovered assets to a point below their pre-privatisation value.

The National Property Fund reported that at the end of February 1995, it had overdue accounts receivable totalling SK 1.2 billion with 141 delinquent buyers. It should be added that the numbers would have been much higher but in 1994 the NPF had rescheduled many contracts, postponing payments.

Instalment plans are always associated with the risks of post-privatisation corruption. The problem is that the new owners acquire property and the right to dispose of it before paying the full price. Real estate may be used as collateral pending the last payment; however, it is not possible to prevent, in the case of defaults or contract termination, some assets from being stripped from the enterprise and transferred to the buyer, to the detriment of the enterprise, i.e. the state or NPF.

Since the Government Manifesto of Prime Minister Mečiar's present Cabinet states that instalment plans will be the prevailing privatisation scheme, the risks are that this form of post-privatisation corruption will continue to blossom. The possibility exists, however, that another risk may also prove to be real.

There are two alternatives of selling an enterprise in instalments. The first one has been used so far, i.e. over 1990-1994. Under this scheme, ownership is transferred to the buyer on the day the contract is signed or the first payment made. Under the second scheme, *de jure* ownership will be transferred to the buyer only after the last payment. Essentially, this would be a leasing scheme and it appears that recently this has been the prevailing approach of the NPF to instalment plans. The argument in favor of this approach is that there is an advantage in the greater ability of the state to hinder asset stripping by defaulting buyers.

This, however, is spurious argumentation. If we were to confine ourselves to a narrow understanding of ownership transfer coinciding with the last payment, arrangements would have to be made, pending the last payment, to prevent the buyer from disposing of the property in excess of routine management. However, this is out of the question because privatised enterprises are in need of restructuring, which cannot be delayed another 10-15 years pending the last payment. Therefore, leasing-like sale schemes amount to privatisation that is almost instantaneous as a *de facto* matter but postponed *de jure*, which by no means and in no way reduces the risk of post-privatisation corruption.

In addition, this scheme has another negative feature. It transforms the buyers of property into long-term (10-15 years) hostages of the powers-that-be, because this is exactly the period for which the *de jure* transfer of ownership rights is delayed. In terms of corruption, the problem is that, in such an insecure situation and deprived of independence, the new "owners" will be indirectly motivated to

divest their enterprises of as many assets as possible to secure their gains should the privatisation decision be revised to the detriment of their interests. Thus, it can be stated that, instead of the announced reduction in corruption risks, this alternative of instalment plans would result in much greater corruption since it would serve as an indirect incentive for just that corruption.

Background on Privatisation and Interest Groups in Political Decision-making

Given that the executive and legislative branches of government decide on the means, pace and scope of privatisation, it is only natural that privatisation-related interests are largely mediated by political parties.

Interestingly, although not surprisingly, there are political parties that go beyond mere advocacy and actually apply policy positions favouring equal opportunities in privatisation. These are parties that attempt to achieve a higher share of private ownership and minimise public ownership, and are typically parties of the conservative and classical liberal type.

On the other hand, parties of the socialist type are often willing to yield to the pressures of certain interest groups and accord to them a privileged position in privatisation. These parties also advocate a larger scope of public ownership which should remain in government hands either permanently or on a long-term basis, thus creating potential room for spontaneous privatisation.

A third group is comprised by non-standard political parties, which not only do not believe that equal opportunities are important but, without any scruples, arrange for preferential schemes favouring individuals and affiliated groups in order to strengthen their economic and political power. This group is obviously represented by individuals trying to play a decision-making role only on the basis of non-transparent schemes and transactions. Many such groups cloak themselves behind support of "neo-liberal" economic policy, making it hard to distinguish them from true liberal parties that seek to maximize equality of opportunities in privatisation.

By far the most influential interest group regarding privatisation is represented by the managers of those state-owned enterprises that have been earmarked for privatisation. In this respect, it does not matter whether the persons involved are the old communist cadre filling their managerial positions since before November 1989 or taking office thereafter (in Slovakia the former group still prevails). What is important is their enormous interest in having a favoured status privatising their enterprises as well as their real and ever-growing influence.

