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## **CONTRADICTIONS IN PRIVATIZATION IN EASTERN EUROPE AS REFLECTION OF CONTRADICTIONS IN THE SOCIALIST CONCEPT OF OWNERSHIP**

Almost two decades after the fall of the Berlin Wall, the privatization of assets in legal systems that were formerly counted as members of the Socialist Legal Family can be described as completed in just a few jurisdictions. In many the programs are still sources of intense dispute, agitation and even bloodshed.<sup>1</sup> We have no intention of judging the choice of macro-economic systems, however, at least several socialist populations in fact remain that, with privatization either barely in progress, stalled or not recognised to be taking place.

The maintenance of systems of private property is regarded as a critical aspect of governance in an economy based on private enterprise. Failure to achieve stable and predictable property laws and administration of relevant registries, such as a land title registry, brings a high economic cost, particularly with respect to the cost of credit to finance business and infra-structural development. The status of legal title to assets is also a major concern for investors and international trading partners. In addition, the establishment and development of these systems is a high priority of international capacity building institutions such as the World Bank. For the nations in Eastern Europe undergoing transition from socialism, it is also an important step in gaining accession to the European Union.

Our objective is to learn from programs that have been undertaken so far in order to research and develop a more objective process for legal systems that have chosen to take the step of dismantling socialism. The process will take account of the interests of those: from whom property was expropriated/socialized; who have acquired valuable interests in property under socialism; and whose investment projects need to be secured.

The process will also include appropriate procedures for the environmental and land use planning assessment of assets and appropriate decision making and action in these fields. Appropriate policy structures for imple-

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1. For a broader view of conflict and other problems in states in transition, see H. Charlesworth, "Picking up the Pieces: Building Democracy in Post-Conflict Societies," public lecture presented at School of Law, Univ. of Melbourne, Sept. 28, 2005.

mentation of land title registration and cadastral structures will also be researched and developed.

### **The Soviet Property Model**

In this paper we refer to the socialist *Soviet Property Model*. The *Soviet Property Model* was developed in the USSR in the 1920s and 1930s. It was transplanted in a relatively intact form to the many new socialist republics that were founded in the early post-war years, from East Germany to China. The *Soviet Property Model* was a structure for the socialist ownership of resources by the state, and by state and public organizations. In it the state was the surrogate for socialist ownership by The People. State and public organizations held socialist property only for the purposes of the relevant state economic plan. Only personal and domestic items could be objects of personal ownership. Land was an object of *exclusive* state ownership. Quasi-proprietary *use rights* were recognised for those legitimately holding possession of land.

This overview is a brief and simplified sketch of the basic concepts and structure of property rights found in the Socialist Legal Family in the mid-1970s<sup>2</sup> which will assist the reader to navigate the details of the system found in other parts of this article and to assess the strategies undertaken to transform the *Soviet Property Model* in the course of dismantling socialism.

The most fundamental distinction in property concepts found in the state socialist legal model<sup>3</sup> is between: (1) socialist ownership, which was divided into (a) state ownership, and (b) ownership by collectives, co-operatives and other mass organizations; and (2) personal ownership.<sup>4</sup>

State property was vested in the USSR as a state on behalf of The People. The property of collectives and other mass organizations was vested in kolkhozes, other collectively organized units of production, trade unions and other social organizations. Personal property belonged to individual citizens and members of the individual farms which together formed a *kolkhoz*.

This conceptualization raises the question of a distinction between *property* and *ownership*. Private property is an institution of the civil law.

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2. In formulating this overview we are indebted to “§26 Ownership in the Socialist Legal Family,” in K. Zweigert and H. Kötz, *An Introduction to Comparative Law*, Tony Weir, trans. (Amsterdam: North-Holland Publishing Co, 1977), 1: 327-37.

3. *Ibid.*, 1: 329.

4. See Article 5ff, the 1936 *Constitution* of the USSR. In Common Law systems *personal property* is another term for goods, chattels or movable property and the term *real property* identifies interests in land. In European systems the concepts of *movable* and *immovable property* express this distinction.

Property is a broader concept than ownership. In day-to-day speech one's property refers to physical objects and valuable items. In legal terminology property can be any valuable asset, including intangible ones, such as a bank's mortgage or copyright in a song, as well as what we own. The main distinction between a personal right and property right is generally that the civil law courts will enforce the right against one who is a complete stranger to the holder of the right, invoking coercive powers of the state if necessary. It is not dependent on an enforceable relationship, like a contract, existing between the holder of the property right and the other party, although that might happen as well. A right of property can generally be (1) enjoyed by the holder of the right as appropriate to the nature of the right, (2) it is generally transferable to others, and (3) interference with the right by others can be prevented. One significant difference between the Common Law and the continental European property law systems hinges around when a property right is recognized as existing, particularly with respect to land. Much of this difference actually comes back to what we mean by property. There are, for example, in the German system some relationships regarding assets that are not described as property which in Common Law systems would be so described, by the rules of Equity for example.

Of all the possible rights of property, the right of *ownership* is the fullest. It entitles the owner to possession and use of the object to the fullest extent possible within the bounds of responsible conduct with respect to an object of that nature, within a community living under the rule of law. Ownership thus complies most fully with the three points made above about property. It lasts forever. Lesser rights can be granted by the owner in favor of other parties. A good illustration of these concepts and their interactions is provided by a lease of land for a fixed term by the owner to another person. In Common Law systems the tenant holds a form of property under the lease. In the German system the tenant's interest is classified as contractual, however, the tenant still enjoys the same protections *vis à vis* third parties, such as power to eject trespassers and superiority of the lease rights above those of a purchaser, should the owner sell the land. When the lease comes to an end the owner regains unburdened ownership as it stood beforehand. A mortgage security granted by the owner to a bank to secure a loan is another illustration. The mortgage could be held over the same land while the tenant holds the lease. All three interests, the ownership rights, the lease (subject to the reservation mentioned), and the mortgage are all forms of property co-existing simultaneously. This capacity in Property Law to hold different forms of property in the same land or object at the same time is called the *fragmentation* of proprietary interests.

One interesting characteristic of the *Soviet Property Model* is the conflation of *property* and *ownership* that is evident in the concepts of *socialist ownership* and *personal ownership*. It would appear to us far more logical to describe them as *socialist property* and *personal property*, however, the ideological and symbolic significance of the state owning the means of production on behalf of the People cannot be understated. State ownership was in principle complete and indivisible, leading, as will be seen below,<sup>5</sup> to enormous practical difficulty and theoretical contradiction. It might be suggested that the conflation identified is mere appearance because the Russian word *собственность* [sobstvennost'] means both *ownership* and *property*.<sup>6</sup> This occurs also with respect to *das Eigentum* in the German language. However, the meaning of the word intended is generally very clear in context. So, for example, when Article 14 of the German *Constitution*<sup>7</sup> employs *das Eigentum* in the constitutional protection of property, it is clear that *property* is intended, and the German Constitutional Court has thus interpreted the provision to encompass many types of interests in valuable assets. Article 14 (1) and (2), provide:

**Art 14 [Eigentum, Erbrecht und Enteignung]**

(1) Das Eigentum und das Erbrecht werden gewährleistet. Inhalt und Schranken werden durch die Gesetze bestimmt.

(2) Eigentum verpflichtet. Sein Gebrauch soll zugleich dem Wohle der Allgemeinheit dienen.

**Art 14 [Property, Inheritance and Expropriation]**

(1) Property and inheritance are guaranteed. Their meaning and limitations are defined in legislation.

(2) Property brings responsibilities. Its use shall at the same time serve the common good.

