

THE WORLD BANK OPERATIONS EVALUATION DEPARTMENT



Russia: Thoughts on the Privatization Debates A Decade Later

David Ellerman

Director-General, Operations Evaluation: Robert Picciotto
Director: Gregory K. Ingram
Acting Manager: Rene Vandendries
Task Manager: Gianni Zanini

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Contact:

Operations Evaluation Department
Partnerships & Knowledge Programs (OEDPK)

email: ecampbellpage@worldbank.org

email: eline@worldbank.org

Telephone: 202-458-4497

Facsimile: 202-522-3125

<http://www.worldbank.org/oed>

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Preface

This paper was prepared in reaction to an earlier version of the Russia Country Assistance Evaluation draft dated September 13, 2001 by the Operations Evaluation Department (OED) of the World Bank (CAE Task Manager, Gianni Zanini).

The author, Mr. David Ellerman, is a Senior Economist in the Development Economics (DEC) Office of the Senior Vice President of the World Bank.

The views expressed in this paper remain entirely those of the author. They do not necessarily represent the views of the World Bank.

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Executive Summary

1. A decade has passed since the privatization debates raged in the IFIs concerning Russia and the other transition economies. It is time for reflection and evaluation of these debates within the Bank and the other IFIs. This note tries to pull together thoughts on two questions: the overall institutional change strategy and the alternatives to and arguments against voucher privatization. The note shows that there were more pragmatic alternatives.
2. History offers few "crucial experiments" but the contrast between the Russian and Chinese transitions is probably the best one could ask for to contrast a "institutional shock therapy" or blitzkrieg approach with an incremental, step-by-step, or staged approach to institutional change. The Yeltsin reformers used rather "bolshevik" methods to try to storm the ramparts during the few windows of opportunity, an approach now called "market bolshevism."
3. What is the alternative? In this case, the alternative has long found its sophisticated expression in the work of Albert Hirschman about incremental 'reform-mongering' change driven more by endogenous linkages rather than by exogenous "carrots and sticks" embedded in IFI loan conditions. The Chinese reform experience represents this incremental approach in practice; crossing the river groping for the stepping stones rather than jumping over the chasm in one last "great leap forward."
4. Another part of the incremental approach, also evident in China, is the willingness to allow experiments in different parts of the country and then foster horizontal learning and the propagation of the successful experiments. This is an important part of the alternative to the bolshevik/jacobin approach of legislating the brave new world from the capital to be applied uniformly across the country. The transition from socialism to capitalism had not happened before in history so the situation *clearly* called out for experimentation and pragmatism. Instead the Bank succumbed out of "la rage de vouloir conclure" (the rage to conclude) to the bolshevik/jacobin mentality, with aid and abetment from elite academic advisors (e.g., the Harvard *wunderkinder*), and supported Moscow legislation to apply the dreamed-up solutions across the whole Russian Federation.
5. After some initial limp resistance, the Bank quickly succumbed to the public relations image of the Czech voucher privatization as being "successful" and then promoted that model in other countries. I would argue that voucher privatization programs such as the Russian MPP actually contributed to the debacle. This argument can be developed in different vocabularies.
6. One approach is via the notion of agency chains. Long agency chains are very difficult to police and maintain. Information economics emphasizes the "information leakage" in the agency relationship so the longer the agency chain, the more the leakages and chances for opportunistic behavior. It took decades to develop the array of institutions to police long agency chains in the West, and a glance at runaway executive compensation in the USA makes one wonder if we have it right even now. The market bolsheviks tried to legislate and install institutions such as stock markets and publicly traded companies as if all that could be done practically overnight. Voucher privatization which threw all companies of any size into the stock market was an almost "pathological" example of trying to legislate well-functioning long agency chains.

7. The analysis can also be approached using the notion of *de facto* property rights. Neoclassical economics tends to follow Coase and to emphasize the importance of establishing clear property rights and then the market will do the rest. Never mind if the "clear cut property rights" are the ownership of shares in voucher investment funds on the end of many-layered agency chains.

8. Progress has been made on this question recently in Hernando de Soto's new book *The Mystery of Capital*. Hernando de Soto did not just argue for formal property rights but for the formalization of *de facto* property rights. The idea is that people by using this property (formally but absentee owned by others) have developed certain capabilities and competencies. It is a form of empowerment (albeit using assets formally owned by others). The people have acquired certain *de facto* property rights which empower them to sow and reap. Any "reform" that would take away those *de facto* property rights (and the capabilities they represent) to assert absentee formal property rights would in fact be disempowering and anti-development. To promote market-driven development, the reforms should find out ways to formalize some approximation to those *de facto* rights so that the people then encounter the market and the underlying private property system as something that empowers them—rather than the opposite.