What is the nature of the influence wielded by the management of state-owned enterprises? First, thanks to the pre-November nomenklatura system, many of

these people have very good connections in those political parties that have emerged either as transformed ex-communists or relying on a substantial segment of their former grassroots, as well as good connections in the executive branch and, particularly, within sector-relevant ministries. Relatedly, but perhaps more importantly, the network influence wielded by managers has grown as a direct consequence of privatisation being slowed and delayed. The growth in influence is a result of ongoing spontaneous privatisation, providing some management teams with increasingly rich financial resources. The political clout of managers also grows as post-communist and populist parties gain ground in popular support, while liberal and conservative parties that favour market transition reform lose ground.

According to the mass media covering the number of persons under criminal investigation or serving prison sentences resulting from corruption charges, the situation is as follows. In the period from 1 January 1990 to 7 November 1994, prosecutors' offices kept on their files 115 criminal procedures pertaining to privatisation irregularities. A total of 193 persons were prosecuted, out of which 88 persons were charged in connection to 48 cases relating to auctions within the small-scale privatisation scheme.

Conclusions Regarding Corruption:

- Corruption cannot be avoided in the privatisation process. However, the degree of corruption is primarily determined by the forms and methods of privatisation that are employed, the pace of privatisation, and the degree of respect for principle of equal opportunities for buyers in the privatisation process.
- As a function of cultural, economic, and legal legacies from the communist era, post-communist countries are prone to high levels of corruption.
- The pace of privatisation is crucial in reducing opportunities for corruption: the longer the transition period with a prevalence of the public sector lasts, the more booming spontaneous privatisation becomes.
- The voucher scheme offers the least room for corruption, making it possible to shorten the transition period with a prevailing public sector, and thus limiting spontaneous privatisation.
- Competitive methods, such as auctions and public tenders, diminish corruption risks. The problem remains that they are not sufficiently versatile. In particular, public tenders are challenging in terms of time, know-how, and the need to harmonise the privatisation efforts of the Government, ministries, the NPF, and consultancies.

- Direct sales are the riskiest in terms of corruption opportunities. The key question is whether a system exists that would transform direct sales into simplified tenders, with clear criteria verifiable *ex post*.
- A slowdown in privatisation logically increases the likelihood and scope of corruption, not only due to blossoming spontaneous privatisation, but also because of the growing political and economic influence of the groups that try to ensure their preferential treatment in privatisation.
- As the political influence of post-communist and non-standard parties grows, so do opportunities for privatisation corruption.
- A homogeneous government or a government in which a single party has a dominant position runs a higher corruption risk.
- Clear, unambiguous, equal and publicly known rules of the game and publication of privatisation-related information constitute the best security against privatisation corruption.
- Lacking rules, unclear rules, objectively unverifiable criteria, withholding information constitute a conducive medium for privatisation corruption.
- Mistrust of privatisation is also increased by the fact that, so far in Slovakia, only a few cases of corruption and extortion relating to small-scale privatisation auctions have been taken to court.
- The most important factor that not only makes privatisation corruption tolerated but literally organised by the government (see the V. Mečiar Government Manifesto for the stated intention to give preferential treatment to management teams) is the almost total absence of pressure by public opinion. This is apparently related to the degree to which the public is prone to behave contrary to laws, morality and ethics but is also associated with the immature and underdeveloped nature of civic society in Slovakia.

Recommendations to Minimise Corruption in Privatisation

- Start privatisation as soon as possible after the collapse of the old system, and proceed as fast as possible, relying extensively on non-standard methods.
- With regard to standard methods, large and important enterprises, if not privatised in the voucher scheme, should be sold by public tender, the organisation of which should, from the very beginning, be managed by eminently qualified international firms.
- In privatisation as a large-scale process, more emphasis should be put on auctions, especially for small and medium enterprises and in instances where the sale price is the only criterion for maximization.

- Direct sales should be organised as simplified tenders (sealed bids) with clear criteria, rules and the possibility of *ex post* compliance verification; rules and criteria should be binding and publicly known; compliance verification should be enabled to all the interested parties, primarily to competing bidders, mass media, political parties, and other interest groups.
- A new law should be passed ensuring privatisation control and, primarily, control over the National Property Fund, by all parliamentary parties; all political parties present in parliament should be able to delegate their nominees to the NPF Presidium and Supervisory Board.
- The NPF should be prevented from growing into a new super-ministry, from being misused in attempts to preserve undue government influence in enterprises, or from primarily advancing the interests of political parties.
- Ensure speedy privatisation of shares held by the NPF.
- The Finance Ministry should be more exacting in playing its supervisory role over investment funds and investment companies, especially in the period between issued shares being transferred to such funds, and the establishment by shareholders of their corporate bodies. Particular attention should be paid to the funds and their founders where higher risks could be assumed of their improper behaviour given the commitments assumed during voucher registration or the zero round of the voucher scheme.