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5. In text below, following note 29.

6. Related terms include *имуущество* [imushchestvo] – things and *имущественное право* [imushchestvennoe pravo] – law of things (Property Law or *das Sachenrecht*). The Russian expression *право собственности* [pravo sobstvennosti] does mean “property right” in the sense of proprietary interests less than ownership but this term was not used to differentiate such rights in the Soviet legal system, and the term is in any case built around *собственность* [sobstvennost'] which, again, doubles as ownership, as explained in the text above.

7. *Grundgesetz für die Bundesrepublik Deutschland* of 23.5.1949 (BGBl. S. 1) [GG]. Often translated as *Basic Law*. The following translations are by M. Raff. For more detailed treatment of German Property Law see M. Raff, *Private Property and Environmental Responsibility – A Comparative Study of German Real Property Law* (The Hague: Kluwer Law International, 2003).

On the other hand, although *das Eigentum* is at the heart of the text, §903 of the German *Civil Code*<sup>8</sup> is clearly dealing with *ownership* when it refers to the powers of the owner, in contrast to the powers of mortgagees or those who hold, for example, hereditary building rights.

### § 903

#### *Befugnisse des Eigentümers*

Der Eigentümer einer Sache kann, soweit nicht das Gesetz oder Rechte Dritter entgegenstehen, mit der Sache nach Belieben verfahren und andere von jeder Einwirkung ausschließen. Der Eigentümer eines Tieres hat bei der Ausübung seiner Befugnisse die besonderen Vorschriften zum Schutz der Tiere zu beachten.

### Para 903

#### *Powers of the Owner*

The owner of a thing can, so far as it is not contrary to law or the rights of third parties, deal with the thing at discretion and exclude others from every use or misuse of it. The owner of an animal has to observe the particular provisions for the protection of animals in the exercise of his powers.

Returning to the *Soviet Property Model* and the Russian language, the objective appears to have been to provide only for *ownership* vested in the state on behalf of The People and no other property rights, apart from the small exception for *personal ownership*, but again, no other rights of property.

The different kinds of proprietor – state, collective or citizen – could own different kinds of things. Only the state could own assets that were vital for production, while citizens could own only relatively unimportant objects.

Thus, all means of production of any importance in the Soviet Union were “socialized” in the sense that they could belong only to the state as state property, or to a co-operative unit of production or to a social organization.

The two forms of socialist property had special protection under legislation. The 1936 *Constitution* of the USSR obliged citizens to look after and safeguard “the socialist property of society as the sacred and indisputable basis of the Soviet order.” Those who attacked socialist property were described as “enemies of the people.”<sup>9</sup> The Soviet criminal law of theft, robbery, fraud and extortion distinguished according to whether the crime was directed against socialist property or *only* the personal property of citi-

8. *Bürgerliches Gesetzbuch* of 18.8.1896 (RGBl. I S. 195, BGBl. III 400-2) [BGB] (consolidation of 2.1.2002, BGBl. I S. 42).

9. Article 131 of the 1936 Constitution.

zens; in the former case the penalties were significantly more severe. Private law also recognized the particular position of socialist property. Execution against socialist property was virtually excluded. Property that belonged to the state or collective associations that was improperly sold could always be reclaimed, even from a good faith acquirer.<sup>10</sup>

### **State ownership**

State ownership was the highest and most important form of property. Article 6 of the *Constitution* of the USSR provided:

Land, its mineral wealth, waters, forests, mills, factories, mines, rail, water and air transport, banks, communications, large state-organized agricultural enterprises (state farms, machine and tractor stations and the like), as well as municipal enterprises and the bulk of the dwelling houses in the cities and industrial localities, are in state ownership, that is, belong to the whole people.<sup>11</sup>

According to Article 21(4) of the *Fundamentals of Soviet Civil Legislation*, land, minerals, water and forests were exclusively owned by the state and only the use of them could be granted to others. Soviet jurists generally considered, however, that the other objects of state ownership set out in Art 6 of the *Constitution* also could only belong exclusively to the state. State enterprises were themselves owned by the state but had juridical personality in their own right.

### **Ownership by co-operatives, collectives and mass organizations**

The second form of socialist ownership was over resources vested in co-operative organizations and associations, especially *kolkhozes* or agricultural cooperatives, such as the installations, buildings, structures, tractors, harvest combines and other machines, the means of transport, draught animals and other productive stock, and similar assets that advanced the aims of the *kolkhoz*.

Article 7 of the USSR Constitution provided:

The common enterprises of collective farms and cooperative organisations, with their livestock and implements, the products of the collective farms and cooperative organizations, as well as their com-

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10. See Article 28 *Fundamentals of Soviet Civil Legislation* (Moscow: Progress Publishers, 1968).

11. J. Hazard, I. Shapiro and P. Maggs, *The Soviet Legal System (SLS)* (Dobbs Ferry, NY: Oceana Publications, 1969), p. 166.

mon buildings, are held in the common, socialist ownership of the collective farms and cooperative organizations.<sup>12</sup>

The land farmed by the *kolkhozes*, on the other hand, remained in state ownership and was made available to the *kolkhoz* by the state “for free and unlimited, that is, permanent use.”<sup>13</sup>

### **Personal ownership**

Only things “intended to satisfy the material and cultural requirements of citizens” could belong to the citizen in *personal ownership*.<sup>14</sup> This included “income and savings derived from his labor, a dwelling house (or part thereof) and a supplementary husbandry, household effects and furnishings, and articles of personal use and convenience.” Personal property owned by the individual member of a *kolkhoz* could include a dwelling house and the minor farm implements needed for farming the land, seldom more than one hectare, granted by the *kolkhoz* to its members as a “supplementary husbandry” or “auxiliary plot.”

A citizen in the Soviet socialist system could not hold any private ownership in the means of production. Article 9 of the *Constitution* of the USSR did authorize “minor private economic activity of individual farmers or trades men” provided they relied on their own work and did not exploit the labour of others. But this residue of private ownership of the means of production remained the exception, at odds with the system and barely tolerated. In practical terms, individual farmers and trades people played a very limited role in the Soviet Union, partly because the law deliberately placed them in positions less favorable than the *kolkhozes* or a co-operative of artisans and much less favourable than the position of a state enterprise.<sup>15</sup>

### **State enterprises, functional limitation and the role of the plan**

State enterprises were held in state ownership. They included industrial enterprises, agricultural enterprises (*sovkhoses*), and trading undertakings (*Torgs*).

They dominated Soviet economic life. The state enterprises were state organs. They had limited capacity as a legal person to enter legal relations

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12. Article 7 of 1936 *Constitution* of the USSR. See also Article 23 *Fundamentals of Soviet Civil Legislation*.

13. Article 8 of 1936 *Constitution* of the USSR. Property in land is dealt with in more detail below, in text following note 25.

14. Article 25 *Fundamentals of Soviet Civil Legislation*.

15. Zweigert and Kötz, *An Introduction to Comparative Law*, 1: 329.

with other state or co-operative organizations or with individual citizens required to complete the tasks imposed on them.

State enterprises did not, however, own the property assigned to them as working capital. It remained vested in the state. The enterprise obtained a “right of operative management.” On the basis of this right, distinct from ownership, state businesses could exercise over the property assigned to them “the right of possession, use and disposition within the limits laid down by the law and in accordance with the purposes of its activity, the obligations imposed by the plans and the destined purpose of the property.” The powers a state enterprise could exercise over particular items of property by virtue of its “right of operative management” were thus limited in advance by duties which the plan imposed on the enterprise and by the function it attributed to the property in question in the process of production.<sup>16</sup>

By the mid-1970s, Ioffe informs us,<sup>17</sup> property under the operative control of production associations in the Soviet Union was divided into several different categories and *funds*, each of which had a different legal status. Buildings and installations, for example, were possessed and used by production associations but they had very limited powers of disposition over them.