9. Now transpose this argument over to the transition economies. In the decentralizing socialist reforms over the years and decades before 1990, the workers, managers, and local communities had developed a range of *de facto* property rights (or "use rights") over their enterprises. One way or another, in often bizarre ways, people learned to get by in a twilight half-and-half system. They developed *de facto* property rights that represented their capabilities to actually get a few things done and to squeak by. When the spell was finally broken in 1989-90, the alternative to institutional shock therapy (market bolshevism) was to find the nearest approximation to the *de facto* property rights that would be accepted as socially fair. If that approach had been taken, then people would have encountered the market as something that would recognize and formalize the capabilities they had already developed and would allow them to do even better. Instead the market bolsheviks designed the "market reforms" based on voucher privatization with the exact opposite purpose to deny the *de facto* property rights accumulated during the "communist past," to righteously wipe the slate clean, and to start afresh with formal property rights.

Резюме

1. Прошло десять лет с тех пор, как приватизация в России и в других странах с переходной экономикой стала предметом острых дискуссий в международных финансовых институтах. Пришло время внимательно изучить и подвергнуть анализу эти споры, проходившие в стенах Всемирного банка и других международных финансовых институтов. Автор этих заметок попытался свести воедино и проанализировать разные подходы по двум вопросам: общая стратегия структурных преобразований и ее возможные варианты и доводы против ваучерной приватизации. Подготовленный материал свидетельствует о существовании более прагматических подходов.

2. История знает несколько «решающих экспериментов», но сопоставление преобразований в России и Китае, пожалуй, может служить наглядным примером различий между «институциональной шоковой терапией», или молниеносным подходом, и поступательными, ступенчатыми или поэтапными методами институциональных преобразований. Реформаторы Ельцина использовали вполне «большевистские» методы, чтобы взять крепость штурмом, используя весьма ограниченные возможности. Этот подход получил название «рыночного большевизма».

3. Какова же альтернатива? В данном случае достаточно полный и глубокий анализ этой альтернативы давно представлен в работе Альберта Хиршмана, посвященной постепенным, «стимулирующим реформы» преобразованиям, вызванным скорее глубинными внутренними причинами, а не исходящей извне политикой «кнута и пряника», лежащей в основе условий кредитования международных финансовых институтов. Опыт проведения реформы в Китае является практическим воплощением стратегии постепенных преобразований: это все равно, что переходить реку, осторожно нащупывая камни под ногами, вместо того, чтобы перепрыгнуть ее одним «гигантским прыжком».

4. Другой отличительной чертой стратегии постепенных преобразований, которая так же проявилась в Китае, является склонность к проведению экспериментов в разных частях страны с последующим горизонтальным изучением накопленного опыта и распространением результатов успешных экспериментов. Это важная составляющая стратегии, отличной от большевистских/радикальных методов насаждения «дивного нового мира» по решению сверху, обязательному для исполнения в масштабах всей страны. Учитывая то, что история доселе не знала примеров перехода от социализма к капитализму, сложившаяся ситуация, *несомненно*, требовала экспериментаторского и прагматического подхода. Вместо этого, Всемирный банк, «поспешив с выводами», пошел на поводу у большевистских/радикальных умонастроений и при содействии и с согласия избранных ученых консультантов (например, гарвардских вундеркиндов) поддержал законодательные инициативы, предусматривающие насаждение на территории всей Российской Федерации принятых в Москве надуманных решений.

5. После недолгих возражений Всемирный банк быстро согласился с сформировавшимся в общественном сознании представлением о ваучерной приватизации в Чехии как об «успешном» эксперименте и приступил к распространению этой модели на

другие страны. Я убежден в том, что такие программы ваучерной приватизации, как Программа массовой приватизации в России, на самом деле, способствовали экономическому краху. К этому выводу можно прийти разными путями.

6. В основе одного из подходов лежит понятие цепочки межведомственных связей. Длинную цепочку межведомственных связей крайне трудно отследить и проконтролировать. В основе экономики информации лежит принцип «утечки информации»: чем длиннее цепочка межведомственных связей, тем выше вероятность утечки информации, тем больше возможностей для беспринципного поведения. У Запада ушли десятилетия на то, чтобы создать сеть институтов, способных взять под контроль межведомственные связи, и даже сейчас, достаточно беглого взгляда на чрезмерные зарплаты и льготы работников руководящего звена в США, чтобы усомниться в том, что нам это действительно удалось. Рыночные большевики попытались законодательно оформить и создать такие институты, как фондовые биржи и компании, акции которых доступны широкой публике, как будто все это действительно можно сделать буквально за одну ночь. Ваучерная приватизация, в результате которой все компании, независимо от размеров, оказались выброшенными на фондовый рынок, на деле стала «патологическим» примером попытки узаконить четко функционирующие цепочки межведомственных связей.