The National Property Fund in Slovakia from the Inside Out

The most important role of any government, in the area of privatization, is to establish an institutional infrastructure capable of organizing the process of selling state-owned assets in the most transparent and effective way possible. This goal is very hard and politically sensitive to accomplish.

It is always a sensitive matter to organize the process where various interest groups meet (politicians, managers, investors, and the general public/electorate). To make this process effective and transparent, the process needs to delineate as appropriate political responsibilities and managerial capabilities and professionalism in specific areas of activities.

The highly sensitive difficulty is to devise methods to constrain the rent-seeking or micro-managing influence of politicians, while allowing the latter to exercise some measure of political oversight of transactions involving state assets. To ensure that this function is working properly, independent professionals have to be invited to run the day-to-day operations of the privatization entity.

The Slovak story is about how to get this mission accomplished with a minimum of (nearly inevitable) privatization scandals or other political and social problems. In terms of corporate governance solutions, the NPF's most direct interface of political representatives with professional managers occurred through the Executive Board proper. Also, interest group input could be communicated to managers through the transmission of political guidance from the Presidium to the Executive Board.

The Fund of National Property of the Slovak Republic ("FNM SR") was established on 28 June 1991 on the basis of Act No. 253/1991 (Digest) of the National Council of the Slovak Republic, concerning the jurisdiction of authorities of the Slovak Republic in matters of transfer of state property to other persons and on the Fund of National Property.

The principal task of the Fund of National Property (hereafter referred to as "the Fund") is to realize privatisation projects, based on privatisation decisions. In cases involving direct sale of property or shares, the Fund organizes selection proceedings, and provides for preparation and procedure in public commercial

tenders. It also prepares and concludes sales contracts with the acquirers of privatised property. In privatisation cases realized by depositing state property in a joint stock company, the Fund acts as the founder and majority shareholder, selling shares of such companies to the individual acquirers.

The property of the Fund consists of privatised property, assigned to it pursuant to Act No. 92/1991 (Digest) on the conditions of transfer of state property to other persons, as amended by later legislation (further referred to as "the Act"); of profit, resulting from participation of the Fund in the business of relevant commercial companies; of earnings, resulting from sales of stock or ownership interest in entities other than joint stock companies; of stock or ownership interest that had not been subject to a privatisation decision but acquired by the Fund as a stockholder or a partner; and of property transferred to the Fund consequently to termination of privatisation-related contracts. Revenues and expenses of the Fund are not included in the SR national budget and may only be used in compliance with the Act.

The Fund is under direct control of the National Council of the Slovak Republic, to which the Fund submits its budgets, proposals of use of its property, and activity reports. Also, the supreme official bodies of the Fund, i.e., the Presidium and Supervisory Board are elected and recalled by the National Council of the Slovak Republic.

The Role of the National Property Fund in the Privatisation Process

Privatisation as a process of change in ownership rights in the economy has been underway in Slovakia since the beginning of the overall transition from the command economy of the Czech and Slovak Federal Republic, and toward a market economy that relies in part on the creation and independent operation of the National Property Fund of the Slovak Republic (hereafter referred to as the "Fund") as a vital institution of economic transformation.

Upon privatisation decisions taken by the government, the Fund concludes contracts for the sale of an enterprise or a part of an enterprise, and/or establishes joint stock companies of the same date as it acquires a property from the State and earmarked for privatisation. Further usage of the Fund's assets is regulated by governmental decision regarding the following methods of privatisation: establishing a joint stock company or other trading company, and handling property ownership shares in such companies; selling the property of an enterprise or a portion thereof through a public tender, public auction or by sale to a pre-set buyer; property transfer to municipalities; property transfer to the Slovak Land Fund in case of property serving to agricultural or forestry production; and, finally, settlement of some restitution claims. The Fund assets comprise, primarily, property ownership participation in trading companies, money means and receivables acquired from the privatised property sale. Moreover, profits flowing to the Fund from its engagement in doing business of trading companies also contribute to the Fund's assets. In terms of legislation, the Fund assets are separate from other state assets, and ,must exclusively be used for the purposes stipulated by the Act.

