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Privatization in Lithuania: General Environment and Case Studies

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GENERAL ENVIRONMENT AND CASE STUDIES

I. INTRODUCTION

The crumble of the Soviet Union left Lithuania, like many of its former republics, at a standstill. With the demise of USSR came the demise of markets in the east and it became important for Lithuania to establish economic ties with the west. The first step in this direction is to privatize much of the public property so that it can be managed with a goal of profitability. The privatization of housing and small firms is very important, but the successful privatization of large enterprises plays a crucial role in the country's overall economic success. Profitability of a large enterprise affects directly the GDP, standards of living, distribution of income and unemployment in countries such as Lithuania which in size barely equal the state of Georgia. In this paper, I will attempt to demonstrate that successful privatization depends on the following four conditions: the competitiveness in international markets and existence of domestic markets, method of privatization, corruption issues, and the role of the IMF. Further, I will show the effects of these conditions specifically in the past privatization experiences of three such large firms in Lithuania. Lastly, I will measure the success of privatization in each firm based on the number of jobs created or saved, profitability of the firm, progress in modernization and investment in infrastructure.

II. COMPETITIVENESS

Competitiveness in International Markets

The ultimate goal of privatization is to enable the privatized enterprises to stand independently. No matter how effectively the methods of privatization are employed, the distribution of IMF funds controlled and the corruption issues avoided, newly privatized firms success in standing alone in international markets largely depends on these firms' ability to achieve and maintain competitiveness in markets. Before dwelving into the current issues in this element, one needs to consider the legacy of central economic planning (CEP) in Lithuania as a former republic of the USSR. This will show the position of Lithuania in the big picture of CEP and will provide an explanation for the position of large enterprises in Lithuania today. Further, I will discuss the economic elements in the Lithuanian economy that will serve as indicators of its ability to be competitive. This again will provide the structure for the analysis of the competitiveness of the three large enterprises to be discussed later. Finally, I will discuss how Lithuania's regional trade agreements work as facilitated international market entry since the collapse of Soviet Union.

Before the end of W.W.II Lithuania was largely an agrarian country and only after Stalin's death did it truly begin to industrialize. The industrialization process was expedited in the framework of the Soviet Union's central economic planning system (CEP). Some industries that already existed were expanded such as food processing, furniture, textiles, construction materials, paper and shipbuilding and new industries of energy, machine building, metal working, chemical and wood products were developed. Lithuania also started refining gasoline in the 1980's (Vardys 66). However, the CEP

was set up in a way that each Soviet republic was unable to stand independently without the other republics or Russia. The CEP economy was a highly centralized command economy where all aspects of the economy were delegated and controlled by the central planning and control agencies. The highest government officials of the Presidium directly supervised these agencies. The objectives of Central Plan Economy (CPE) were rapid growth and industrialization, centralization of planning and control and social ownership. CPE was a pressure economy where ambitious plans for production were often illogical given the economic conditions. Minimum input levels and inventories were stressed at the same time when extremely high levels of production were emphasized. It was a closed economy based on principles of trade aversion where limited foreign trade existed only to pay for needed imports (Bornstein 358 – 360).

Following this economic model, Lithuania, like other republics of the former Soviet Union, had large enterprise that were controlled by central agencies. These large enterprises were highly specialized which made them highly dependent. For example, one factory in Lithuania was making almost 100 per cent of the compressors for pneumatic brakes for automobiles assembled anywhere in the Soviet Union (Vardys 67). Many times, this specialization was economically unsound since it was based on political factors, such as the guarantee of political integration of Lithuania and other republics into the Soviet Union. For example, metal working enterprises in Silute, Lithuania, only 112 miles away from a local metal foundry had to import their cast iron from Armenia, Leningrad, and Kolomna in the Soviet Union that were more than 1,000 miles away (Vardys 67). The central agencies decided from where the large enterprises received their resources and where they sold their final products.

The specialization, as mentioned before, made the enterprises very dependent, although the lack of natural resources in Lithuania also played a big role. Lithuania had to import 80 per cent of its natural resources from the Soviet Union. Lithuania would be able to pump only 15.5 million tons of recently discovered oil over the next 20 years, when it consumes at least 7 million a year (Vardys 67). Most of Lithuania's oil was supplied by Bashkiria, natural gas by Ukraine, and coal by Russia (Vardys 67).

As you can see, CEF left Lithuania with no legitimate base to be competitive in the world. Right after independence, Lithuania was still highly dependent on Russia for natural resources and the quality of their products were significantly below the quality standards in western countries. In 1982, Lithuania exported 80.5 per cent of its industrial production to Soviet republics (mostly Russia – 43.9 per cent) and imported 89.1 per cent of goods and supplies from them. Only 19.5 per cent of industrial products were exported abroad to the third world or former socialist countries, where the quality standards were as low as in Lithuania (Vardys 67).

There are several factors that need to be considered when discussing the likely success of a privatized large enterprise. Transfer from state hands to private individuals may improve the management of the corporation and in turn production, but it will not guarantee entry into new markets. Possession of natural resources would facilitate this entry but, as mentioned earlier, Lithuania imported most of its natural resources from the former Soviet Union. However, Lithuania possesses certain assets that could make the process easier. A highly educated and low-cost work force is one of them. About 18 per cent of the population own higher degrees and 44.1 per cent have specialized education such as technical degrees. Average salary is $288 per month, which makes it one of the

lowest in Europe. Lithuania also has a great transportation infrastructure that includes high quality railway and highway system, an ice-free port facilities in Klaipeda, and easy access to air and sea routes. Also Lithuania's location makes it a major transit country between Russia and Western Europe ("Country Information" 3, 11).

A necessary condition for Lithuanian firms to become competitive in international markets is that those firms have free access to markets. Since this access was largely denied under the CEP system, it is very important to establish free trade relations with as many countries as possible. If the country doesn't have any access for its exports in foreign markets, most surely the large enterprise will not have markets for its products. Since the collapse of the Soviet Union, Lithuania has stepped into a number of regional trade arrangements (RTA) with different custom unions and separate nations, such as European Union (EU), European Free Trade Association (EFTA), Central European Trade Association (CEFTA) and a most favored nation (MFN) agreement with Russia.

Integration with the West is one of the most important developments that helps facilitate Lithuania's entry into foreign markets. In 1996 Lithuania exported 33 per cent of its goods and services to EU as opposed to nothing in 1991 (Sorsa 7). While providing market access for Lithuanian exports, free trade agreements (FTA) with EU have some drawbacks. There is an imbalance in agreements on goods trade due to the fact that EU gave mostly quota-restrained concessions on a limited number of products in agriculture and fisheries, while Lithuania and other Baltic states gave concessions on all products (Sorsa 11). For industrial goods, FTAs are liberal where Lithuanian exports are duty-free but subject to annual quotas that specified the maximum quantity of products that Lithuania can export. In the services sector, coverage is limited in relation to both

partners. This limits trade potential for Lithuania in the area that Lithuania is likely to be competitive (Sorsa 12). Also, according to Piritta Sorsa, the FTAs between EU and the Baltics are of "hub-and-spoke" nature, meaning that trade is liberalized between a large country [hub] and many small countries [spokes] bilaterally (Sorsa 15). Investments under this model are concentrated in the hub country when exports to and imports from other markets of the spoke are subject to barriers (Sorsa 15). These types of restrictions would limit large Lithuanian enterprises from taking full advantage of their competitive advantages, such as the educated low cost work force. Despite all these drawbacks, EU FTAs created a significant amount of trade in Lithuania, as well as other Baltic countries. The main effect of EU FTAs has been an increase in trade of processing EU inputs for further export. Lithuanian firms take raw materials and parts form EU countries and add value to the product through assembly and other operations. The product is then returned to EU. This arrangement resulted in the transfer of technology and expertise to Lithuania (Sorsa 12). However, these restrictions are temporary and will be removed once Lithuania becomes a member of EU.