7. К анализу сложившейся ситуации также можно подходить и с точки зрения понятия фактических прав собственности. Один из постулатов неоклассической экономики, основанной, прежде всего, на теории Коаза, гласит о необходимости, в первую очередь, обеспечить четкие права собственности, а все остальное сделает рынок. И неважно, что «четко установленные права собственности» - это владение акциями в ваучерных инвестиционных фондах в конце многослойной цепочки межведомственных связей.

8. Шагом вперед в решении этого вопроса стала вышедшая недавно книга Хернандо де Сото «Тайна капитала». Хернандо де Сото доказывает необходимость не только формальных прав собственности, но и законодательного оформления фактических прав собственности. Его идея состоит в том, что, используя эту собственность (формально, но реально принадлежащую другим), люди приобретают определенные возможности и навыки. Это своего рода форма расширения полномочий (пусть используя активы, формально принадлежащие другим). Люди приобретают определенные фактические права собственности, которые обеспечивают им возможность действовать и пользоваться плодами своего труда. Любая «реформа», которая исключает фактические права собственности (и возможности, которые они предоставляют), заменяя их оторванными от реальности формальными правами собственности, на деле, ограничивает возможности и препятствует развитию. Для того чтобы реформы способствовали развитию рыночной экономики, необходимо найти способы для официального оформления хотя бы некоего подобия фактических прав, поскольку люди воспринимают рынок и лежащую в его основе систему собственнических отношений как возможность расширить свои возможности и полномочия - а не наоборот.

9. Теперь перенесем эти доводы на страны с переходной экономикой. В результате направленных на децентрализацию реформ, которые проводились в социалистических странах в течение многих лет и даже десятилетий до 1990, работники, управленцы и местные сообщества получили определенный перечень фактических прав собственности («права пользования») на свои предприятия. Так или иначе, нередко весьма причудливыми способами, люди научились ориентироваться в этой оторванной от реальности половинчатой системе. Они получили фактические права собственности, которые отражали их весьма ограниченные реальные возможности и позволяли кое-как сводить концы с концами. Когда в 1989-90 гг. этот период наконец закончился, альтернатива шоковой терапии (рыночный большевизм) заключалась в том, чтобы найти вариант, максимально приближенный к системе реальных прав собственности и приемлемый с точки зрения социальной справедливости. Если был бы избран этот подход, то люди восприняли бы рынок как систему, призванную признать и официально оформить те полномочия, которые они уже получили, и способную предоставить им еще более широкие возможности. Вместо этого, рыночные большевики разработали «рыночные реформы» на основе ваучерной приватизации, направленные на достижение как раз совершенно противоположной цели: отказ от фактических прав собственности, полученных в период «коммунистического прошлого», решительно покончить с этим прошлым и начать новую жизнь с формальных прав собственности.

1. Institutional Change Strategies

1. A decade has passed since the privatization debates raged in the IFIs concerning Russia and the other transition economies. It is time for reflection and evaluation of these debates within the Bank and the other IFIs. This note tries to pull together thoughts on two questions: the overall institutional change strategy and the alternatives to and arguments against voucher privatization.

2. History offers few "crucial experiments" but the contrast between the Russian and Chinese transitions is probably the best one could ask for to contrast a "institutional shock therapy" or blitzkrieg approach with an incremental, step-by-step, or staged approach to institutional change. As Chubais has acknowledged, the Yeltsin reformers did use rather "bolshevik" methods to try to storm the ramparts during the few windows of opportunity. In Stiglitz (1999) and Reddaway and Glinski (2001) this is called "market bolshevism." There was also a sort of institutional "Coase Theorem" involved in this change strategy; once the impediments of the socialist past were removed, the "natural market forces" would emerge to build a market economy. I suspect that history will judge this strategy a failure—particularly in contrast to the incremental strategy used in China.

3. What is the alternative or counterfactual? In this case, the alternative has long found its sophisticated expression in the work of Albert Hirschman about incremental 'reform-mongering' change driven more by endogenous linkages rather than by exogenous "carrots and sticks" embedded in IFI loan conditions.¹ The Chinese reform experience represents this incremental approach in practice; crossing the river groping for the stepping stones rather than jumping over the chasm in one last "great leap forward."

4. Nick Stern has suggested that "step-by-step" might be less misleading than "incremental"—and step-by-step is more in keeping with the Chinese "stepping stones" metaphor. "Incremental" might be misleading if it is construed as "gradual" or "slow" since the Chinese reforms were neither. The point is to find and build step-by-step upon the reform efforts of the past (which requires taking into account past conditions) rather than trying to wipe the slate clean and legislate ideal institutions in one fell swoop. Black et al. (2000) have used the word "staged" in much the same sense. In Lau, Qian, and Roland (2000), the "two-track" system of reforms is analyzed where a second track, step, or stage is inaugurated and can then grow to eventually render the earlier stage obsolete. In *Whither Reform?* (Stiglitz, 1999), the two "ideal types" were compared in a table as a "battle of metaphors."