The Fund's property is used for the purposes of privatisation or its promotion; for meeting liabilities of enterprises identified for privatisation; for strengthening the bank sources defined for credits; for meeting guarantees for the credits of trading companies where the Fund is engaged, in terms of ownership, with not less than 34%; for increasing the equity of trading companies where the Fund is a shareholder or a partner; for transfer of means into the municipalities' assets, etc. The Fund's resources are also used for Slovak development program support. The amount of financial resources used for the foregoing purposes is approved by the National Council of the Slovak Republic upon proposal by the Fund.

In terms of size of property, the privatization method of creating a joint stock company and the subsequent sale of shares pursuant to the privatisation decision is the method most often used in Slovakia. In the first stage of the privatisation process, the major part of shares is sold via coupon privatisation (by investment coupons / vouchers). Due to the changes in the government's privatisation strategy, the coupon privatisation method has been changed to a bond method, and any investment coupon holder has been entitled to be financially compensated by Fund in the form of a bond issued by the Fund (hereinafter referred to as a "Fund bond").

If, when carrying out the above mentioned activities in the privatisation process, rights and liabilities accrue to the Fund; the Fund has the right, on one hand, to obtain court or other authoritative bodies' enforcement of its rights; on the other hand, the Fund may be sued for not meeting its liabilities or other obligations. The Fund guarantees all of its liabilities by all of its assets.

Official Bodies of the Fund

The Presidium

The Presidium is constituted of nine members. Its powers include appointment and revocation of Executive Board members, submission of proposals of the annual balance of accounts and annual reports on Fund activities in the preceding year for approval by the National Council of the Slovak Republic upon debate in the Government of the Slovak Republic, submission of draft Fund budgets and proposals for the use of Fund assets under § 28, para 3, indent b) for approval by the National Council of the Slovak Republic after debate in the Government of the Slovak Republic.
The Presidium's scope of activities includes:

a) appointment and dismissal of Executive Board members;
b) approval of the Rules of Procedure for the Presidium and Executive Board, and the Organizational Chart of the Fund;
c) submission of the following to the relevant bodies for discussion and approval:
    - proposals on how to use Fund assets;
    - Fund Budget proposals;
    - annual financial statements for previous year;
    - By-laws drafts.

Through amendment of the original Act, the Presidium has been given added competencies for approving direct sales which have become a dominant

privatisation method. The Presidium issued decisions on direct sale privatisation to a pre-determined buyer. Consequently, after the Constitutional Court issued its findings in November 1996, the Presidium no longer has the right to issue decisions on direct sale privatisation, nor to change decisions issued. The Constitutional Court findings do not apply to the Presidium's decisions on sale of the property ownership participation of the Fund in trading companies, nor does it refer to the property acquired by the Fund as a result of contract withdrawal (Article 28, Parts 5 and 6 of the Act).

The Presidium is composed of:

- 1 President
- 1 Vice-President
- 7 Members

The Supervisory Board
The responsibilities of the Supervisory Board include control of the activities and of the economic management of the Fund, including its Presidium and Executive Board, from the viewpoint of compliance with the law, with other generally binding legal regulations, and with the by-laws of the Fund. Any identified inadequacies are communicated by the Supervisory Board to the Presidium, the Government, the National Council and/or other authorities.

The Supervisory Board oversees the activities and management of the Fund, its Presidium and Executive Board. If any deficiencies are revealed, it provides warning, due to the nature of the matter, to the Presidium, Government, National Council and other competent authorities, if needed. It also assesses materials submitted to the Slovak Government, including budget drafts, annual financial statements and annual reports.

The Supervisory Committee comprises 6 members who are voted for and dismissed by the National Council of the Slovak Republic by ballot upon proposal of its Committee. Vice-Chairman is voted for from and by the Supervisory Board members. Fund staff cannot become members of this body.

In terms of conflict of interest, membership on more than one body among the Presidium, Executive Board, and Supervisory Board, is mutually incompatible, except for the position of the Presidium Vice-president. No member of the Government, and/or MP can become a member of the Presidium, Executive Board, or Supervisory Board.