Attempts for intra-Baltic integration began in 1994 in industrial goods and in 1997 were extended to industrial goods. However, economic potential for trade gain in this area is small because of small economic size of each Baltic country. Also they cannot compliment each other in trade since all three are exporters of textile, food and wood. Differentiation, however, is possible between Lithuania and Estonia, Lithuania being a more agrarian country (Sorsa 16). In terms of coverage, the Baltic Free Trade Agreement includes all industrial and agricultural products with low restrictions. Services trade is not included. The intra-Baltic FTA might lack deep integration, but is

most effective in dealing with the hub-and-spoke nature of EU FTA. When EU puts restrictions on Lithuania exports, Lithuania can export the surplus to Estonia or Latvia.

After the fall of the Soviet Union, trade between Lithuania and former Soviet Republics and Russia declined severely, but has been growing in the past couple of years. Russia and Ukraine are important markets for Lithuania's exports, especially services such as transit. Major trade potential therefore lies in the service sector especially when Russia's only access to seaports to Europe is through the Baltic States. Also, some trade will exist in sectors such as energy. According to Piritta Sorsa, deeper integration currently, however, with the BRO (all 15 former Soviet states) region is unlikely, given their protectionist nature and the lack of solid economic infrastructure characteristic to economies in transition (Sorsa 20).

Overall, regional trade agreements with different nations, whether in western or Eastern Europe or Baltics, facilitated the detachment from the centrally planned economic system and aided in the establishment of a new trade infrastructure in Lithuania. Most importantly these RTAs provided an assurance that the privatized large enterprises will have markets for their products.

For large enterprises that have their markets in Lithuania, factors other than the new regional trade agreements control success. Overall economic situations in Lithuania determines the purchasing power of the local consumer and, in turn, the demand for the product. If the product(s) of a large enterprise, whether it is a good or service, is an everyday necessity, the chances of success are greater. Existence of local competitors also determines success. If the large enterprise has monopolistic powers it is much more

successful than a company with a large amount of competitors in its industry since it does not have to compete for customers.

III. METHODS OF PRIVATIZATION

This section will provide the reader with the background on how privatization emerged in Lithuania. This background is necessary to understand the forces that led to the privatization of the three large enterprises discussed below.

At the very beginning of the privatization process in former Soviet republics, different methods were tried in transferring public property to private owners. Many countries adopted equal public access voucher privatization where privatization vouchers were distributed equally throughout the population with every citizen having an equal chance of owning shares of private property. This method worked very well in privatizing housing, but lacked in ability to establish strong corporate governance in firms. In insider voucher privatization, employees and management were encouraged to privatize by receiving discounts on shares. This method prevented the influx of much needed new capital, new skill and ideas. Other methods used included privatization through public subscription of shares, auctions, public tenders, leases with an option to purchase, and direct negotiations. Before privatizing large enterprises, Lithuania experimented with and applied a number of these methods to the privatization of small-scale private property.

A. First Stage

Privatization in Lithuania consisted of three stages. The first stage, lasting from 1991 till 1995, was largely dominated by voucher privatization. The number of shares that a

citizen received depended on age. For example, my family received 18, 000 vouchers. My parents, as adults, received 6,000 vouchers each and my brother and I, as minors, received 3,000 vouchers each (about 200 vouchers were equivalent to US$1). Lithuanian citizens were allowed to use vouchers as payment for 80 per cent of the price when privatizing their apartments. At the end of this phase, 95 per cent of the formerly state-owned apartments became private ("First Phase" 1). In addition to housing, 97 per cent of all agricultural assets were privatized through restitution (restoration of assets to former owners) and the land that was not subject to restitution claims was privatized using privatization vouchers. About 24 per cent of all vouchers were used in privatization of rural and urban land plots. Priority was given to residents of rural Lithuania willing to undertake farming ("First Phase" 2). The restitution method contributed to the development of a private sector but had a few shortcomings. Unfortunately, many people who could have purchased land using vouchers, chose not to because of fears of restitution, or restoration of property, claims (From Plan 59).

Privatized state-owned capital amounted to US $975 million and accounted for 30 per cent of the value of total state owned assets. The majority, 78 per cent, were sold through public subscription of shares, 11 per cent were privatized through tenders for the best business plan and 2.4 per cent were privatized through auctions ("First Phase" 1). About 45 per cent of all these assets have been sold against vouchers and 30 per cent were sold for cash.

During this time, 93 per cent of all vouchers were used up for privatization purposes and the rest were deposited into private investment accounts settled by the government to be used for privatization of not yet privatized housing or land. Out of

these 93 per cent of used up vouchers, 65 per cent were used in exchange for the shares for the state enterprises, primarily small and medium sized, 19 per cent were used in privatizing housing and the rest in acquisition of agricultural enterprises and land ("First Phase" 1).

Privatization with vouchers is speedy and fair. Every citizen receives an equal chance to own private property and it does not take very long to distribute the vouchers. This privatization method is very effective in privatizing housing, which is of essential importance to economies in transition. It develops housing markets so the real estate value can be realized and citizens can be compensated for their losses during the period of hyperinflation since the asset maintains value during hyperinflation and cash assets dry up. To illustrate, my grandparents' lifetime savings were dissolved during this period. However they were compensated for these losses through the privatization of their housing. The townhouse that they privatized in the first stage of privatization was valued at about US$200,000 in 1996. It also improves the financial position of the government by ridding it of the high costs associated with utilities and maintenance of housing. Soviet local governments shortly before the fall of Soviet Union dedicated 25 per cent of their budget for housing maintenance. Households spent 2.4 per cent of their cash income on housing ("From Plan" 61).

Privatizing small firms was relatively easy. These small companies, as mentioned before, don't require a lot of capital, but can serve as schools for entrepreneurs and also provide employment to workers that are laid off from large enterprises. For example, my neighbor that had worked at the local grocery store in my town, in collaboration with other co-workers that have been laid off pooled their vouchers together and privatized a

small building. They decided to open a grocery store on their own. So far they have been in business for 6 years and seem to be doing quite well. However in many cases, voucher privatization in this sector was not very successful, whether it was equal access voucher privatization or manager-employee privatization. Voucher privatization by outside individuals basically just delays the real privatization until the owners that can manage effectively arrive. When a company is owned by a great number of investors, it lacks corporate structure and management ("From Plan" 54-55).