¹ See the "two basic approaches" in Hirschman (1973, 247-8) where he contrasts an ideological, fundamental, and root-and-branch approach to reform with an incremental, remedial, piecemeal, and adaptive approach.

Table 1: "Battle of Metaphors"

	Shock Therapy	Incrementalism
Continuity vs. Break	Discontinuous break or shock—razing the old social structure in order to build the new.	Continuous change—trying to preserve social capital that cannot be easily reconstructed.
Role of Initial Conditions	The first-best socially engineered solution that is not "distorted" by the initial conditions.	Piecemeal changes (continuous improvements) taking into account initial conditions.
Role of Knowledge	Emphasizes explicit or technical knowledge of end-state blueprint.	Emphasizes local practical knowledge that only yields local predictability and does not apply to large or global changes.
Knowledge Attitude	Knowing what you are doing.	Knowing that you don't know what you are doing. ²
Chasm Metaphor	Jump across the chasm in one leap.	Build a bridge across the chasm.
Repairing the Ship Metaphor	Rebuilding the ship in dry dock. The dry dock provides the Archimedian point outside the water so the ship can be rebuilt without being disturbed by the conditions at sea.	Repairing the ship at sea. There is no "dry dock" or Archimedian fulcrum for changing social institutions from outside of society. Change always starts with the given historical institutions.
Transplanting the Tree Metaphor	All at once transplantation in a decisive manner to seize the benefits and get over the shock as quickly as possible.	Preparing and wrapping the major roots one at a time (<i>nemawashi</i>) to prevent shock to the whole system and improve chances of successful transplantation. ³

5. Out of force of habit, I will continue to use the "incremental" label with the step-by-step and staged connotations and without the implication of "slow" or "gradual."

6. Another part of the incremental approach, also evident in China, is the willingness to allow experiments in different parts of the country and then foster horizontal learning and the propagation of the successful experiments. This is an important part of the alternative to the bolshevik/jacobin approach of legislating the brave new world from the capital to be applied uniformly across the country. The transition from socialism to capitalism had not happened before in history so the situation *clearly* called out for experimentation and pragmatism ("It is not important if the cat is black or white, but that it catches the mice.") Instead the Bank succumbed out of its own arrogance and "la rage de vouloir conclure" (the rage to conclude) to the bolshevik/jacobin mentality, with aid and abetment from elite academic advisors (e.g., the Harvard *wunderkinder*), and supported Moscow legislation to apply the dreamed-up solutions across the whole Russian Federation.

7. It is here that there is so little credibility in the TINA ("There is/was no alternative") pleadings. Not only was it feasible for experiments to take place, they *were* taking place but were stopped and ignored in the market bolshevik frenzy to legislate the brave new world during the window of opportunity. I will focus on the alternatives available concerning privatization.

² See Benziger 1996.

³ See Elster et al. 1998 for the "rebuilding the ship at sea" metaphor and Morita 1986 about *nemawashi*.

2. The Privatization Debates

8. After some initial limp resistance, the Bank quickly succumbed to the public relations image of the Czech voucher privatization as being "successful" and then promoted that model in other countries.⁴ In my 1998 paper (which, incidentally, I tried but failed to get published within the Bank prior to Stiglitz's arrival so it previously circulated for 2 years in *samizdat* form), I argued that the economic case for voucher privatization was remarkably superficial and that the basic rationale was political. The Stiglitz paper (1999) and Stiglitz-Ellerman paper (2001) develop an additional argument as to why the voucher privatization programs such as the Russian MPP actually contributed to the debacle. This argument can be developed in different vocabularies.

The Argument in terms of agency chains

9. One approach is via the notion of agency chains. Long agency chains are very difficult to police and maintain. Information economics emphasizes the "information leakage" in the agency relationship so the longer the agency chain, the more the leakages and chances for opportunistic behavior. It took decades to develop the array of institutions to police long agency chains in the West, and a glance at runaway executive compensation in the USA makes one wonder if we have it right even now. The market bolsheviks tried to legislate and install institutions such as stock markets and publicly traded companies as if all that could be done practically overnight. Voucher privatization which threw all companies of any size into the stock market was an extreme "pathological" example of trying to legislate well-functioning long agency chains.

10. Market economies start with short, not long, agency chains—indeed, they start with the identity of principal and agent in the owner-operated firm and farm. The decentralization that is part of building a market economy in transitional countries needs to similarly start with agency chains as short as possible, not as long as possible. In the preferred plan of voucher privatization with investment funds, the principal-agent links in the long agency chain were:

- the millions of shareholders of voucher investment funds who are supposed to control
- the boards of the funds which are supposed to control
- the fund management companies which are supposed to control
- the boards of their hundreds of portfolio companies which are supposed to control
- the managers of the portfolio companies who are supposed to control
- the middle managers and workers who are supposed to actually produce something that somebody wants to buy.