Thus far, the composition of the Supervisory Board is as follows:

- 1 Chairman
- 1 Vice-Chairman
- 5 Members

The Executive Board
The Executive Board is the statutory body of the Fund that is responsible for the management of its activities. The function of its Chairman is executed by the Vice President of the Presidium. The remaining ten members, elected by the Presidium, are responsible for management of the individual Sections. All members are employees of the Fund.

The Executive Board is a statutory body of the Fund ensuring the Fund's operation pursuant to the Presidium's instructions. Members are entitled to act on behalf of the Fund and are registered with the Commercial Register.

The Executive Board acts on behalf of the Fund to the extent regulated by its by-laws. The validity of written legal actions requires the signatures of two members, one of them being Chairman or Vice-Chairman.

The Executive Board consists of 11 members. The Executive Board Chairman's role is performed by Vice-President of the Presidium. Other members are voted for by the Presidium and all of them are considered Fund employees.

The Executive Board is composed of:

- 1 Chairman
- 2 Vice-Chairmen
- 8 Members

Members of Fund bodies and Fund employees cannot act in contradiction with the interests of the Fund. Members of the Presidium, Executive Board, or Supervisory Board cannot acquire Fund assets, apart from Fund bonds and shares for such bonds. Any member of the Presidium, Executive Board, or Supervisory Board may waive his or her function by written announcement to the body which appointed him or her to the position; the corresponding membership then ceases to exist on the day of delivery of written announcement on waiving the position.

Members of the Executive Board are hired based on public recruitment tenders announced and organized by a governmental advisor. This advisor is hired based on the tender run under conditions of the Public Procurement Act of the

Slovak Republic. The advisor is a company with professional expertise in management recruitment or executive searches. All recommendations of the advisor given to government have to be confirmed by government on its official meeting. Refusal of the advisor's recommendations is an act that has to be argued and publicly announced.

The Executive Board of the NPF is where professional management capabilities interface with a small group of political representatives. This match is crucial for smooth operations of the NPF. It is also why an independent, professional management team is hired to help to mitigate potential influences which might lead to costly or damaging compromises affecting Board members' professionalism.

The Executive Board is empowered to call on the assistance of any professional entity regarding any privatization transaction in order to eliminate transactional risks the NPF faces. Thus, the Board calls out tenders for lawyers, advisors (evaluators), auditors, etc. All contracting partners have to be tendered under conditions of the Public Procurement Act.

Formal control of these procedures is carried out by the National Control Office (an independent office whose chairman is elected by Parliament).

Organizational Structure of the NPF

The organizational structure of the Fund and its activities are governed by Statutes approved, after discussion with the Government, by Parliament. The Statutes also define the scope of mutual co-operation between the Fund, the Ministry of Finance, the founders and the Government, as related to the activities of the Fund, especially concerning the founding of companies under Privatization Awards, among other activities. The Statutes define also the mode of co-operation between the Fund and the Slovak Land Fund.

Termination of the Activities of the Fund

The mode of termination of the activities of the Fund, its liquidation, and the use of the balance remaining on its accounts will be determined by the National

Council of the Slovak Republic by a special Act. The termination of the NPF's activities is expected by the end of 2005.

Further enumeration of the strict laws and rules regarding the NPF's property and its use can be found in Appendix B at the end of this document.

Lessons Learned

1. *It is vital to set the right mechanism to split political control, at the highest controlling level, and process control functions within the restructuring involved entity. It is possible to keep the system politically independent while maintaining a high level of professionalism at the management level of operations.*

2. *Any system operating in the area of restructuring state-owned assets (and beyond this field) has to be as transparent as possible. Very exact rules (provided by political administration) have to be in place for a state agency involved in the area of high risk transactions. Without such written, publicized rules, the management is facing risk that will never meet expected level of transparency and even highly professional decisions would be undermined in the process of revision of those rules.*

3. *The state agency's administrative staff should be kept as small as possible in order to keep "the cost of transactions" low. Management principles have to be very strict, and should allow the management of the entity to maintain a high level of professionalism while providing transparency for all major stakeholders.*