Even though insider privatization is fast and easy to implement, it has many problems. Since in this stage of privatization the government charges low prices for insiders, it does not profit from the privatization. For example, former general manager of Azotas and former prime minister Bronislovas Lubys, in alliance with a couple of other investors teamed up to privatize Azotas fertilizer factory. They managed to privatize the company for 32 million vouchers, which is equal to about US$ 750,000. Under Lubys' leadership the company was falsely portrayed as a bankrupting institution to lower the privatization price. In a couple of years Azotas had a profit of US$ 17.5 million (Grinveviciute, Danguje, 6).

Also, in insider voucher privatization new skills and new capital are not brought in. This was certainly true for the example of Lubys. Any manager-employee quarrels can prevent reforms. This type of ownership is historically proven to be not very stable and results, like outsider voucher ownership, in eventual ownership by outsiders (From Plan 54 - 55). One approach of dealing with multiple vouchers was the creation of intermediary investment funds. In the Czech Republic, for example, voucher privatization was effective because the vouchers were pooled in by these investment

funds and were invested on the owner's behalf ("From Plan" 56). In Lithuania more than 400 of such investment funds were created which were involved in the privatization of 1,092 enterprises and acquired assets of approximately US $400 million ("First Phase" 2). However, this method left an open door for illegal actions. It was illegal for the investment funds to buy privatization vouchers and it was also illegal for the voucher holders to sell their vouchers. Investment funds could only invest these vouchers on the owner's behalf. Most citizens, after having privatized their housing, still had some vouchers remaining that they perceived to have little value for them. Some "entrepreneurs" like Jonas[1] created an investment fund and bought these residual vouchers illegally to privatize different private property such as department and grocery stores. Later he, acting as an owner, would sell them at much higher price to interested buyers. In some other cases these institutions that were privatized by investment funds were not sold but were used as collateral to restructure and renew the privatized enterprise. However, in some cases, the money was never reinvested in the firm and instead ended up in individual Swiss bank accounts.

It's naturally easy to privatize small companies due to their small size and relatively simple structure. The failure of voucher privatization in these firms is a clear indication that it should not be applied to the privatization of large enterprises, which are much bigger in size and with more complex structures.

[1] The name has been changed.

B. Second Stage

The Law on Privatization of State and Municipal Property of 1995 started the second phase of privatization in Lithuania by setting a framework and procedures for privatization of enterprises. A lot of power in the process of privatization was given to the founders of enterprise ("Second Phase" 1). Privatization under this law was for cash only and vouchers were completely rejected. In order to make the privatization process more active, new methods of privatization were introduced in addition to the old ones. The law announced five methods of privatization: by public subscription of shares (for small and medium sized enterprises, by auction (small enterprises), by public tender (medium and large), by lease with an option to purchase and direct negotiations. As mentioned earlier, this law delegated significant powers to the enterprise founders, specifically the different government agencies. These governmental agencies had to submit the list of companies to be privatized to the Privatization Agency and completely oversee the execution of the privatization process ("Second Stage" 1).

During this stage the government approved a new list of 1,114 companies to be privatized with state capital of US $390 billion. By the end of this stage, 489 of these entities were privatized, providing the government with a profit of US$ .6 billion ("Second Stage" 1). Among these companies were the three large enterprises discussed in the case study below.

C. Third Stage

The establishment of the State Property Fund in 1997 started the third stage of privatization that is ongoing to this date. It was a new privatization agency that was created to take over the responsibilities of enterprise founders and the Privatization Agency. SPF concentrates on the privatization of large state controlled enterprises of national importance in the sectors of transportation, telecommunications, and energy by way of international tender. Privatization of these enterprises is carried out through transparent procedure of international tenders prepared and executed by internationally financial advisors ("Third Stage" 1).

IV. CORRUPTION ISSUES

There are a number of legal issues that must be resolved in any privatization process to make sure that the privatization of large firms is successful. After most favorable method of privatization is selected, corruption must be curtailed. To accomplish that, laws associated with private property must be established and enforced to ensure the continued success of privatization. Once privatization is completed, certain measures must be taken to ensure that corruption will be minimized in the future so that no firm in the industry has an unfair advantage over another firm.

The method of privatization basically determines who the owner of the newly privatized enterprise will be, whether it is management or employees, a foreign or a domestic investor, or a government official. The logical way would be for the government to choose methods that meet the needs of the enterprise the best. Unfortunately, government officials often have ulterior motives. This is the case in most

former Soviet republics including Lithuania. Corruption, or abuse of official power for private gain, sometimes decides how the enterprise will be privatized. It is important to know, however, that corruption is not a product of transition. It has always been an integral part of the centrally planned economy. Bribery was the only way of acquiring a signature from governmental officials for an approval of any kind or getting business done. For example, my grandmother used to bribe her dentist with merchandise that was available to her as a member of nomenklatura elite, to get better quality fillings. Corruption in modern times is prevalent in the implementation of privatization and to a lesser extent in the choosing of a specific privatization method. Therefore, corruption can have devastating effects on the success of a privatized enterprise. The method of privatization could be chosen based on a bribe or abuse of political power and not in the best interests of the entity. Also, corruption in the post-privatization stages could make competition unfair between the companies in an industry. For example, by bribing an official, one company will have an unfair advantage over another company.

The relationship between corruption and privatization, however, is a two-way relationship. Corruption affects privatization and, in turn, privatization affects levels of corruption. Factors relevant to the privatization process, such as speed and transparency, for example, allow for higher or lower levels of corruption. The faster and more transparent privatization process leads to lower levels of corruption ("Privatization and Corruption" 7-8). Also, some privatization methods are prone to corruption more than others are. In this section, I will also discuss corruption in the post-privatization environment and how it can be diminished.

As mentioned earlier in this paper, corruption will be defined as abuse of official power for private gain in two categories: misallocation of wealth for the benefit of a government official and extraction of bribes, kickbacks or special favors (Kaufmann and Siegelbaum 2-3). The information discussed below on corruption is largely based on an article written by Kaufmann and Siegelbaum (1997). They argue that corruption is correlated with the extent of control rights over economic activity exercised by politicians and the degree to which cash flow rights are misaligned with control rights. Control rights are rights to decide how to utilize the assets and cash flow rights are rights to income that is earned from the assets. When Lithuania, as well as other former Soviet republics, had a socialist economy, politicians and bureaucrats had control rights over specific state owned assets but did not possess cash flow rights (Kaufmann and Siegelbaum 6).