11. Economic historians may find it hard to believe, but the "experts" in the IFIs actually thought that such agency chains could be legislated and successfully installed in economies

⁴ Actually it was more than PR, at least in the usual sense. Some Bank economists churned out reams of accommodating econometric studies "scientifically" showing how "successful" the Czech privatization and restructuring was.

after 70 years of communism.⁵ The legislation and formal implementation of this dysfunctional Rube-Goldberg system in Russia should not be counted as a big success.

12. I am reminded of the old joke where the general manager tells the sales manager that they are losing a dollar on each unit sold, and the sales manager replies, "But look at how many we are selling!" In a similar manner, some Bank managers now acknowledge that voucher privatization turned out to be a lousy idea, but say, on the brighter side, look at how many firms were voucherized!

The argument in terms of *de facto* property rights

13. The analysis can also be approached using the notion of *de facto* property rights. Neoclassical economics tends to follow Coase and to emphasize the importance of establishing clear property rights and then the market will do the rest. Never mind if the "clear cut property rights" are the ownership of shares in voucher investment funds on the end of many-layered agency chains.

14. Progress has been made on this question recently in Hernando de Soto's new book *The Mystery of Capital*. Although this was little noticed by many cheerleading book-jacket commentators, de Soto did not just argue for formal property rights but for the formalization of *de facto* property rights. That's a horse of another color. After all, all the land occupied and farmed by peasants or occupied and used by slum dwellers already has formal owners; it was not part of some "commons." The idea is that people by using this property (formally but absentee owned by others) have developed certain capabilities and competencies. It is a form of empowerment (albeit using assets formally owned by others). The people have acquired certain *de facto* property rights which empower them to sow and reap. Any "reform" that would take away those *de facto* property rights (and the capabilities they represent) to assert absentee formal property rights would in fact be disempowering and anti-development. To promote market-driven development, the reforms should find out ways to formalize some approximation to those *de facto* rights so that the people then encounter the market and the underlying private property system as something that empowers them—rather than the opposite.

15. Now transpose this argument over to the transition economies. In the decentralizing socialist reforms over the years and decades before 1990, the workers, managers, and local communities had developed a range of *de facto* property rights (or "use rights") over their enterprises. Central planning never worked well and as it got worse, forms of decentralization took hold in varying degrees across much of the socialist world including the Yugoslav self-management system, the Hungarian goulash communism, the Polish Solidarity-dominated self-management committees, and the Gorbachev reforms to increase enterprise self-accountability. One way or another, in often bizarre ways, people learned to get by in a twilight half-and-half

⁵ In Ellerman 1998, I argued that the attempts to use vouchers to jump-start "stock markets" in all transition economies from Mongolia to the Czech Republic could also be viewed "cargo cult" reforms driven by their totemic significance rather than by any real economic need. One should not be too surprised when cargo-cult reforms turn out to be rather dysfunctional. It should also be no surprise that the countries that resisted vouchers and let their stock markets incrementally develop according to economic needs (e.g., Hungary and Poland) now have the strongest markets. Perhaps the Bank could learn something about institutional change from that episode.

system. They developed *de facto* property rights that represented their capabilities to actually get a few things done and to squeak by.

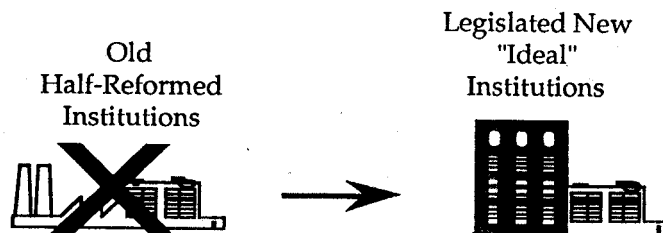
16. When the spell was finally broken in 1989-90, the alternative to institutional shock therapy (market bolshevism) was to find the nearest approximation to the *de facto* property rights that would be accepted as socially fair. If that approach had been taken, then people would have encountered the market as something that would recognize and formalize the capabilities they had already developed and would allow them to do even better. Instead the market bolsheviks designed the "market reforms" with the exact opposite purpose to deny the *de facto* property rights accumulated during the "communist past," to righteously wipe the slate clean, and to start afresh with formal property rights deliberately unrelated to the previous "vestiges of communism." Sometimes the "ideal reforms" were compromised by "vested interests" but, by and large, the "reforms" were successful in denying the *de facto* property rights acquired during the earlier decentralizing reforms. For instance, outside of a small elite, most Russians encountered the market not as something that strengthened their capabilities and empowered them to do more but as something that took away what they were capable of doing and left them in a position to grab what they could in the face of a very uncertain and uncontrollable future.