4. *Management's goals for the restructuring agency are not always identical to other stakeholders' goals. The reason concerns the durability of the restructuring agency over time: while it is in the state's interest to sell assets as quickly as possible, the management of the entity is not necessarily motivated to close the agency down quickly, such that management, depending on its incentives, might prolong the agency's operations as long as possible. That is why the strict rules given to the management have to be exact and strict.*

5. *The restructuring agency should be required to prepare a detailed financial plan for each fiscal year, and the plan needs to be discussed and approved on the state budgetary level (ministry of finance, parliament, etc) in a timely manner. If such a plan is not approved, the level of effectiveness of the agency's operations will be dramatically lower than is in case when the financial plan is in place.*

6. *All transactions with state assets have to be transparent and all operations of the entity have to be audited by an independent, reputable financial auditor. Without such an independent audit, all operations will be hard to defend against any political, public or media opposition.*

7. *It is very important to keep senior political actors involved in some controlling function over the entity's operations. Only elected politicians have a mandate to control whether or not transactions involving state-owned assets are being done properly, transparently, and effectively. On the other hand, politicians must not have influence over any of the professional decisions on specific transactions that management must take. The role of politicians is to control the entity mainly through financial and liquidity plans, consultations on crucial areas of operations with an independent auditor, and through parliamentary committee hearings involving the agency's management.*

8. *The list of hard elements (laws, regulations, progress measurement by the government) and soft elements (e.g., issues of corporate governance, declarations of commitments, etc.) of control mechanisms covers all relevant controlling elements for this kind of business. It is essential to insist on holding to all those parameters and not to apply a selective (arbitrary) approach in imposing those elements. Any exception or controlling elements of selection will definitely lead all stakeholders to deadlock -- either being unable to execute any transaction effectively, or unable to ensure transparency and trust from the community of outside stakeholders. Both outcomes will lead to the collapse of the agency.*

Appendix A

Overall Sale Process

Stage 1

Preparation for Privatization
(Review, and preliminary decision to privatise)

⇩

Stage 2

Preparation for Sale
(Assessment by NPF)

⇩

Stage 3

Pre-Qualification of Bidders

⇩

Stage 4

Tender preparation and submission
(For short-listed bidders)

⇩

Stage 5

Evaluation of offers and award of contract

Appendix B

Property of the NPF and Its Use

1. The property of the Fund consists primarily of:
    a. property transferred under the ownership of the Fund
    b. proceeds from the participation of those companies in whose business the Fund itself participates;
    c. proceeds from the sales of shares and/or interests in other than joint-stock companies;
    d. shares or property interest that were not subject to Privatisation Awards, and shares and property interests acquired by the Fund in its capacity as a shareholder or business partner;
    e. property, that has been transferred under the ownership of the Fund due to a withdrawal from a contract under Section 6.
2. Financial resources comprising a part of revenues of a special account of the Ministry (special regulations 8c)) that become, after clearing under Section 4, property of the Fund.
3. Revenues and expenses of the Fund do not comprise a part of the national budget of the Slovak Republic and may be used only for the following purposes:
    a. in accordance with the Privatisation Award:
        1. for privatisation purposes according to Paragraph 12, Section 2;
        2. for property transfers under the Restitution Investment Fund;
        3. for defrayal of expenses accrued by the acquirer due to settlement of environment-related liabilities arising prior to the privatisation of the enterprise, including those that were unknown to the acquirer before entering into the purchase agreement concerning the enterprise or a part thereof.
    b. in accordance with a resolution of the Government;
    c. to discharge the obligations or liabilities of enterprises designated for privatisation, mainly liabilities related to credits collateralized by a lien;
    d. to strengthen the resources of credit institutions;
    e. to meet the obligations due to credit guarantees granted to companies with at least 34% permanent capital participation of the Fund;