Certain factors that play a role in the privatization process can diminish or contribute to the level of corruption. The speedier the process of privatization the less time there is to arrange corrupt transactions and to exercise control rights. The level of administrative discretion plays a large role. Whenever in the process of privatization there is a requirement for an official signature, rents can be extracted from private parties to facilitate the signature. For example, when an official delayed signing a document, saying that he/she is very busy and will do it at later time was a true signal that nothing will get done if bribes will not be involved. Many times corrupt behavior can result from lack of financial transparency or resistance to making the enterprises' financial records public. It allows officials to collect bribes by permitting exceptions and violations of legal standards. It is probably one of the reasons why others like Jonas never got

persecuted for their illegal actions with investment funds. However, when privatization is administered by an independent entity, such as the State Property Fund in the case of Lithuania, corruption is more difficult because the independent entity takes control rights from the traditional politicians and bureaucrats. The new owner of the property should only be responsible for the process of privatization and not day-to-day operations. Also chances for corruption are lessened when domestic and international experts outside the government are brought in temporarily to help out with the process of privatization. This action also widens the distance between politicians with control rights and private parties. It makes no sense to bribe these experts because they have no decision making power (Kaufmann and Siegelbaum 7-9). Kaufmann and Siegelbaum did not discuss the corruption issues associated with privatization through direct negotiations. However, that information can be inferred from factors associated with other privatization methods. It can be assumed that transparency would be low since the negotiations take place only between two parties. Also since negotiations are taking place directly between the government and the investor, government official involvement in the matter is high. Therefore, I will conclude that corruption is very likely to exist in the privatization by direct negotiations. The privatization of Mazeikiu Oil oil refinery through direct negotiations, discussed in a case study below, is an example. The press accused the investors of back room bribery.

The different methods of privatization mentioned earlier play a significant role in the levels of corruption. Voucher based privatization has the lowest potential for corruption. The process is almost always administered by independent agencies and

information about it is widely available (excluding enterprise-level info) and it is relatively quick (Kaufmann and Siegelbaum 9-10).

Privatization through business tender (sale of assets to the bidder who offers the highest and best business plan) is slow and requires a lot of administrative discretion. However, transparency is high, since this process requires information about the privatized enterprise to be made public. Also due to the technical expertise necessary for this process, it is usually administered by a special agency. The level of corruption in tender privatizations seems to vary from case to case depending on circumstances. If a natural monopoly is privatized, there is more pressure to distort the information. On the other hand, when foreigners privatize an enterprise, transparency can be increased (Kaufmann and Siegelbaum 11). This is the case in the on-going privatization of a Lithuanian telecommunications company Telecom, discussed in a case study below. A German bank Dresdner Kleinwort Benson and Austrian bank CA IB Investmentbank are advising in the privatization of the remaining 35 per cent of Telecom's state interest.

The management –employee buyout method is one of the most corrupt privatization processes due to the fact that it is slow and requires a lot of governmental discretion (Kaufmann and Siegelbaum 11-12).

The most corrupt method of privatization, however, is spontaneous privatization. I have not mentioned it in the section on privatization methods due to the fact that it is an unofficial method of privatization and therefore it is very difficult to obtain information on the number of assets privatized under this method. It is a transfer of assets by stealth to the managers of the enterprise and/or high officials and politicians. According to Kaufmann and Siegelbaum, this spontaneous method is the essence of corruption. It is

completely non-transparent and is not administered by a specialized agency (Kaufmann and Siegelbaum 12). This method has been most wide spread in Lithuania out of the three pre-Baltic countries (Norgaard 153). This is because the majority of communist nomenklatura in Lithuania survived the changes and were in possession of large sums of state money. This permitted them to be investors in privatized companies (Norgaard 153). A prime example is the spontaneous privatization of KLASCO Stevedoring company, discussed in a case study below, that was transferred into the hands of the former Prime Minister Bronislovas Lubys.

Once the process of privatization is complete, there are certain factors, specific to both privatization processes in general and method of privatization, that can contribute to the lingering of corruption. After an enterprise is privatized, residual state ownership in the enterprise increases chances for corruption. Residual state ownership means that when privatizing an enterprise, the government keeps a certain percentage of shares for future sale to strategic investors. Maintaining this connection between the enterprise and the government reinforces control rights of the government officials that are accompanied with opportunities for corruption. Also, residual ownership provides these partially privatized firms with access to the officials that have control rights. This access could put these firms at an unfair advantage in respect with other firms in the industry (Kaufmann and Siegelbaum 14).

In the privatization of large firms, an investor is sometimes required to make future investments in the firm or maintain certain levels of employment. This residual purchase obligation has positive effects since it preserves employment and increases

investment. However, it again maintains a link to the government that can foster corruption (Kaufmann and Siegelbaum 14).

As shown above, all forms of privatization carry some risk of corruption. Voucher-based privatization is effective in curtailing corruption, but there is a danger of corruption through residual government ownership. In business tenders, new strategic investors are effective in cutting off links with the government in the implementation stage. However, in post-privatization environment residual ownership, which is very common in business tenders, tends to maintain government's control rights. Management-employee buyouts, even though they rarely involve residual ownership, reinforce ties to the government officials due to deferred payment obligations to the government (Kaufmann and Siegelbaum 15). No matter what method of privatization, where privatization process was executed in such a way as to create monopoly positions in the firm, the new owners of the firm will most likely continue to bribe politicians for market protection and subsidized resources (Kaufmann and Siegelbaum 14).

Even though privatization process in countries such as Lithuania provided new opportunities for corruption, privatization is preferable due to the fact that privatized sectors of the economy are significantly less corrupt than public sectors (Kaufmann and Siegelbaum 20). As far as corruption is concerned, speedy mass privatization involving full transfer of assets sold with no special deals for insiders nor obligations for further investment would result in the privatization process that is least corrupt (Kaufmann and Siegelbaum 22).

Besides choosing a method of privatization that will encourage the least amount of corruption, clear-cut private property protection, competition and bankruptcy laws

must be established and they need to be enforced efficiently. Before that is done, there are no effective mechanisms in place to monitor corruption.

V. THE ROLE OF THE IMF

International financial institutions such as the IMF are sometimes involved in the privatization of large enterprises in economies in transition. IMF indirectly provides financial assistance necessary for the privatization and restructure of the unprofitable firm. The IMF functions like a credit union, "lending to any member that experiences difficulties in paying its import bills and for servicing its foreign debt, and that agrees to undertake reforms to correct the imbalances that underlie the problem ("How" 1). One of these "reforms to correct imbalances" is undergoing the process of privatization, which is to solve the "problem" by increasing governmental revenue through proceeds from privatization and taxation of profits.

In order to be able to borrow money from the IMF, Lithuania had to become a member. It became a member on April 29, 1992 and contributed a certain sum of money, determined by IMF, called a quota. Twenty five per cent of the quota contribution was supposed to be paid in hard currency or SDRs and the rest in local currency Litas. SDR (special drawing right) is a monetary unit created by IMF whose value is based on the average worth of the world's five major currencies (US dollar, French Franc, Pound Sterling, Japanese Jen and Deutsche Mark) ("SDR" 1). As of January 31, 2000 Lithuania's quota was 144.20 million SDR ("Lithuanian, Republic" 1).