17. These points are perhaps easier to understand when applied to dwellings. People also acquired various *de facto* property rights over their flats in the socialist countries. Since the distribution of housing also partially reflected the power relationships under communism, one might pursue the same logic to suggest that the slate should be wiped clean of the communist past and all apartments should be put on the market and auctioned off to the highest bidder. Just think of the efficiency gains by jump-starting the housing market! Instead most of the post-socialist countries figured out ways to arrive at formal rights that were the closest socially fair approximation to the *de facto* rights.

18. Moreover, this analysis and critique is not just "hindsight." The following was written almost a decade ago in 1992 and published (outside the Bank, of course) in 1993.

"After the collapse of the socialist idea in the late 1980s and early 1990s, the question of institutional change strategies came to the forefront. Broadly speaking, two opposed strategies emerged. The Big Bang approach advocated just drawing a big X over the old half-reformed institutions and then legislating new "ideal" institutional forms.

"BIG BANG" INSTITUTIONAL CHANGE

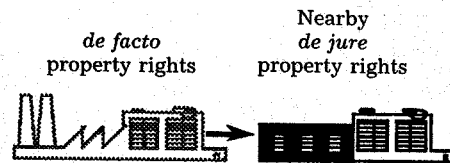


The old *de facto* property rights embodied in the half-reformed institutions would not be recognized in any significant way, and the new *de jure* property rights would be legislated by the new "revolutionary" democratic government.

What is wrong with moving in one great leap to some desired ideal form? Nothing—if institutional change could actually take place in that manner. But it usually does not. People will resist and "drag their feet" in countless ways when their *de facto* property rights are canceled or trivialized. The imagined great leap breaks down in chaos. Instead of disappearing overnight in favor of the new ideal institutions, the de-legitimated old institutions break down in favor of a shadowy anarchy of *ad hoc* opportunistic forms. The Big Bang becomes a Big Bust.

The alternative is a strategy of incremental institutional change. Instead of an imagined great leap forward over the chasm between socialism and capitalism, incentives would be devised to move people incrementally but irreversibly from the existing quasi-reformed institutions towards the "ideal" institutions. Instead of just negating the *de facto* property rights of managers and workers, they can arrive at a nearby set of legitimized *de jure* property rights by moving in the right direction.

INCREMENTAL INSTITUTIONAL CHANGE



These two strategies are posed as opposites. No country would adopt a totally pure strategy, and one country might use both strategies in different parts of its reform program. For instance, the privatization-by-liquidation program in Poland is based on an incremental strategy while the Polish mass privatization plan originates from a Big Bang approach. The Czech voucher plan is a Big Bang strategy, while small business privatization in the Czech Republic (and in most other countries) is based on an incremental approach. Aside from the lease buy-outs and other MEBOs, the Russian mass privatization program is a Big Bang program, while the Chinese reforms in agriculture and industry are the clearest example of a thoroughgoing incremental approach." (Ellerman 1993)

The Lease Buyout Counterfactual

19. What are the forms of privatization that try to move to a set of formal or *de jure* property rights that are a socially acceptable approximation to the *de facto* property rights that resulted from the earlier reforms during the socialist era? In *Whither Reform?* (Stiglitz 1999), the general strategy was called "stakeholder privatization." Look at the parties who actually have to cooperate in order for an enterprise to succeed regardless of the "ownership structure." This includes the workers, managers, suppliers, long-term customers, and local authorities. It

does not include voucher fund managers sitting in Moscow. Then shrink-wrap the ownership structure around those stakeholders to arrive at the minimal agency-chain structure. In the above passage written almost a decade ago, the Polish privatization-by-liquidation (also called "Polish leasing") program, the Soviet lease-buyouts, and the Chinese reforms in agriculture and industry (i.e., family responsibility system and TVEs) were all picked out as examples of this up-close strategy to strive for formal rights close to *de facto* rights and to minimize the distortions of information and effort involved in long agency chains.

20. What is the state of the debate about the lease buyout counterfactual in Russia? Here are some of the points. If the state of the debate on this issue is taken as the state of the Stiglitz-Ellerman (2001) versus Dabrowski-Golmulka-Rostowski (2001) debate, then it should be understood that DGR are "not Poles apart" from SE on the substance of these issues (although DGR seem much concerned about imagery so that minor disagreements in emphasis and semantics are magnified into major questions). DGR agree on the strategy of minimizing agency chains and they agree (two-thirds belatedly) on the negative judgment about voucher privatization. DGR even agree on supporting enterprise forms like the Polish lease buyouts and the Chinese TVEs. However, they apply a different linguistic framework where these forms are classified as "*de novo* SMEs" rather than stakeholder privatizations. Of course, SE support *de novo* SMEs but also develop the information-economics-based minimal agency chain (or "shrink-wrapped ownership structure") analysis to show *why* such enterprise forms are generally more successful. The debate was about privatizing medium-sized firms and about busting up the large dinosaurs through spin-offs of medium-sized firms so that the large SOEs could also be handled with these methods.