Moving on to funds, the *charter fund* consisted of *basic and circulating assets* which, taken together, represented the annual payments to be made to the State Treasury for use of means of production, calculated in accordance with established rates.

*Basic assets* included equipment and means of transportation which could have been productively used for more than one year and had a price of more than 100 *rubles*. In the absence of any of these features those things became *circulating assets*. When *basic assets* were used in production, the production association had no right of disposition – only planning agencies could redistribute these objects. If, as a result of changes in plans or technology, some basic assets ceased to be necessary planning agencies could redistribute them or supply agencies could sell them. If within a designated period none of these agencies had exercised its right, the production association could sell the assets to any economic or other organization. The proceeds obtained from the sale became part of the production association’s *production development fund*. Equipment or means of transportation that were temporarily unused for less than one year, but were not

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16. Article 94 *Civil Code* of the RSFSR.

17. O. S. Ioffe, *Soviet Civil Law* (SCL) (Dordrecht: Martinus Nijhoff Publishers, 1988), p. 99.

surplus assets, could be leased at predetermined rates, with rental payments transferred to the *amortization fund*.<sup>18</sup>

*Circulating assets* included raw materials, other supplies, fuel and money earmarked for current economic activity. Those assets could not be withdrawn by a superior agency if they were within the limits of a designated amount (*the standard*, which had to be confirmed by superior agencies). Production associations had no rights other than to use and possess *circulating assets* necessary for productive activity. Only money for use in production was at their disposal. However, money that related to *circulating assets* had to be deposited in the State Bank, and no payment could be made otherwise than through the bank and under its control. Any surplus in kind of *circulating assets* was subject to redistribution by superior agencies or to sale by supply agencies. The production association could sell its surplus assets only when those agencies declined to act. The proceeds from such sales had to be included in the monetary part of circulating assets, deposited in the bank. A surplus of *circulating assets* in monetary form could be withdrawn by the production association at the end of the economic year, if the surplus had resulted from economic success attained by a production association. However, if the surplus had resulted from modification of the association's planning tasks by a superior agency, the agency was empowered to withdraw the surplus at the very moment when the changes were effected.

There were numerous *monetary funds*, each had a specific objective and could be spent solely in furtherance of its objective, and on condition that relevant regulations were strictly observed. A production association could have a *capital investment fund* which was a temporal fund, created if the plan issued by a competent agency provided for construction of a new object, with the designated amount of money deposited on a special account at the *Stroibank* (the Construction Bank). A production association always had a permanent *amortisation fund*. The association was obliged to make regular amortization deductions during the periods and in the manner provided for by law. The purpose of the fund was to finance major repairs as well as to acquire the components necessary for the fulfilment of such work. It could also be used to cover expenses connected with the acquisition of new equipment to replace obsolete equipment, the major repair of which was no longer economically viable.<sup>19</sup>

*Incentive funds* existed only in monetary form and their purpose was to stimulate economic growth. The *production development fund* was created from a portion of the amortization transfers, a portion of the profit, and

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18. Hazard *et al.*, *The Soviet Legal System*, pp. 99-100.

19. Ioffe, *Soviet Civil Law*, pp. 100-01.

money from the sale of surplus basic assets and similar transactions. The *fund for social-cultural measures and housing construction* was created in conformity with the amount set aside for it under the plan. Deductions for this fund were correspondingly increased or decreased when the plan was over-fulfilled or under-fulfilled. The accumulated money was used to build new houses for the workers, for the reconstruction of old apartment buildings and for the acquisition or building of health or vacation facilities. The *material incentive fund* was formed similarly to the fund for social-cultural measures and housing construction and served as a source of bonuses paid to workers and officials.<sup>20</sup>

### **Limitations on other forms of ownership**

The principle that property rights were strictly linked to the plan and purpose applied to property that was held by manufacturing collectives and social organizations as well as to state property. Thus a *kolkhoz*, which had legal personality, owned the business installations, machines, vehicles, livestock and the agricultural products thereby engendered, but it could not deal with this property just as it liked. In respect of “its” property the *kolkhoz* had only the powers consistent with its role in the national production plan. Thus the *kolkhoz* could not by itself dispose of objects in the basic fund. It could not, for example, lease out an orchard or sell a harvester in order to pay for deliveries of fertilizer or satisfy the wage-claims of farmers in the *kolkhoz*. The powers of the *kolkhoz* over its agricultural products were subject to special regulation: products had to be sold to the state in the quantities and at the prices fixed by the plan. Only the excess could be disposed of in the so-called *kolkhoz* markets. Thus collective socialist ownership, just like the “right of operative management,” conferred only rights and powers required by the plan and purpose.<sup>21</sup>

There were functional limitations also on the *personal property* of Soviet citizens. Citizens were not directed what they must do with their property by a general plan, as was the case for state enterprises and collectives. However, the powers of personal ownership were negatively restricted. Article 5 of the *Fundamentals of Soviet Civil Legislation* contained the general rule that civil rights were only protected so far as “their exercise [did] not contradict their purpose in socialist society in the period of communist construction.” Article 25 clarified this, stating that the personal property of citizens may only serve “to satisfy their material and cultural needs” and may not be used by them “to derive unearned income.”<sup>22</sup>

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20. *Ibid.*, pp. 101-02.

21. Zweigert and Kötz, *An Introduction to Comparative Law*, 1: 333.

22. *Ibid.*

It was an on-going issue to determine whether a citizen was using his or her personal property "to derive unearned income." For example, it would have been practically feasible for an enterprising citizen secretly to run a profit-making horticultural business in his or her garden, or for a mechanic to refurbish a discarded machine and hire it out. Such cases were frequently reported in the Soviet press. Household articles also provide interesting examples of the indeterminacy of this limitation on personal property. Citizens could use items such as furniture, clothing, motor vehicles and sewing-machines only for the satisfaction of their personal needs. A citizen could lease such objects to others, but the hire could not exceed the value of the loss of use or depreciation. As soon as the agreed rent contained an element of "profit" and the letting out was for a business purpose, it became impermissible and was punishable under some circumstances. Zweigert and Kötz relate the apparently well-known case of a mechanic named Poliakov, who was given a motor car as a bonus for his exertions in the construction of a motor vehicle factory. He rented the car to a state enterprise but after about a year had to commence legal action to recover outstanding instalments of rent. The Supreme Court of the USSR held the contract void as being directed to procuring unearned income. The car was confiscated.<sup>23</sup>

The citizen did not have an unlimited right to sell the objects of his or her personal ownership. Citizens were entitled to sell their chattels for a price and to keep the proceeds in their savings accounts or use the money to buy other objects they needed. However, the matter was different when goods were sold at a price higher than that paid for them. If the citizen did this regularly the contracts involved were void and he or she could be prosecuted for "speculation."<sup>24</sup> "Illegal private trade" presented great problems in a planned economy where the production of consumer goods fell far behind demand. The courts of the Soviet Union were constantly occupied with them.<sup>25</sup>

### Land

It will be recalled that according to Article 6 of the 1936 *Constitution* of the USSR land remained state property.<sup>26</sup> However, according to Article 106 of the *Civil Code* of the RSFSR the citizen could hold a dwelling or part of a dwelling in personal ownership. The land on which the house was built did not and could not be owned by the citizen. For the purposes of this paper, this aspect is very instructive in respect of applicable legal princi-

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23. *Ibid.*, pp. 333-34.