When in need of assistance, Lithuania can immediately withdraw 25 per cent of its quota that it paid in hard currency. If that is not enough, Lithuania can request further

assistance. Further needed assistance from IMF does not come in the form of loans per se. Basically Lithuania, "purchases" "more acceptable" stronger currencies, typically dollars or European currencies, from the IMF with SOME of its own currency, in this case Litas, as a sign of good faith ("How" 1). After some time, typically three to five years, Lithuania will have to repurchase Litas with the hard currency. Some times, although, repayment periods are extended up to 10 years (Driscoll 10). Lithuania is charged an interest rate to cover IMF's operational expenses as well as the interest payment for the loan to the creditor country. The money that is borrowed becomes part of international reserves in Lithuania. Therefore, the IMF does not oversee the distribution of the loan for specific projects believing that it is the responsibility of development or central banks. Also, it is very important to mention is that Lithuania, upon requesting a loan, must also present a plan of reform for economic stabilization and reform that will enable it to pay for its foreign obligations. Assistance for Lithuania, as well as other countries, is conditional upon IMF's annual reviews of Lithuania's fulfillment of specific conditions determined by the IMF (Driscoll 10).

As mentioned earlier this assistance from the IMF is vital in privatizing large enterprises but the strings attached to this assistance sometimes can have negative affects on privatization. In a speech given in Vilnius on October 3, 1997, Michel Camdessus, the managing director of the IMF, stressed a speedy execution of privatization in Lithuania (Camdessus 3). He advocates speed believing that the privatization itself will improve the performance of the firm and that judicial and legal frameworks can be developed later. Sadly enough, experience shows that inefficiency of these institutional frameworks leads to the opposite. However, according to critics like John Nellis, many

privatizations have and will continue to fail if the process is too fast (Nellis 18). According to him, the reason why financial institutions stress speed so much is their belief that there is an immediate need to build capitalism and that the institutional framework can be developed later. Nellis believes that creation of capitalism requires more than private property, "it [capitalism] functions because of the widespread acceptance and enforcement in an economy of fundamental rules and safeguards that make the outcomes of exchange secure, predictable, and widely beneficial" (Nellis 18). According to him, in some countries, where speedy privatization proved unsuccessful, like Russia and Ukraine, for example, there are even talks about renationalization for reprivatization at some later date. Nellis believes that this course of action is unlikely and if implemented would fail due to weak administrative, policymaking, and enforcement capacities of the government. Nellis urges international assistance community to stop demanding speedy privatization and instead to focus on implementing slower, case-by-case and tender types of privatization (Nellis 19).

There are some factors, however, that need to be considered when the financial assistance is distributed. In the speech mentioned above, Mr. Camdessus also mentioned that when international finance is readily available, domestic banks tend to overborrow from the IMF and keep lending money to risky borrowers and projects. He mentioned a problem that exists in Lithuania as well as in other countries in transition, but did not offer a practical solution. The IMF needs to more closely supervise the distribution of its funds or develop local institutions that will accomplish that task.

VI. CASE STUDIES

I have just discuss different methods of privatization that were used in Lithuania, the dangers of corruption and the use of IMF funds in privatizing large enterprises in Lithuania. I also talked about the legacy of Central Economic Planning on the Lithuanian economy and Lithuania's ability to maintain old markets in the East and develop new ones in the West. All these factors contribute to the success or failure of privatization. In the following section, I intend to show how these conditions contributed to the privatization of three specific firms and I will measure the success based on the following factors: created or saved employment, profitability, modernization and investment in infrastructure.

A. Mazeikiai Oil

1. Privatization Method

Mazeikiai Oil refinery was privatized on October 29th, 1999 through a direct sale by the US firm Williams International, Inc. [from here on Williams] for US$150 million in cash and promissory notes (Vipotnik 1). Williams is a subsidiary of an US-based energy and telecommunications company based in Tulsa, Oklahoma. In September 1998, a new law was adopted recognizing Williams as a strategic investor. Mazeikiai Oil is the only petroleum product producer in the Baltic States and has a capacity to produce about 15 million tons per year. Williams has a 33 per cent interest in Mazeikiai Oil, the Lithuanian government has a 59.3 per cent interest and small investors own the remaining 7.7 per cent. Williams has a five-year operational control of the refinery, the crude oil terminal Butinge and the pipeline from Butinge to Mazeikiai Oil. At the time when the

firm was privatized, Mazeikiai Oil has a debt of US$300 million that is due to business partners at the end of year 2000 (Ray, *Lithuania Agrees,* 2). Mazeikiai Oil was privatized through a direct sale reversing the earlier decision to sell the stake by open business tender. In this contract, Williams promised to invest about US$700 million in the future to modernize the facilities and complete building the Butinge terminal ("Lithuanian Oil Sector"). On March 2, 2000 Lietuvos Rytas daily announced that Williams is planning to start negotiations with European Reconstruction and Development Bank soon. Williams is trying to secure a loan of about USD 550 million in total for Mazeikiai Oil (Damauskas 3). The modernization would include the upgrades to the refinery that will permit the processing of petroleum in accordance with the new EU environmental standards.

The privatization method was not an open tender because Lithuanian politicians feared that Russian oil companies might gain a stake in the company. (Maheshwari 2). The negotiation terms were kept secret and therefore contributed to the popular resistance by Lithuanian citizens and the press to privatization by Williams. Rumors circled that this privatization process involved backroom bribes (Maheshwari 2). Lithuanian citizens came out to the streets to protest the deal on the day it was signed (Maheshwari 2). The negotiations between Williams and Lithuania continued for about two years and resulted in the resignation of two Prime ministers and their cabinet members because they opposed the deal (Maheshwari 2).

2. Role of IMF

Former Prime Minister Rolandas Paksas opposed privatization by Williams because of the terms of the deal, specifically the loan of USD 323,928 million that the Lithuanian government was committing to provide to Williams that came from loan

money from the IMF. Paksas believed that would create a fiscal crisis in Lithuania (Ray, *Lithuanian Executive,* 1). Paksas as well as IMF officials are concerned that the deal may worsen the country's financial problems. This concern needed to be looked at with much consideration since at the time Lithuania was close to securing another very large loan from IMF (Lithuania (Ray, *Lithuanian Executive,* 1). As mentioned previously, the money that Williams plans on investing in Mazeikiai Oil is coming from the Lithuanian government which it in turn borrowed from the IMF. The president of the Lithuanian Confederation of Industrialists, Bronislovas Lubys expressed his disenchantment with foreign investors in an interview with Lietuvos Rytas newspaper, "How much of its own money did Williams invest in Mazeikiai Oil? How much is it planning to invest? Not a cent. The flow of foreign investors in Lithuania is just an illusion. They invest borrowed money and not their own capital" (Slusnyte 2).

3. Corruption Issues

As discussed earlier in this paper, residual government ownership leaves the window open for corruption. In Mazeikiai Oil the government has a 59.3 per cent interest. The fact that Williams is obligated to make a future investment assures the tight connection between the firm and the government in the future and hence encourages corruption. The process of privatization itself of Mazeikiai Oil was tightly connected to the political elite. This supports the circling rumors that the process involved bribes (Maheshwari 2). Privatization of Mazeikiai Oil was also a political and not an economical move. Rushing to sell controlling rights to the Lithuanian oil industry to an American firm is connected to Lithuania's plans to join the EU and NATO and it seems possible that Lithuania received some promises in that respect ("Russian Investors" 1). It

seems that EU would view an American firm as a more credible investor than a Russian one. Shortly after Lithuania selected Williams as a strategic investor, a group of U.S. Senators representing the United States in the NATO Parliamentary Assembly arrived in Vilnius to evaluate Lithuania's readiness to join NATO. Further, the World Bank expressed willingness to finance Mazeikiai Oil refinery's upgrade ("Russian Investors" 1-2).