21. If the logic (minimizing agency chains and building on *de facto* property rights) is sound, then the Soviet lease buyouts and related experiments seem to be the closest thing to grow out of the reform experience in the FSU. As noted above, this option was argued for at the time and on the basis of roughly these arguments. Marty Weitzman also at the time gave a pragmatic argument for the worker ownership version of stakeholder privatization.

"Under worker ownership, the workers themselves, or their agents, will have to control pay and negotiate plant shutdowns. The most acute 'us vs. them' stalemates may be avoided. Ownership is more concentrated relatively close to management decisions and can put more immediate pressure on performance. Regulatory capture may be avoided. Hard budget constraints may be more acceptable. There is less opportunity for financial manipulation." (Weitzman 1993. 267)

22. Note Weitzman's version of the minimal agency chain and shrink-wrapped ownership argument in his statement: "Ownership is more concentrated relatively close to management decisions and can put more immediate pressure on performance." Unfortunately, the Russia program chose to privatize in the way that Soviet-expert Weitzman recommended "How Not to Privatize."

23. Moreover, the IFI specializing in the region, the EBRD, was not only aware of the option but sponsored a set of pilot projects to show how lease buyouts could be done using

modern corporate forms. (Lloyd, 1993) The structure of these deals and a host of other examples were presented in the EBRD's 1993 technical note, *Management and employee buy-outs in central and eastern Europe—an introduction*. Thus all these ideas were known to the IFIs in the early 90s.

24. The counterfactual is often caricatured as arguing "that institutional and regulatory reform should have preceded privatization." However, the point is that stakeholder privatization minimizes the need for the institutions to police long agency chains so that the *appropriate* forms of privatization can go forward as those institutions are being developed and can, indeed, drive that institutional development through the endogenous Hirschmanian linkages (in contrast to the IFI conditionalities). It would be more accurate to say "that institutional and regulatory reform should have preceded privatizations *involving extensive agency relationships*". As those institutions develop, then enterprises could evolve beyond the initial forms of lease buyouts, TVEs, and the like.

25. It might be argued about lease buyouts that "Russia did not have a sufficiently well developed national or regional institutional environment, as in Poland, to prevent large-scale managerial expropriation of assets under such a scheme." There are at least three problems with this "argument."

25.1 The stakeholder theory did not depend on a "well developed national or regional institutional environment" to protect the self-interest of those who have to cooperate together on a daily basis to earn their economic livelihood. They are all "mutual hostages" to the success of the enterprise so they can exercise their *de facto* property rights directly, not by trying to get "national or regional" institutions to enforce any formal rights. Unfortunately, the "experts" did not seem to have understand the argument then—or now. When the "experts" have a quasi-religious faith in *ersatz* national or regional institutions enforcing long agency chains and fail to see how people will try to enforce their *de facto* property rights in their concrete day-to-day self-interest, then SE argue that the "experts" have shown a "faulty understanding of economic principles".

25.2 Secondly the actual argument usually offered by the conventional experts (e.g., at the Bank) was exactly the opposite. It was not that lease buyouts would lead to workers having too little power to resist managers but to workers having too much power to resist managers so that they would resist the restructuring and reallocation of the assets elsewhere by "market forces." In any case, when "experts" give opposite arguments for the same conclusion (e.g., opposing lease buyouts), one suspects that the real reasons for the conclusion might lie elsewhere (see Ellerman 1998).

The helpless-stakeholder argument never had much plausibility. It "argued" that the workers, middle managers, long-term suppliers and customers, and the local authorities would stand by idly while the top *nomenklatura* managers stripped the assets and destroyed the livelihood of all the others—unless, of course, there were "national or regional" institutions that could intervene to save the livelihoods of the hapless locals. DGR recognize that the Solidarity-dominated self-management councils in the Polish

SOEs (in contrast to conventional regulatory institutions) played an important role to prevent management looting but they seem to resist applying the same stakeholder logic to Russian enterprises even after lease buyouts. Certainly the Poles are right to be proud of Solidarity but they should not preclude similar but later developments in Russia when given a little help.

25.3 Since there were some 10,000 lease buyouts, it is an empirical question whether there was more managerial looting in lease buyouts or in the voucherized firms. My casual empiricism in Russia gives a clear answer to this question, but I would welcome some more systematic and objective empirical investigation which was not financed or supervised by those who have built their careers on voucher privatization.