24. See Article 154 *Criminal Code* of the RSFSR.

25. Zweigert and Kötz, *An Introduction to Comparative Law*, 1: 334.

26. Set out in text above, following note 10.

ples, however, as a practical matter most of the population of the USSR was housed in state apartment buildings and private buildings were of less importance, as were residential collectives.

Nevertheless, it followed from the legal principles that there could be no formal private transactions with title to land. Any purported sales, mortgages or leases of land were void. However, land was “handed over for use” to individuals as well as to *sovkhozes*, *kolkhozes*, and other state, cooperative or social enterprises and organizations. The importance of “use rights” in socialist property law is generally under-estimated. This area of the law was re-codified in the *Fundamentals of Soviet Land Law* of December 13, 1968, setting out the legal position of the user of land and laying down the conditions under which a transfer of use rights might take place. Under this law, land was never handed over to a land user to use simply as he or she wished, but only for particular purposes expressly laid down for the individual case by the relevant authorities. The user of land was not only entitled but was actually obliged to use the land for the purpose for which it was granted. If the land was not used as required or was managed in a way inconsistent with the detailed rules for proper land use, the state could withdraw the right to use the land. Priority was given to state organizations and collectives such as *kolkhozes* and associations for building dwellings and gardens. In the mid-1970s grants of land for use by individuals were restricted, especially in the large cities and where the citizen wanted the land for the construction of a summer-house, or *dacha*, rather than a dwelling.<sup>27</sup>

There were also limits on the citizen’s personal ownership of the building that constituted a dwelling-house or part of a dwelling-house. A citizen, along with his or her resident spouse and children, could have only one dwelling-house or part of a dwelling-house at a time. However, one could own a *dacha* as well. According to the law of the RSFSR, the living area of a dwelling house could not exceed 60 square metres, although if there were many children in the family the authorities could grant additional living space. If the citizen or a member of his or her family acquired another house by succession or otherwise, one of the dwellings had to be sold within a year. If this was not done, the authorities could force a sale. The proceeds were to be transferred to the expropriated owner. The letting of dwelling-space normally produced unearned income and thus was to be forbidden. However, in view of the housing shortage the state had to encourage the owners of dwellings to let other citizens live in them, so leasing was permitted, provided the rent did not exceed by more than 20 percent the unit rents laid down by the state.

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27. Zweigert and Kötz, *An Introduction to Comparative Law*, 1: 334.

The sale of dwellings and parts of dwelling-houses was permitted, provided that it was not done commercially in pursuit of gain. To prevent this, Article 238 of the *Civil Code* of the RSFSR provided that no person was permitted to sell a house or part of a house more than once in three years. When ownership of the dwelling was transferred, the use rights with respect to the land on which it was built automatically passed to the transferee. Although neither title to the land nor the use rights could be sold, in practice, despite all state controls, the purchase price of the building included an element for the situation and amenity of the land in addition to its value. In consequence, a citizen with good connections who acquired free of charge from the state the use rights with respect to a plot of land in order to build a dwelling was able to erect a building of very low value and then sell it at a far greater price to someone who was really interested in acquiring use of the land. Battles waged constantly in the Soviet press against popular “tendencies to private ownership” suggested that the rules concerning personal ownership of dwelling houses were not applied strictly in practice, especially with respect to more influential citizens.<sup>28</sup>

It is an interesting question whether the use rights with respect to land were a form of property. They are from time to time described as *usufructuary*. In a European legal system this would suggest a proprietary right. As with other objects of state ownership,<sup>29</sup> on the other hand, largely for ideological reasons, the Soviet legal system was set against formal recognition of the fragmentation of ownership into lesser proprietary rights. However, what one could do with the use rights and their importance in the lives of citizens suggests that they were extremely valuable rights and within another ideological structure they would have been recognized as proprietary in nature, even if less than ownership.

### **Development of and dilemmas in the *Soviet Property Model***

Having set out what we mean by the *Soviet Property Model* we shall now set out to provide some more texture to the picture by recounting how it developed and issues debated about it.

In the aftermath of the 1917 Revolution the Soviet legal profession was faced with the vital questions: What kind of law, if any, should regulate socialist society and economy? What is to be done about law when the socialist state moves further, to true communism?

The Soviet legal system experimented radically with the balance that is found in all European legal systems between *public law* and *private law*, which is also referred to as *civil law*. All Soviet models strongly favored

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28. *Ibid.*, 1: 335.

29. Discussed with respect to the “right of operative management,” in text below, following note 34.

public law, and particularly administrative law, as one would expect in a planned economy based on state ownership. The question of whether there could be a “socialist civil law” in contrast to “bourgeois law” was one of the main points of debate in the 1920s, 1930s, and again in the 1950s. As explained above,<sup>30</sup> private property is an institution of the civil law, which also deals with the law of contract, and many thought that both would disappear in a socialist planned economy or certainly a communist society.

This view attributed insufficient importance to the need for state enterprises and private individuals to enter transactions with each other about the use of even minor resources as economically independent actors. Basing economic relationships on contract, and even some private property rights, was briefly revived during the period of the New Economic Policy [NEP] of 1921-28. The thought that law might disappear altogether failed with consolidation of the Soviet state under Stalin, who rediscovered the usefulness of law as an instrument of power.

The 1936 *Constitution* of the USSR set out a structure for the *socialist ownership* of resources by the state and state and public organizations, such as collective farms and cooperatives. State ownership was a surrogate for socialist ownership by all The People. State and public organizations held socialist property only for the purposes of the relevant state economic plan. Only personal and domestic items could be objects of personal ownership.

Article 6 of the 1936 *Constitution*<sup>31</sup> provided a most extensive definition of the assets in the ownership of the state. As explained above, at the level of ideology and legal principle, the state held exclusive ownership and fragmentation of property rights was not acknowledged. However, in reality, state owned assets did not all have the same status with respect to rights over assets. Viewed practically, there was a “ladder” of powers over property, some more exclusive than others. There were groups of assets that were managed *directly* by the state with the help of the governmental agencies, acting not in their own name but on behalf of the state.<sup>32</sup> In respect of those assets, in the view of Ioffe and Maggs, the state remained the *right*

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30. See text above, following note 4.

31. Article 6 is set out in text above, following note 10.

32. O. S. Ioffe and P. Maggs, *Soviet Law in Theory and in Practice* (SLTP) (New York: Oceana Publications, 1983), p. 157. These were: 1) objects of exclusive State ownership, such as land, its resources, water, forests; 2) money which was the subject of budget appropriations before it was distributed among economic and other organizations; 3) all other objects, which were reserved from distribution among economic and other organizations (such as State reserves of consumer goods, technical supplies, etc.) to be distributed among economic and other organizations at a later point, such as newly built factories, power plants, etc, still in the hands of the State pending formation of a new autonomous enterprise or other economic organization to hold and manage them for economic or other purposes.

*holder* and dealt directly with other parties through agencies which represented the state.<sup>33</sup>

A leading legal theorist of the Stalinist era, Vyshinsky, put forward a concept of Soviet socialist civil law that could embrace property relations between citizens, between the citizen and a state or public organization, as well as between state and public organizations themselves, when the underlying relationship fell outside administrative management. This opened the way to formulation of quasi-ownership rights even in respect of state enterprises. However, even with recognition of an expanded role for civil law, the Soviet concept of ownership remained subject to prevailing norms developed by administrative management in central planning authorities.