4. CEP Planning and Comparative Advantage

The issues of the legacy of CEP and its ability to have markets for its products are very real for Mazeikiai Oil. The legacy of CEP has both positive and negative effects on the refinery. Mazeikiai refinery is dependent on supplies of crude oil from Russia through the Soviet pipeline Druzhba. After the Lithuanian government selected Williams to be the strategic investor in Mazeikiai Oil instead of Lukoil, Russia's number one oil producer, some problems arose. Since the privatization, Mazeikiai Oil was forced to shut down for a total of 27 days due to halt in crude oil delivery by Lukoil, each day costing about US$250 thousand in losses (Sotvariene 2). Lukoil claimed that prices that Mazeikiai Oil was willing to pay was too low, but Lithuanian officials argue that Lukoil was disappointed with Lithuania's decision to sell 33 per cent stake to Williams (Ray, *Lithuania Agrees,* 2). The situation has since improved. Mazeikiai Oil has signed a contract for oil supply for the next year with Lukoil ("Mazeikiu Nafta" 1). A long-term supply agreement is still being negotiated which seems to be dependent Lukoil's ability to buy interest in the firm. Lithuania is currently contemplating giving Lukoil up to a 10 per cent interest in the firm (Dliuzas 1). Besides if that deal does not work out, Russia's

number two oil producer Yukos Oil Company has shown eagerness to pursue different projects with Mazeikiai Oil (Grumadaite 1).

It appears that Mazeikiai Oil is gaining a comparative advantage in Western markets as well as maintaining old relationship in the East. The percentage of exports to the East has decreased as the percentage of exports to the West has increased. As a result of CEP, Mazeikiai Oil has a market for its products in Russia and former Soviet Republics. In 1998, 35. 4 per cent of end products from Mazeikiai Oil were sold in Lithuania, the rest were exported. The export was directed towards Russia and Ukraine in 1997 and 1998. After the economic crisis in Russia, exports shifted towards the West, with about 20 per cent of gasoline and 45 per cent of diesel products being exported to Western Europe ("AB 'Mazeikiu Nafta'") Also, exports have increased to Poland, Latvia and Estonia largely due to regional trade agreements ("AB 'Mazeikiu Nafta'").

5. Was the privatization of Mazeikiai Oil a success?

At this point in time it is hard to judge confidently whether the privatization of Mazeikiai Oil has been successful or not. From the above analysis, it can be deduced that there are positive and negative sides of this privatization. However, the data shows that the positives outweigh the negatives. On the positive side, privatization of Mazeikiai Oil, a bankrupting institution at the time of transaction (Ray, *Russian Oil,* 1), saved jobs. It now employs an average of 3434 employees. Even though it is using IMF's money to modernize and improve the refinery, at least the money seems to be used efficiently. On February 8, 2000 Lietuvos Rytas daily announced that Williams has serious plans in increasing Butinge oil terminal's capacity by building another buoy and another pipeline

from Butinge to Mazeikiai Oil which would allow it to export and import oil simultaneously. The construction would take from a year to a year and a half to complete and according to Williams' International president Bumgarner, it would be financially sound to import crude oil from the West ("Lithuanian Oil Concern" 1).

The privatization resulted in increase in production which would in turn increase the revenue. In January and February of the year 2000, Mazeikiai Oil refined 47 per cent more raw materials than at the same time in 1999 ("Mazeikiu Naftai 1). Mazeikiai Oil also produces a significant amount of revenue for the government. In 1999, Williams contributed more than US$ 250 million to the national budget in taxes (Sotvariene 4). Williams's relationship with Lukoil has warmed up significantly and looks promising. Also, Williams is regaining some trust with the Lithuanian public, by trying to be as transparent as possible in their actions with the press (Maheshawari 2).

On the negative side, alleged corruption in the deal between Williams and the Lithuanian government could be a cause for concern. Through bribery, Mazeikiai Oil could acquire favoritism from the government and develop an unfair competitive advantage over other producers of petroleum product who service Lithuania. It could use this advantage to develop monopoly powers and raise products prices. Therefore corrupt practices need to be monitored more closely.

The positives definitely offset the negatives in this case and it is safe to claim that privatization of Mazeikiai Oil has been a success, at least so far.

B. KLASCO: Klaipeda Stevedoring Company

1. Privatization Method

KLASCO was privatized on March 5th, 1999, through the spontaneous privatization method by a consortium Viachema formed from the Lithuanian company Viachema and Estonian Transiidikeskese AS for US$ 50 million (State Property Fund). Viachema owns 90 per cent of the shares and the Lithuanian government owns the remaining 10 per cent (State Property Fund). The company Viachema is owned by Bronislovas Lubys, former Lithuanian Prime Minister and currently the president of the Confederation of Lithuanian Industrialists. Although there are no documents stating that this privatization method was "spontaneous", all of its characteristics coincide with the characteristics associated with spontaneous privatization. KLASCO was basically transferred to Lubys for a price that is allegedly much lower than its true value. In addition to that, Lubys did not even pay that lowered price. Spontaneous privatization can have devastating affects on the well being of the company. It was disregarded that privatization of KLASCO by Lubys might not be in the best interests of KLASCO considering that he might not have the expertise, interest or financial capability to make the company profitable.

KLASCO is the biggest stevedoring company in the port of Klaipeda handling about 55 per cent of all cargo: metal, containers, cereals, fertilizers, molasses, timber and perishable goods ("AB Klaipeda" 1). It consists of a dry cargo port and a handling port complex called Eurogate Klaipeda which includes an international ferry terminal and a container terminal.

2. *Role of IMF*

Due to the type of privatization used and the relatively low privatization price of KLASCO, use of IMF funds was not necessary in this case.

3. *Corruption Issues*

As mentioned earlier, spontaneous privatization is synonymous with corruption. It is transfer of assets by stealth to the managers of the enterprise and/or high officials and politicians. The enterprise was valued at a higher price, but Lubys, having tight connections with the government, convinced the Privatization Committee to lower the price of KLASCO to US$ 50 million (Grineviciute, *Danguje,* 1). Not only did he convince the committee to lower the price, but Lubys also convinced them to let him privatize KLASCO on credit, that is, he would pay the sum of privatization in periodic payments over a period of five years (Grineviciute, *Danguje,* 1). Basically KLASCO was privatized from its own future profits.

KLASCO is not the first company that has been privatized by Lubys. In 1993 he teamed up with a couple of small investors and privatized a fertilizer producer Achema (formerly known as Azotas) for less than US$ 1 million. Achema since then has created 23 daughter companies in Lithuania and 3 abroad. These companies are involved in variety of different industries ranging from newspapers, radio stations and banks to restaurant and café chains (Grineviciute, *Danguje,* 4). These companies are not very profitable. In 1999 this group of companies, also known as Viachema Group, made about US$ 2.13 million in profits while having a lingering debt of about US$ 7.9 million (Grineviciute, *Danguj,e* 3). If KLASCO will fail to be profitable enough and Viachema

fails to provide the periodical privatization payments for KLASCO, Viachema will be forced to sell some of its assets (Grineviciute, *Danguje,* 2).