26. Aside from the helpless-stakeholder argument, another bogus argument is that the Russian MPP was "fast privatization." This argument is misleading on both counts—that MPP was fast and that the alternative was slow. MPP only appears to be fast because one restricts attention to the technocratic achievement of formal privatization, and one does not count the time it will take to climb back out of the chasm that Russia failed to jump over in one leap. In less metaphorical terms, since the point of MPP was to override and dissolve the social-organizational capital and *de facto* property rights accumulated by the stakeholders in the past, it was designed to be disempowering to them. It awarded the individual formal rights to workers, managers, and voucher funds on the other end of rather long agency chains.

27. The advice of employee ownership experts both inside (e.g., the author) and outside the Bank (e.g., Joseph Blasi) was unanimous that any genuine attempt to use a worker ownership or MEBO model (see previous quote from Weitzman) would require a mechanism for collective decision-making such as the US or UK ESOP. In terms of game theory, the firm should be organized as a cooperative game (i.e., enforceable collective decision-making). Repeated attempts to allow this option in the MPP ("Option 4") were specifically prevented by the GKI and western advisors in the IFIs who wanted the worker ownership to be strictly temporary and not subject to collective decision-making. Those advocating a worker ownership option in the MPP and those opposed to it at least agreed that by allowing individual sell-outs, there would be a prisoners' dilemma (PD) situation with the eventual non-cooperative solution of most people selling out (particularly when helped by managers withholding wages). The GKI even outlawed shareholder agreements since they quite explicitly wanted a non-cooperative game (no enforceable collective decision-making). Thus the stakeholders who could have helped to prevent managerial looting were deliberately prevented from coalescing as a stable decision-making group with a common interest in bettering the enterprise.

28. Those who deliberately designed the MPP to prevent the collective empowerment of the stakeholders in the enterprises entertained the hopes that this would lead to the concentration of ownership and the top-down power to restructure enterprises and reallocate assets.⁶ The MPP worked as planned to concentrate formal rights—in this case in the hands of the top enterprise managers. But the top managers had little reason to follow out the rest of the

⁶ This sort of top-down coercion seems to be the restructuring methodology favored by "tough minded" visiting economists and desk-bound IFI experts. Those with practical experience who have made their living in the restructuring business tend to have a slightly more subtle view of the matter.

hoped-for "logic" since they had little confidence that any increased value of the enterprise as a profitable going concern could be capitalized upon their impending retirement. This created the situation where many managers felt the most rational response was just to grab what they could while they could. Since the stakeholders were formally disempowered, they were somewhat less assertive to stop the attempted plunder (although there have been several hundred plant occupations in Russia by workers trying desperately to stop managerial looting). New schemes of plunder could be arranged with the other major holders of formal rights (called "tunneling" in the Czech context). Thus MPP contributed to a genuinely dysfunctional system ("falling into the chasm") and it will take a long time to climb back out. So much for being "fast."

29. Since the MPP was deliberately designed and implemented to undo insider social capital and to disempower the insider coalition of stakeholders with the collective interest in preserving and improving the enterprise as a going concern (all dismissed as "impediments to restructuring"), it is a bit disingenuous to picture the asset stripping by the top managers as an untoward side-effect of the MPP. After deliberately tying up an albeit less-than-perfect watchdog, one shoulders some responsibility for the foxes having better access to the chicken coop.

30. The argument is also misleading in the implication that the stakeholder privatization option was slow. I am unaware of any serious argument here. In the Bank, we often heard a specious dichotomy of mass privatization (meaning vouchers) versus "case-by-case privatization" where by the latter one meant pains-taking negotiation of each deal. Yet the lease buyout schemes were a form of mass privatization in the sense that each deal simply had to satisfy certain cookie-cutter requirements (like the voucher deals) in order to go through. Polish leasing was not slow, the rise of the Chinese TVEs was not slow, and the 10,000 or so Soviet lease buyouts before 1992 when the door was shut indicate that they were also not slow.

31. Indeed, one of the "problems" with the lease buyouts is that they were too fast and too popular at the firm level, not that they were too slow. If the lease buyouts had not been stopped, then the market bolsheviks feared that there would not be any good firms left to go into the voucher auctions. If that had remained an option, then "too many" firms would have selected that option so, instead, the door was closed. Unfortunately that sequence does not jive too well with the "story" that the reformers were forced to the MPP because everything else was "too slow."

3. Conclusion

32. In summary, the Russians (and the EBRD) experimented with the lease buyouts as a more home-grown option but the Russian reformers, with the full support of their Bank and other western advisors, stopped the experiments and deliberately stopped repeated attempts to include something like the lease buyouts in their new Master Privatization Plan for Russia.

33. I have focused on the overall questions of institutional change strategy and the privatization debates because those questions seem the most fruitful for "learning opportunities". And they are the debates in which I was the most involved.

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