In his post-war theory, Venediktov recognized that, as a matter of practice, the state ownership of state enterprises led to a division of “ownership” in all but name between the central state ministries and the enterprise. He developed a theory of *operative management* in which the state enterprises held the rights of possession, use and disposition, conventionally attributed to ownership. Those rights still had to be exercised for achievement of the plan and could be curtailed through the administrative prerogatives of central planning authorities. Berman has pointed out that Venediktov developed the distinction between rights over property derived from “operative administration” and the powers associated with the property right of “ownership” so that the actual benefits of ownership, the “incidents” of ownership, namely possession, use and disposition, could be vested in the enterprises, while maintaining the fiction of unitary ownership by the state.<sup>34</sup> As to the extent of operative management, Ioffe argued that since the late 1920s the legally permissible limits of such administration of assets had been steadily restricted, although the 1965 economic reform gave economic entities some new rights with respect to property. This reform enlarged the limits of operative management by encompassing some incentive funds.<sup>35</sup> The state was considered to be exercising its ownership of assets, in respect of which an enterprise held a right of operative management, by providing fixed and circulating (turnover) assets to the enterprise and through central planning of the enterprise’s production and distribution.

A prominent aspect of the Soviet system was the abolition of free contracts entered by economic agents in favor of obligatory contracts entered by enterprises with specified production objectives defined under a central

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33. *Ibid.*

34. H. J. Berman, “The Possibilities and Limits of Soviet Economic Reform,” in O. S. Ioffe and M. W. Janis, eds., *Soviet Law and Economy* (Boston: Martinus Nijhoff Publishers, 1987), p. 33.

35. O. S. Ioffe, “Soviet Law and the New Economic Experiment,” *ibid.*, p. 23.

plan. In the Soviet system contracts were the “means for detailization and concretization of the planning tasks.”<sup>36</sup> The parties were unable to relieve themselves of their contractual obligations either by unilateral acts or by mutual agreement, or even to change the terms of a contract.<sup>37</sup>

Higher governmental agencies could administer assets held by a state enterprise side by side with the direct holder of them.<sup>38</sup> In the terminology of Ioffe and Maggs, the government agency held the *right of ordinary administration*, while the state enterprise was the *right-holder of operative administration*.<sup>39</sup>

The state enterprises had rights of property protected by the law in so far as the state organization, as the right-holder, could recover its belongings from another organization. However the structure reveals a conflation of the legal ideas of ownership and property. The consequent limited ability of relatively autonomous economic actors, such as state enterprises, to assert rights over “their assets” against third parties without calling upon higher levels in the bureaucracy to enforce the relevant economic plan emphasised the contradiction within the structure.

The right of operative management was applied to “monetary commodity” transactions excluding those involving land.<sup>40</sup> Private property in land was abolished by the famous Bolshevik Decree on Land, leaving land as an object of *exclusive* state ownership. There could be personal ownership

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36. Hazard *et al.*, *The Soviet Legal System*, p. 266. Contract assisted: 1) the preparation of plans for enterprises were encouraged to make contracts with each other even while the plans were still being drafted; 2) concretization of plans by fixing details of the exchange of goods or services left out of the plan; 3) the execution of plans through material interest of enterprises in the performance of contracts: Zweigert and Kötz, *An Introduction to Comparative Law*, 1: 350.

37. P. S. Romashkin, ed., *Fundamentals of Soviet Law (FSL)* (Moscow: Foreign Language Publishing House, 1961), p. 199. The disputes over contract were settled by an arbitration board (Romashkin).

38. “For example, a ministry can redistribute buildings and structures among subordinate organizations as well as industrial associations can withdraw surplus equipment or raw stuff from one of its production associations and transmit them to another. Planning tasks ordered by the same agencies, determining goals of production, involve administration of property not to lesser extent than the productive activity of those who administer this property and use it in conformity with the established plan.” (Ioffe and Maggs, *Soviet Law in Theory and in Practice*, p. 163).

39. *Ibid.*, p. 164. Moreover each economic organization had several property kinds, subordinated to various legal regulations, such as, buildings and installations; basic assets; circulating assets; money funds; incentive funds, introduced in 1965: *ibid.*, pp. 164-67. In Mironov’s view, the “workers’ collective” of the enterprise had legal ownership of the incentive funds, constituting another kind of socialist ownership: Iu. K. Tolstoi and V. F. Lakovlev, *Pravo Sobstvennosti v SSSR* (Moscow: Iuridicheskaja literatura, 1989), p. 95.

40. S. N. Bratus held that the right of operative management and the right of land use were not dissimilar (*ibid.*, p. 59).

only of buildings erected on the land. Quasi-proprietary *use rights* were recognized for those legitimately holding possession of land. Especially extensive were agricultural use-rights of collective farms and state agricultural enterprises. Land holding thus in reality also displayed elements of divided ownership.

Paradoxically, even socialist enterprises with full legal ownership rights, such as collective farms, could have their ownership rights curtailed by central planning authorities. Except with respect to money, which had to be deposited in a state bank or sent to the centralized funds, the right of possession was held by the collective farms. However, the collective farm could use its property only in accordance with the pre-determined destinations assigned to different kinds of assets.<sup>41</sup> In the view of Ioffe and Maggs, “collective farms declared owners [had] no more property rights than economic organizations of the state declared non-owner.”<sup>42</sup> As with other forms of cooperative property, so far as a collective farm was originally set up with the property of individual members, in a legal sense, it constituted separate legal ownership. However, so far as the collective farm property was “socialist property” it was under similar limitations in respect of its ownership rights as were other enterprises in the “planned economy.” The collective farms’ free use of state land makes this parallel with the state enterprises even stronger. Already, according to Article 8 of the *Constitution* of 1936, land was secured to the collective farm for use free of charge and for eternity.

We may therefore identify the following apparent deficiencies and contradictions within the *Soviet Property Model*:

- indistinct definition of property rights and conflation of property with ownership;
- exclusive ownership of state enterprises and land by the state as a surrogate for socialist ownership of the means of production by all of The People;
- overwhelming reliance on public law, and particularly administrative law measures to govern relationships between the state central planning authority and the enterprises under its administrative control, with very little recognition of a role for the capacity of the civil law to allow

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41. Ioffe and Maggs, *Soviet Law in Theory and in Practice*, p. 160. The duty to create numerous funds narrowed the right of disposal, especially in face of the obligatory sale of products to the state within the limits of the plan and beyond its limits. Only the sale of a product in the market or through consumer cooperatives involved the right of disposal, which was possible only after performance of all other economic duties, and then the money gained was to be spent in the order established and for pre-determined aims (*ibid.*).

42. *Ibid.*, p. 160.

economic agents with equal legal rights to arrive at legally enforceable arrangements between themselves;

- a functional conception of the powers associated with property tied to implementation of economic plans, in turn based on a public law model with deliberate limitation of civil law rights, as well as constitutional civil rights.

Nevertheless, although not formally recognised as a form of property within the system, the rights recognised in practice with respect to assets and resources were highly valuable.

### **Transplantation of the *Soviet Property Model***

The early post-war years saw rapid growth in the number of socialist republics, from East Germany to China. Rather than re-inventing the legal system of state socialism, the *Soviet Property Model* described above, with all of its ideals, illusions and dilemmas, was transplanted in a relatively intact form to most of the new republics.

In some places, however, it appears that the 1917 Bolshevik slogan “factories to the workers” retained influence. This interpretation was most strongly represented in development of the Yugoslav concept of “social capital.” There the legal status of a “social capital enterprise” fell somewhere between the Soviet model of state ownership and collective-cooperative ownership. The property managed by Yugoslav enterprises, like all means of production, was held in *social ownership* rather than state ownership. The conceptual differences between the two remain elusive. Yugoslavia also developed its own model for the organization and governance of enterprises. The enterprises were run by collectives of those who worked in them and were managed without much state intervention. Thus, formally, they were entitled to use their property pretty much as they chose and could dispose of it quite freely. In sharp contrast to the Soviet Union, the assets under their control could only be taken away by the state in pursuance of a law and in return for equitable compensation, though the freedom of disposition was not unlimited.