4. CEP Planning and Comparative Advantage

KLASCO's main competitors are other stevedoring companies on the Eastern Baltic coast of Estonia, Latvia, and St. Petersburg. One significant advantage that KLASCO holds is that port of Klaipeda is the only completely ice free port on the Eastern Baltic coast (Grineviciute, *Danguje,* 5). This could give KLASCO a comparative advantage over stevedoring companies in nearby ports. Further, at the Crete Conference, it was decided that 2 out of 9 multimodal European transport corridors that cross Lithuanian territory are of vital importance in the creation of Trans-European Networks. Klaipeda seaport serves as a branch of corridor 9B extending it to Western European ports ("The Services" 1). In addition to that, on February 15^{th} of this year Lithuanian Parliament endorsed the new wording of the law of the state seaport in Klaipeda. A section of Klaipeda's port will be granted free port status by the end of this year. According to the Transportation Minister Rimantas Didziokas, this will increase the cargo turnover in the port and will increase its competitiveness among the other Baltic States ("Lithuanian to set" 1).

Profitability of KLASCO largely depends on overall economic environment in the Seaport of Klaipeda, whose amazing recent success seems to have very positive effects for KLASCO. In the months of January and February of 2000, the seaport handled 74 per cent more cargo than in the same months last year. Klaipeda's seaport handles more dry cargo than the ports of Estonia and Latvia (Valeckas, *Atsigavo,* 1). According to some specialists this immense increase in cargo turnover is due to the improved economic

situation in Russia (Valeckas, *Atsigavo,* 1). This again demonstrates how much still Lithuania's trade is dependent on Russia.

5. Was the privatization of KLASCO a success?

The data on whether KLASCO saved or created new jobs in unavailable but evidence shows that KLASCO is committed to preserve jobs and works very actively with worker organizations such as Independent Trade Union of Dock Workers and the Lithuanian Seamen's Union. Recently, Lubys signed a collective agreement with the trade unions that, according to him, involved mutual compromises and is thought to improve relations between the two ("The Services" 2).

KLASCO was quite profitable last year. It reported revenue of US$ 42.5 million. KLASCO has a debt of around US$ 15 million ("The Services" 2). Klaipeda State Port Authorities are planning to invest twice as much, on average, as in previous years in rebuilding the seaport's infrastructure – about US$ 29 million. The priority this year is to renovate quays to 14 meters in depth. According to Valeckas, KLASCO is one of the firms to benefit the most from this investment (Juraite 7). KLASCO is also planning to invest about US$ 6.25 of its own money into the infrastructure (Juraite 7). Last year KLASCO invested US$ 33 million to restructure it's container terminal which, unfortunately, is working only at a 15 per cent of its capacity (Valeckas, *Privacios,* 7). Even though KLASCO was privatized by a local industrialist, attempts were made to bring in foreign expertise. Eurogate Klaipeda (KLASCO's international ferry port + container terminal) is managed by German specialists (Juraite 2).

Even though money is being invested in KLASCO and its infrastructure is being rebuilt, Lubys' own lack of focus in one industry and his concentration on creating

numerous daughter companies instead of investment into the infrastructures of already privatized firms, might hurt the companies under his ownership, including KLASCO. The competitive environment for KLASCO, however, is a bit tougher than that for Mazeikiai Oil. About 70 per cent of cargo turnover in Klaipeda's seaport are transit cargo (Valeckas, *Atsigavo,* 1). The seaport is capable of handling 22 to 25 million tons of cargo, but the cargo turnover is only 15 million tons (Valeckas, *Privacios,* 7). The seaport works under its capacity due to the competition that it faces. Russia is planning to invest millions of US dollars to rebuild the infrastructure of its seaports. Last year alone Russia took away about 10 million tons of cargo from the ports of Ukraine, Finland and the other two Baltic States (Valeckas, *Privacios,* 7).

The privatization method of KLASCO, as mentioned earlier, was quite corrupt. The post-privatization environment is likely to involve corruption due to Lubys' close ties to the government. Lubys, in an interview with Veidas magazine, admitted to have financed numerous politicians from different political parties in their entrance to Seimas (Lithuanian parliament) (Grineviciute, *Vos,* 5).

Another real challenge for KLASCO will be its ability to stay competitive in the very competitive environment.

C. Lithuanian Telecom

1. Method of Privatization

Telecom, Lithuanian telecommunications company was privatized on July 7th, 1998 through public tender by Amber Teleholdings Consortium (formed from the Swedish Telia and the Finnish Sonera) for US$ 510 million. Amber Teleholdings owns a 60 per cent stake in the company (State Property Fund). As mentioned earlier, privatization through public tender is a sale of assets to the bidder who offers the highest price also considering the bidders proposals for the future operation of the enterprise. Amber Teleholdings has committed to invest an additional US$ 210 million in the company. This is the largest foreign investment in the Baltic States to date ("Among the best" 1).

Telecom, formerly a state monopoly, currently is a legal private monopoly. The new telecommunications law legalized Telecom's monopoly powers until the year 2003 (Grineviciute, *Monopolininkas,* 6).

This privatization method was very successful in transferring assets to people likely to effectively manage the firm. Besides providing a considerable amount of revenue for the government, this method also considered the best future plan for the company. Also, the assets were transferred to investors that have expertise in the area of telecommunications.

2. Corruption

In business tender privatization, as mentioned earlier, corruption is less likely due to the fact that this process requires a lot of information to be made public, hence it increases transparency. Also, privatization by foreign investors increases transparency.

The residual ownership by the government should not increase chances for corruption since the government is currently preparing another 35 per cent for sale. However, Amber Teleholdings' commitment for future investments ties it closer to the government and provides opportunities for corrupt acts. Also Siegelbaum and Kaufmann suggest that in privatizations of natural monopolies information presented to the public might be distorted.

Theoretically privatization of Telecom could have involved corruption, but the lack of evidence or accusations in the press leads me to believe that privatization of Telecom was corruption-free.

3. Role of IMF

IMF funds were not involved in the privatization of Telecom.

4. Competitiveness in Domestic Markets

Since Telecom has been granted monopoly powers until the year 2003, it has an extremely secure domestic market. If Telecom will be able to modernize and rebuild its infrastructure to provide excellent service at competitive prices by the time other telecommunication companies are allowed to enter the market, it will continue to do well. There is also a chance that this company might move into markets in other countries in the future. Telecom's success in these markets will again depend on their ability to provide excellent services at lowest prices.