f. to support development programmes of the Slovak Republic up to a level approved according to Paragraph 33, Section 3;
g. to increase the equity capital of companies of which the Fund is a shareholder or partner;
h. to cover the expenses related to the operation of the Fund, up to a level determined by the Fund's budget;
i. to provide financial compensation to subjects that the Fund was liable to for damages, if such liability was not taken over by the acquirer of the privatised property;
j. to cover the expenses related to the support, provided to the privatisation process;
k. for purchase of property, or property interest to which the Funds holds pre-emptive rights;
l. to meet the claims of persons qualifying under special regulations to cover those court expenses of privatisation and restitution-related judicial lawsuits that are to be covered by the Ministry and/or the Fund, or to cover the expenses related to indemnification for damages caused by the Ministry and/or the Fund;
m. to be credited to a special account of the ministry for uses under special regulation;
n. to transfer funds under the ownership of municipalities to an extent amounting to 25% of the total share from the net proceeds from the sales of those operating units under special provisions and which fell under the competence of municipalities and local bodies of state administration in individual districts of the Slovak Republic; after December 1, 1992, these resources will be distributed among individual municipalities of a given district according to the size of their populations;
o. to defray the outstanding environment-related debts owed to the State by bankrupt firms fully owned by the Fund;
p. for other purposes, if so required by special Acts;
q. to cover the expenses related to the issue and repayment of bonds issued by the Fund, including their yields;
r. to cover the expenses arising due to withdrawals from contracts and/or to leasing of property acquired in that way;
s. to deal with the property interests of the Fund that the Fund acquired in accordance with Section 1.

4. The Ministry and the Fund undertake regular annual clearing of the revenues under Section 2 and expenses under Section 3, of the Fund that must be finalized by the end of the February of the following year.
5. The property of the Fund and its interests in enterprises owned by other legal persons that were not privatizable under Privatisation Awards will be dealt

with by the Fund in a manner decided by the Presidium upon a proposal of the Executive Board.

6. The same procedure as in Section 5 will be used to deal with that property of the Fund and its interests in enterprises, formerly owned by other persons, which the Fund acquired as a consequence of withdrawals from agreements due to violations of contract conditions by the acquirers of the privatised property.

Legal Acts Concluded by the Fund

1. Based on the Privatisation Award, the Fund concludes on its own behalf contracts, agreements, and other legal acts, such as:
    a. founding of companies and/or taking part in their founding
    b. acquisition of shares due to its participation in the business activities of stock companies and execution of other shareholder's right;
    c. execution of partner's rights due to its participation in other companies that are not stock companies;
    d. sharing of the economic results (i.e., profits and losses) of companies' business activities in which the Fund takes part;
    e. sales of shares and/or interests of other companies that are not stock companies;
    f. acquiring of shares from the residual value of a company after its liquidation to the extent proportional to the Fund's participation in that company in the case of liquidation settlement;
    g. conclusion of sale contracts regarding enterprises or parts thereof and doing so, the Fund may act through tenders;
    h. sales of the privatised property through public auctions;
    i. transfer of privatised property under the ownership of municipalities and the Slovak Land Fund;
    j. transfer of privatised property for the purpose of health insurance, sickness insurance and retirement insurance and for other purposes within the active employment policy financed by the Employment Fund of the Slovak Republic;
    k. lease of property for fixed time until its privatisation.
2. Prior to founding of a company under a Privatisation Award, the Fund carries out an update of the value of its non-cash contribution. If such update results in a requirement to found a company with a value of equity capital and/or reserve fund differing from that stated in the Privatisation Award, the Fund may do so only with prior approval by the Ministry.

3. If the update of the value of a non-cash contribution as of the effective day of the founding of a company has been carried out by the Fund after the founding of that company, and the general assembly of the shareholders decides to increase the value of equity capital of that company before April 5, 1995, the effect of that increase of the equity capital takes place on the date of such decision. Such increases of the value of the equity capital are not affected by the provisions of Paragraph 181 Section 2, and Paragraph 202 Section 4 of the Company Code.
4. Government guarantees granted for credits provided under special provisions before January 1, 1995 are taken over by the Fund in the case the Fund's participation in companies' permanent capital reaches a level of at least 34% on the effective date of this Act.
5. The Fund may found companies by either cash or non-cash contributions.
6. Legal acts concluded by the Fund under Section 1, require the co-operation with the founders of the enterprises.
7. The Fund will also settle the claims of qualifying persons in cases when the deprivation of the property happened in a way specified in Paragraph 2, Section 3 of the Act No. 87/1191 Corpus Iuris On Extrajudicial Rehabilitation, and the Fund will have to do so within a schedule specified in the particular Privatisation Award, but not later than within one year from the date of issue of the Privatisation Award. The Fund will settle such claims only in the case of their timely filing by the qualifying persons who must also give the name and location of the enterprise holding those claims.

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