The economy of Hungary also displayed significant elements of a market economy following the reforms of 1958.<sup>43</sup>

A variation of the “social enterprise model,” embracing employee participation in management decisions, emerged in Poland in the 1980s as a result of the *Solidarity* pressure. In the very late 1980s, there was also a shift toward employee ownership in the Soviet Union.

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43. Zweigert and Kötz, *An Introduction to Comparative Law*, 1: 332.

### **Dismantling the *Soviet Property Model*: The privatization of property in former socialist legal systems**

On one side, state property could never have been so decentralized as to become the property of all. On the other side, the centralization of state property proved to be illusory as the limits of bureaucracy were discovered and economic actors exercised quasi-proprietary rights. If the dismantling of the paradox demonstrated anything, it was that some were more equal than others in respect of the property of The People held by the surrogate socialist state.

Two approaches to privatization in socialist systems may be identified: an economics-based schemes for the sale of assets, and a rights-based translation into Western property concepts of the relationships of people to resources that formed within the *Soviet Property Model* as a matter of practice.

Examples of the first approach can be found in a number of *voucher privatization schemes* implemented in the Eastern Europe in 1990s. In one sense, the socialist idea of *ownership of the means of production by all of the people* found its last incarnation in the distribution of vouchers to the population as a representation of their individual shares in the whole. The vouchers could then be invested in the public assets that were put on sale. This and other schemes struck new dilemmas, such as more favorable treatment of employees above domestic small investors above foreign investors. They led to a dispersal of ownership that hindered control by operators with better business acumen or experience in Western commercial methods. On the other hand, once control was obtained, perhaps by influence rather than ability, the absence of a comprehensive system of property rights and legal protections of minority shareholders lent itself to asset stripping and a second wave of privatization in which small investors floundered. Even in the highly regarded Czech privatization scheme, secondary privatization brought the dominance of some well-connected shareholders at the cost of the mass minority shareholders, who were squeezed out. Other identifiable economics-based schemes include “insider privatization schemes,” “selective (direct) privatization,” and the commercialization approach that commenced in Hungary in the early 1980s.

It might not be surprising that simultaneously decentralizing property rights and protecting them appears to have been more difficult to achieve under economics-based approaches. Economics-based approaches appear generally to have displayed these aspects:

- absence of respect for formal structures as well as the less formal normative patterns followed by stakeholders in legitimate resource use;

- conviction grounded in abstract economic models that an *efficient* system of property rights would arise spontaneously once assets were distributed to players in a market;
- lack of support for preparation of appropriate legal structures, and especially systems of property law;
- undue orientation to the big picture and the struggle of grand narratives at the expense of the fate of citizens and their valuable rights.

The rights-based approach was perhaps best exemplified in former East Germany,<sup>44</sup> which provides a special, even privileged example due to the unification process with the wealthier former West Germany. There legal structures were carefully put in place and further refined, providing:

- restitution of, or compensation for expropriated property;
- translation of the formal and informal rights of East German citizens under socialism, in land for example, into the comprehensive framework of German civil law;
  - the orderly sale of state enterprises;
  - a timetable for bringing administration into compliance with constitutionally guaranteed civil rights in staged steps.

The plan for future directions in this project is to amass a sound body of knowledge about privatization in the legal systems of former members of the Socialist Legal Family and analyse it within comparative legal methodologies. At present we are particularly interested in the experience of the process in Russia, the former East Germany, Lithuania, Czech Republic, Poland, Hungary, People's Republic of China, and the former Yugoslavia.

This will be drawn upon in evaluating what can be regarded as a successful program of privatization and the steps needed to achieve it. We have set out below trends identified in our work to date.

### **The choice of privatization schemes**

Among the wide variety of privatization approaches that have been implemented in Eastern Europe, a limited number of significant models or alternatives might be identified. Identification is assisted by posing the following key questions:

- Was it “large scale” enterprise or “small scale” enterprise privatization?

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44. See generally, R Stürner, “Das Grundstücksrecht der neuen Bundesländer,” in J. F. Baur and R. Stürner, *Sachenrecht*, 17th ed. (München: C. H. Beck'sche, 1999).

- Was it “mass privatization” or “selective privatization”?
- Was it privatization through the distribution of “vouchers” or by commercial sale for a purchase price?
  - Were residents and domestic investors treated preferentially?
  - Were employees of the privatized enterprise treated preferentially?
  - As to the concrete mechanism of privatization, was it by auction (centralized or decentralized), public offering of shares, sale by way of tender, or something else?

What has determined the choice of the privatization approach? One hypothesis might be that the state of pre-privatization property rights affected choice of the eventual privatization process. So, the countries that endured an all-embracing state nationalization program were to be the countries most likely to undertake radical privatization, in order to re-establish the legal position of private property rights as the foundation of society as quickly as possible.

There were a number of unresolved issues with respect to property rights in former socialist countries, as outlined above. The dominant type of ownership was so-called *socialist ownership*. It contrasted to *personal ownership*, which was supposedly rooted in one’s own labor. There were two categories of socialist ownership – (1) state ownership, and (2) ownership by collectives. The main unresolved issue was the concept of state property itself as property of “the whole people.” On one hand, after the years of socialism, the concept of state ownership was seen as an inefficient and irresponsible method of “bureaucratic ownership.” On the other hand, there was lingering feeling that state property, at least in theory, did belong to “the people.” So “mass privatization,” which was effectively *free* privatization, was developed, in which vouchers were distributed to the people representing their share in the old order, with which they could purchase shares in specific assets. The *voucher privatization scheme* could be seen as a fair way to return state property to “the people,” in a sense a method of “restitution” to the society as a whole. Another feature of the scheme reflected its basis in the idea of ownership by “the whole of the people”; this preferential treatment of the citizens allowed more favorable opportunities above those allowed to foreign purchasers. Moreover, if the aim of privatization was to foster changes in the structure of domestic ownership, considering the lack of savings among the general population, in contrast to the far greater value of assets to be privatized, there were no clear alternatives to some form of *entitlement privatization*.

Not everybody saw it that way. Janos Kornai viewed voucher privatization as a substitution of “impersonal state ownership with an equally im-

personal private ownership.”<sup>45</sup> Voucher privatization was, then, seen as creating inefficiencies associated with the dispersal of ownership. The alternative to voucher mass privatization was the direct sale of selected enterprises.

Another claim to share in assets that was grounded in the socialist concept of ownership was the expectation of the workers of enterprises that they held some ownership rights in “their” enterprises. Thus, there was a tendency to give preferential treatment to the employees in the privatization of their enterprises. This was not only true in regard to the collective forms of ownership, but also to a degree in regard to ownership of state enterprises with separate legal personality. This tendency to see socialist ownership as “collective” property in practice conflicted with the tendency to treat such ownership as a form of property of “the whole of the people.”

One phenomenon of the early post-Socialist years was so-called *spontaneous privatization*. This took place in the ambiguous legal environment of the late 1980s, when managers of state-owned enterprises were gaining growing autonomy from the central administration. The valuable assets were “leased” to the enterprises established and controlled by the managers.