5. Was the privatization of Lithuanian Telecom a success?

Telecom employs an average of 9,415 employees a year. {}. Since the privatization Telecom has been increasingly more profitable. In 1999, its profits were about US $29 million, showing a 19 per cent growth from 1998 (Luksyte 32). Telecom

operates only in the domestic Lithuanian market which is secured at least till the year 2003 by the Lithuanian government. Quite naturally, privatization by foreign investors brought in a lot of needed expertise into Lithuania's telecommunications industry. There is a lot of capital invested in personnel training (Grineviciute, *Monopolininkas,*4). In an interview with the Lithuanian Development Company, Telia AB Business Area International's vice president Lars Lindborg stated that modernization of telecommunications technology at Telecom is a priority. Digitalization is very urgent, since only 15 per cent of Telecom is digital today ("Among the best" 1). Further, Amber Teleholdings' commitment to invest another US$210 million into Telecom's infrastructure will improve it significantly. Also, the lack of corruption in the privatization process adds to the success of the privatization.

	Telecom	**Mazeikiai Oil**	**KLASCO**
Effectiveness of **Method**	* * *	* *	*
Level of **Corruption**	**N/A**	**low**	**high**
Efficiency in use of **IMF Funds**	**N/A**	*	**N/A**
Ability to be **Competitive**	* * *	* * *	* *

*** - very good; ** - good; * - bad.

VII. ANALYSIS AND CONCLUSION

In the first section of this paper I discussed four different conditions affecting privatization of large enterprises in Lithuania: method of privatization, use of IMF funds, corruption and competitiveness in markets. Further I analyzed the existence of these conditions specifically in privatization of three large enterprises in Lithuania – Mazeikiai Oil, KLASCO and Telecom. I measured the success of privatization of these three firms based on the number of people that each of them employed, profitability and investments in infrastructure.

Now it is important to compare the privatization processes of these firms to prove that their success does depend on method of privatization, amount of corruption, use of IMF funds and availability of markets for their products.

A. Method of Privatization

All three large enterprises were privatized using a different method: Mazeikiai Oil was privatized through direct negotiations, KLASCO through spontaneous privatization and Telecom through a business tender. The success of the method of privatization will be determined by whether the method was effective in transferring the company's assets to owners that are most likely to manage the company effectively.

Direct negotiations and business tender methods are two of the five acceptable privatization methods for large enterprises listed in the latest version of Lithuanian Privatization Law. The business tender method is most effective in transferring assets effectively because it involves a competition between a number of interested investors based on the highest bid and the best plan for the company's future operations. Also, in

many instances there is prerequisite of a certain number of years of expertise in the area for taking place in this competition. Direct negotiations method is less effective. In that case, only one bidder takes part in an auction or tender through a direct negotiation between the bidder and the State Property Fund (the Lithuanian privatization agency). Since there is only one bidder the State Property Fund has less choice and therefore might have to back down on some issues affecting the specifics of the privatization process, such as bidder's future obligations to the company.

Spontaneous privatization, however, is not mentioned in the privatization law as a valid method of privatization. It transfers assets to a politician or a manager for an undervalued price. It does not provide significant revenue for the government nor make any assurances that the investor will benefit the privatized company. Interests of the privatized company play little role in the selection of the investor.

Judging by method alone, Mazeikiai Oil and Telecom have more chances of being successful than KLASCO due to the fact that their privatization was in accordance with the law.

B. Corruption Issues

Corruption, as mentioned earlier, stands in the way of successful privatization. It can result in choosing a method of privatization that is not the best for the company and in the post-privatization stages it might create unfair advantages over another company.

Privatization of KLASCO was most corrupt due to the fact that it's method of privatization was "spontaneous" and transferred assets into the hands of former Prime

Minister. Also, due to KLASCO owner's close ties with the government, corruption is likely to continue.

Mazeikiai Oil would be second in line for the amount of corruption. It has a large residual ownership by the government which will assure its close connection to the government providing more opportunities for corruption.

Telecom is the least likely to experience corruption. Telecom was privatized through a business tender method which is usually associated with high transparency and leads to less corruption. Also, lack of proof to the contrary, all the evidence lets me to assume that privatization of Telecom was corruption-free.

C. Use of IMF Funds

If it is necessary to borrow funds to complete privatization, the use of IMF funds in the privatization of enterprises contributes to the success of privatization only if the funds are used efficiently. If IMF funds are not used efficiently, the firm could fail and the government would still have costly foreign debt.

Based on use of IMF funds alone, I would say that privatization of Telecom was most successful since it did not involve any IMF funds. The same is true for the privatization of KLASCO. Mazeikiai Oil used IMF funds in the privatization process and, as mentioned earlier, it seemed to use the funds efficiently. However, since not borrowing from IMF is preferable to borrowing, Mazeikiai Oil is least successful in its privatization process.

D. Competitiveness

As I have mentioned earlier, even though companies are successful in their privatization based on the above mentioned three conditions, their ability to have markets for their products is the most important determinant of their success. If the company does not have a market, it will not meet the highest purpose of privatization – profitability.

Mazeikiai Oil had a market for its products in Soviet times and these markets still remain after the independence. Also, regional trade agreements have facilitated Mazeikiai Oil's entrance to western markets. There is also a demand for Mazeikiai Oil's products domestically. Privatization of Mazeikiai Oil in that respect has been very successful.

Based on all the evidence surrounding KLASCO's privatization, it seems that it will be a struggle for KLASCO to protect its markets due to heavy competition from the other ports on the Eastern Baltic Coast. Even though a lot money is invested in KLASCO's infrastructure and it is quite profitable currently due to the improvement on the situation in Russia, tough competition might prevent it from being successful. The fact that KLASCO is working at less than full capacity is a sign that aggressive competition is reducing its opportunity to be profitable.

Telecom is assured a market and protection from competitors at least until the year 2003. Profitability will not serve as a problem and hence, in that respect it's privatization is a success. Therefore, Telecom is most successful, Mazeikiai Oil is right next to it, and KLASCO is least successful in its privatization process based on existence of markets for their products and competitiveness.

E. Evaluation and Conclusion

It is probably too early to evaluate these firms based on jobs saved, profitability and investments into infrastructure because of the recentness of their privatization. However, we can consider their prospects for the future based on the analysis that I have done in this paper. Telecom, because of its monopoly powers, is very likely to be profitable and to retain and increase employment. Also, Amber Teleholdings' has already committed to invest more money in Telecom's infrastructure. Mazeikiai Oil has a good chance, but unreliability of Russia's suppliers might cut into the profits and force some layoffs. Also there isn't much expansion associated with a refinery plant, therefore chances for increase in employment is unlikely. On the positive side, Williams has made a commitment to invest significant amounts of money in Mazeikiai Oil's infrastructure. KLASCO is little worse off than Mazeikiai Oil and Telecom. That fact that it is own by an insider might result in dislocation of funds and decrease profitability. High competition will cut also cut into profits and employment. Further, there is no assurance that Bronislovas Lubys will invest any money in the modernization of KLASCO. He has not made any commitment "on paper" yet.

In this paper I have attempted to show how success of privatization of large enterprises in Lithuania, such Telecom, Mazeikiai Oil, and KLASCO, was affected by the chosen method of privatization, amount of corruption involved in the process, use of IMF funds, ability maintain and develop new markets and be competitive in them. I measured the current and predicted future success based on how many employment places were created or saved, how profitable the enterprise was, and how much money was invested in its infrastructure as a result of privatization.

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