The privatization of small enterprises, such as those operating in retail trade and services, has been termed so-called *small scale privatization*. It was comparatively simple in realization, since it did not require the preparation of significant documentation by the authorities, or money resources on the part of prospective buyers. Small scale privatization could also resemble “entitlement” privatization if the employees were allowed to acquire property on preferential terms. Small scale privatization could be described as *pre-privatization*.

### **Mass voucher privatization**

Mass voucher privatization was almost a universal phenomenon in post-socialist countries, the most notable exceptions being Hungary, Serbia and, with some qualifications, Poland.

There were two main reasons behind this approach: the desire for social justice, and the overhauling of the property rights structure. The common principles were: predominantly free redistribution of property rights and inclusion of most of the domestic population in privatization initiatives.

However, there were some variations in the approaches taken to mass privatization in different countries. These will be discussed in turn under the following headings:

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45. J. Kornai, *The Road To A Free Economy: Shifting from a Socialist System – The Example of Hungary* (New York: W. W. Norton, 1990), p. 91.

1. *Method of mass privatization*, encompassing the presence or absence of:

- a list of enterprises to be exempted from the mass privatization program, or
- a requirement for sale of a certain share of the capital of enterprises in exchange for vouchers tendered by the outside public.

2. *Preference schemes for employees*.

3. *Terms of participation*, encompassing the presence or absence of a charge for the acquisition of vouchers; the choice of voucher-only privatization schemes, or voucher-plus-money privatization schemes, a system of “points” or money denominations for the vouchers, and the presence or absence of transferability of vouchers.

4. *Mechanism of privatization* that was chosen: auctions (centralized or decentralized), offer for public sale, sale by tender, and so on.

### **Czech mass privatization program**

The Czech mass privatization program of the early 1990s was one of the most inclusive and least discriminatory, thus supposedly coming closest to the objective of social justice.

#### *Method of Mass Privatization*

There was no list of special industry enterprises to be excluded from privatization. Up to 97 percent of the shares could be included in a voucher privatization scheme.

#### *Preference Schemes for Employees*

It had no provision for preferential treatment by privatizing an enterprise to its employees.

#### *Terms of Participation*

All adult citizens were entitled to receive a voucher after a subscription fee of US\$35. However, vouchers were nominated in “points,” not money and were non-tradable. Citizens could use their vouchers to buy shares in any share company included in the listed privatization projects or to acquire participation in commercial companies founded especially for this purpose. As it happened, the public, rather than participating in a national auction to acquire shares in concrete enterprises, turned their vouchers over to privatization investment funds that emerged spontaneously; in particular, those created by the banks with majority state ownership.

### *Mechanism of Privatization*

The preferred mechanism of privatization was a centralized auction process, proceeding in a series of rounds under supervision of the Ministry of Finance's price-setting committee.

The outcomes of privatization were mixed. By the late 1990s the state still held majority stakes in the major utilities and had majority ownership in 40 large firms and banks that were considered strategic, as well as the majority shareholding in 30 non-strategic firms. Moreover, the dispersed ownership that resulted from more "socially just" initiatives was, in the second part of 1990s, transformed into concentrations of ownership that formed at the expense of the mass of small shareholders by means that could on occasion be described as corrupted. One reason was the weak protection of small shareholders and the comparative ease with which large shareholders could achieve dominating control under Czech corporate law. Another reason was weak financial market regulation, which did not require disclosure of information about the level of shareholding acquired and changes of ownership.

### **Russian mass privatization scheme**

#### *Method of Mass Privatization*

Russian privatization was not all-inclusive in regard to enterprises to be privatized. Enterprises with more than 10,000 workers were exempt from the mass privatization program, as well as "special interest industries."

#### *Preference Schemes for Employees*

The Russian privatization program assigned preferential positions to employees. The managers and workers of privatizing enterprise acquired the right to buy 51 percent of shares. Twenty-nine percent of shares in all privatized enterprises were to be sold in auctions to the public.

#### *Terms of Participation*

In Russia the vouchers were in effect distributed free to all citizens, including children. Vouchers were denominated in cash (10,000 *rubles*) and were tradable. They could be turned over to a private voucher investment fund, or could be used personally to buy shares in one's own company or at the voucher auction of any privatizing company.

### *Mechanism of Privatization*

At an early stage of privatization decentralized regional auctions took place, later supplemented by central and inter-regional auctions.

The Russian mass privatization scheme discriminated strongly against outsiders, thus consolidating insiders' positions in privatized enterprises at

the expense of uninformed outsiders. As a result, managers and workers controlled about two thirds of the shares in the average privatized firm. Nevertheless, the greatest resentment to privatization was actually excited by the next stage of privatization in 1995-1996, when selected enterprises were effectively privatized by so-called oligarchs in exchange for loans to the government. Still, the mass privatization did not create a new class of small owners, nor were small investors' property rights sufficiently protected in the law. Ironically, as later experience showed, the oligarchs, or any dominant shareholders, were not themselves protected from hostile take-over in the absence of transparent financial regulation, reliable corporate law or an impartial court system with sufficient expertise in commercial legal issues.

### **Lithuanian mass privatization scheme**

#### *Method of Mass Privatization*

The Lithuanian mass privatization program was not all-inclusive in the choice of enterprises to be privatized, aimed to allow the private sector to dominate in industry, construction, trade, consumer services and agriculture, while leaving energy, communications, and, to a great extent, transportation, in state ownership.

#### *Preference Schemes for Employees*

Lithuanian privatization provided for preferential treatment of employees. Initially, 10 percent of the shares, later increasing to 50 percent, of privatized state enterprises were to be sold to the employees, at nominal value. A further 11 percent were to remain with the state and the remaining 39 percent of capital were to be freely sold.

#### *Terms of Participation*

Vouchers were distributed universally but valued relative to the age of the recipient (citizens, who were 35 years or older, received vouchers with the initial face value of 5,000 *rubles*; those under 18 years received vouchers valued at 1,000 *rubles*). "Investment vouchers" were held in special accounts for investment vouchers that were opened with the national savings bank and accessed by a special passbook. Initially the vouchers were denominated in *rubles* and were non-tradable but later, with the introduction of the new national currency, the vouchers were denominated in *litas* and became tradable.

#### *Mechanism of Privatization*

Most enterprises were privatized by share subscriptions, without restriction on the number of buyers, or on their qualification, or on the

amount of shares purchased, or were sold at auctions. Auctions were later conducted by mail with the submission of price offers in advance, thus resembling a sale by tender.

Lithuanian privatization discriminated against outsiders in so far as employees could gain control of up to 50 percent of the share capital of an enterprise. At later stages of privatization, less transparent closed subscriptions for shares and closed auctions were introduced. Still, mass privatization in Lithuania did not produce the degree of resentment comparable with that in Russia.

### **Summary on mass privatization of the early 1990s**

Mass privatization had the appeal of promoting social justice with regard to society as a whole, in so far as every member of society in theory held a “restitution” claim against state property. In practice, the principle of social justice could be understood as providing equal opportunity in the privatization process for all participants.

However, there were several distortions in the process of privatization as it concerned the position of outsiders:

- The scope of privatization could be limited and some enterprises exempted from the privatization.
- There could be sometimes extensive provisions for the preferential treatment of insiders.
  - There could be provisions for restriction of trade in vouchers.
  - There could be provisions discriminating against outsiders in the concrete mechanism of privatization, such as restrictions on participants in an auction.

Moreover, the general presence of asymmetrical information, or transaction costs, in any transaction would objectively discriminate against the mass of inexperienced voucher investors taking part in the privatization scheme.

Aside from considerations of social justice, another appealing aspect of mass privatization was in the speedy creation of a system of decentralized property rights. However, the system of decentralized property rights has also been seen as an ineffective system that dispersed ownership, hindering the necessary restructuring of privatized enterprises. There could be several instances of such inefficiency. For example, if voucher privatization allowed insider managers to participate and remain, the former managers of state enterprises could be seen as more interested in keeping employment than in restructuring. Besides, some vestige of residual state control rather than decentralized ownership might be preserved, so the privatized enter-

prises were still ultimately under state control; for example, via state residual control of investment funds established for investment of vouchers by citizens who did not wish to trade on their own behalf.<sup>46</sup> Even in a case of fair and non-discriminatory mass privatization, with a widely dispersed structure of ownership, the absence of a “strategic” investor, at least initially, would also hinder restructuring. There probably was a tendency for privatized enterprises in the long run to find “strategic” investors anyway, through development of the secondary share market.

Still, in retrospect, mass voucher privatization did not live up to the high hopes that it inspired. It did not deliver social justice, since small shareholders were outcasts without protection. It did not create an effective secure structure of property rights; for example, the new owners could not be free from the fear of hostile take-over and the consequent insecurity of their positions as minority shareholders.

### **Employee privatization schemes**

#### *Serbia*

By mid-1991 the Republic of Serbia adopted a law governing the transformation of social property into other forms of ownership. The law implemented a revised “insider privatization scheme” with discounts for employees at 20 to 60 percent. Only a few firms attempted privatization through this scheme. At the same time, a process for the transformation of social capital enterprises back into state owned enterprises was set in motion, involving 33 percent of Serbia’s social capital and a 10 percent share of the entire Serbian capital held in state ownership. The 1994 *Revaluation Law* made it more difficult for enterprises to finance insider privatization, with some previously privatized enterprises being restored to their socially owned status. The *Ownership Transformation Law* again followed an “insider privatization scheme,” with 60 percent of the equity going to current and former employees, and then to pensioners and farmers.

The especial feature of Serbian privatization in the late 1990s was the emphasis on elimination of social capital enterprises. This development reflected the ambiguous nature of ownership of social capital enterprises as economically independent legal entities with control over state owned assets. Another feature of the Serbian 1990s experience was preference for “insider scheme of privatization” discriminating against outsiders. “Insider” privatization was not aimed to bring in a “strategic investor” to modernize the enterprise (although a major, or strategic, investor might emerge eventually through “secondary privatization”).

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46. See text below, for example, with respect to *Selective Privatization* in Poland.

## **Selective privatization**

### *Serbia*

The Serbian *Privatization Law* of 2001 was aimed at attracting strategic investors and large partners. However, there were still provisions for preferential treatment of insiders. The two major mechanisms of privatization were outlined in the law: tenders and auctions. Tender sales were intended for attractive medium to large socially owned companies. Auctions, with their simpler application procedure and low investment and social requirements, were meant for small and medium sized enterprises, targeting local investors, including managers, as well as foreigners.

### *Hungary*

The essential feature of Hungarian privatization was its main reliance on “traditional” approaches to privatization, as undertaken world-wide, aimed at “outsiders” with the necessary capital strength. The mechanisms of “traditional” privatization could be direct sales, public auctions, public tenders and the public issue of shares. The focus was on relatively gradual commercial privatization involving larger investors and attracting foreign investors, with the initial 1990 target to privatize 50 percent of state owned assets (by value) by 1994.

Aside from Yugoslavia, Hungary had been exceptional among the socialist countries in her efforts to move away from a centrally planned economy. Economic management reforms were launched as early as 1968. The emergence of small private business was legalized from the early 1980 and was encouraged.

### *Poland*

In 1991 a scheme was announced to privatize 400 (later increased to 500) of the largest Polish state enterprises through the establishment of National Investment Funds (NIFs). The creation of private investment funds was prohibited. The NIFs were to accept vouchers distributed to the population, since initially vouchers could not be invested directly in privatized stock. Only fifteen NIFs were accredited. They were to retain a controlling 33½ percent stake in each of the privatized enterprises. Until late 1998 the Polish government held the majority of voting power in the NIFs, providing some reassurance for minority shareholders against mistreatment by controlling shareholders.

Poland did not have a disastrous experience of privatization, though it was a rather slow and limited process. In Poland favorable conditions were created for the establishment of new businesses, which was positive for development of a market economy. One such crucial step was to lay down legal conditions for the protection of private property, including transparent

records of ownership, high disclosure standards, restrictions on “creeping control” acquisitions that preclude a shareholder from assembling a controlling shareholding without tendering for all shares. In Poland such steps were found to be more important for achieving a market economy and sustainable privatization than unprepared massive and rapid privatization.

### **Summary on selective (direct) privatization**

The common tendency in selective or direct privatization initiatives in the second part of 1990 was to promote the privatization process with the strategic investor in mind. However, just like mass privatization, selective privatization could be subject to discrimination, such as “conditions” on investment or employment. The public tender process, being a more regulated process in comparison with the public sale of shares or open public auction, give more opportunities for the pursuit of potentially inefficient privatization choices.

### **Conclusion**

*Ownership of the means of production by all of the people* appears to have found its last incarnation in the program of free voucher privatization, but the illusive egalitarian notion of ownership by the whole people haunted the employee programs of privatization as well. It was as if the outsiders were destined to lose out to the insiders. It appeared to be most difficult to achieve decentralization of property rights as well as their protection.

The idea of workers’ collective ownership was apparent in the “insiders” privatization schemes allowing for preferential treatment of the members of workers’ collectives or their management. The presence of a significant trend towards “entitlement” employee privatization in Russia (with the same trend obvious in some former Soviet republics, such as Lithuania), as well as the absence of such a trend in the Czech Republic could be viewed as manifestation of respective variations in adaptation of the state ownership concepts of the *Soviet Property Model*. Further, the dominance of the social employees’ ownership concept in Yugoslavia could explain the choice against a wide voucher scheme in Serbia. Just as the presence of employee ownership in Poland in the 1990s might be viewed as having placed a brake upon the implementation of mass privatization. Participation of workers in enterprise management might help to explain relatively successful implementation of management-worker buy-outs in Poland. Still, the insider privatization arrangements, by definition, discriminated against outsiders – the mass of “unprivileged” citizens. Moreover, where there has been a weak tradition of worker participation in management, such as in

Russia, insider privatization would lead mainly to control by managers, who might or might not be interested in restructuring the enterprise.

The presence of a relatively sizable “non-socialist” private enterprise sector, such as in socialist Poland, might assist the flourishing of new private enterprise.

Hungary was an exception among the former socialist countries in her rejection of the free distribution of state assets among its population in favor of commercial sale of state assets. Possibly, her trend towards commercialization of enterprises from early 1980s was one of factors responsible for the choice.

We have identified the following deficiencies and contradictions within the *Soviet Property Model*:

- Indistinct definition of property rights and conflation of property with ownership;
- Exclusive state ownership of state enterprises and land by the state as a surrogate for socialist ownership of the means of production by all of The People;
- Overwhelming reliance on public law, and particularly administrative law measures to govern relationships between the state central planning authority and the enterprises under its administrative control, with very little recognition of a role for the capacity of the civil law to allow economic agents with equal legal rights to arrive at legally enforceable arrangements between themselves;
- A functional conception of the powers associated with property tied to implementation of economic plans, in turn based on a public law model with deliberate limitation of civil law rights, as well as constitutional civil rights.

These undoubtedly led to deficiencies and difficulties also in the implementation of programs of privatization. However, they were not resolved by privatization processes unduly orientated to economics-based schemes in preference to careful translation into Western property concepts of legitimate, if informal, relationships of economic agents to resources that formed within the *Soviet Property Model* as a matter of practice.

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