STATE POWER, INSTITUTIONAL CHANGE, AND THE POLITICS OF PRIVATIZATION IN RUSSIA

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IN January 1992 Russia’s first postcommunist government launched a comprehensive economic program to transform the Soviet command system into a market economy. Privatization was and remains the heart of this plan. The original program had a clearly defined objective, namely, to create profit-seeking corporations, privately owned by outside shareholders and not dependent on government subsidies for their survival. As of two years later, however, this objective had not been achieved. By the summer of 1993 insiders had acquired majority shares in two-thirds of Russia’s privatized and privatizing firms, state subsidies accounted for 22 percent of Russia’s GNP, little if any restructuring (bankruptcies, downsizing, unbundling) had taken place within enterprises, and few market institutions had been created. During the

* The author would like to thank the Carnegie Corporation of New York for supporting the research of this article and Annelise Anderson, David Bernstein, Elizabeth Cousins, Larry Diamond, Lynn Eden, Jim Goldgeier, Arthur Khachikian, Sangeev Khagram, David Holloway, Sarah Mandelson, Donna Norton, Flavia Pellegrini, Tova Perlmutter, Steve Solnick, and Steve Stedman for comments on earlier drafts.


3 There has been only one recorded bankruptcy, while official unemployment, a key indicator in discerning the level of restructuring, is still less than .5%. See Leyla Boulton, “Bankruptcy Law Claims First Victim,” Financial Times, September 17, 1993, p. 3. On credits, see World Bank, Subsidies and Directed Credits to Enterprises in Russia, 11782-RU, April 8, 1993, v. On insider ownership, see “Obzor Invesstii i Privatizatsii,” Kommersant, no. 7, February 15–21, 1993, p. 16. For an overview of the lack of restructuring and unbundling, see Philippe Aghion et al., “Industrial Restructuring in Eastern Europe” (Manuscript, European Bank for Reconstruction and Development, London, April 1993).

World Politics 47 (January 1995), 210–43
first two years of its existence, the Russian state simply did not manage
to dismantle old Soviet institutional arrangements governing property
directors’ rights of large enterprises. Specifically, the state failed to implement
its original vision of privatization, enforce hard budget constraints for
large enterprises, or stimulate the creation of market-supporting institu-
tions such as a legal code regarding private property and corporate
governance or a social safety net. In sum, the allocation of property
rights according to market principles had not yet even begun to occur.

Why not?
This article argues that the particular set of institutions constituting
the Russian state was not capable of realizing the originally defined
objectives of privatization. Thus, during the Soviet era enterprise di-
rectors had de facto already seized many of the rights associated with
ownership of property. When these property rights were challenged by
the Yeltsin government’s privatization program, directors organized to
-defend their interests and were successful because of the particular in-
stitutional configuration of the Russian state at the time. Specifically,
these directors organized to capture the Congress of People’s Deputies;
this holdover from the Soviet era, initially ignored by the Yeltsin gov-
ernment, eventually reasserted itself as an important component of the
state in both defining and implementing state policies regarding pri-
atization. In the initial battles between the Russian government’s blue-
print for privatization and the interests of these directors’ interest
groups, societal forces from the ancien régime prevailed.

By examining privatization of large state enterprises, a critical com-
ponent of successful economic transformation in Russia, this article
seeks to explore more generally the relationship between state power
and revolutionary economic transformation. Section I first defines
state power and then makes an institutional argument for why a strong
state is necessary for bringing about rapid socioeconomic transfor-
mation, whether to a command or to a capitalist economy. Section II then
turns to the specific case study examined in this article—the reorganiz-
ation (of the lack thereof) of property rights in Russia. This section
describes the institutions, collective identities, and organizations in-
volved in the assignment and exercise of property rights in the Soviet

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4 This article focuses on the privatization of large state enterprises, which constitute the bulk of all
Russian property, and does not address the more straightforward privatization of shops, services, and
small enterprises.

5 The creation of private property rights (or the lack thereof) is therefore a subset or case study of
the larger phenomenon of economic transformation. Regarding postcommunist transitions, other de-
pendent variables within the larger set of economic transformation might include price liberalization,
macroeconomic stabilization, or structural adjustment.
era. A large portion of property rights was already allocated well before August 1991, creating powerful societal groups with real interests to defend in the postcommunist period. Section III addresses the institutional designs of the Soviet and Russian states. From being the strongest state in the world under Stalin, the Soviet regime had significantly weakened by the end of the Gorbachev era. The Russian state that emerged from the collapse of the Soviet Union continued on a downward spiral, bordering on collapse by the fall of 1993. Section IV then discusses how the two variables—"strong" economic interest groups in society and a "weak" state—interacted to (1) produce insider ownership in most of the privatizing large enterprises, (2) stimulate the flow of credits and subsidies to insolvent firms, and (3) retard the formation of market-supporting institutions. Section V concludes by exploring two plausible counterfactuals to the actual history of Russian state development: a more authoritarian state and a more democratic state.

I. State Power and Economic Transformation

Revolutions are rare and distinct moments in history characterized by "a sweeping, fundamental change in political organization, social structure, economic property control and the predominant myth of social order, thus indicating a major break in the continuity of development." In emphasizing the simultaneity of radical change in both the polity and the socioeconomic structure, this definition distinguishes revolutions from situations in which the polity and/or government changes without altering the organizing principles of the socioeconomic structure and from historical developments in which the socioeconomic structure changes without altering the basic organization of the polity. Coups d'états, rebellions, and even changes in regime that do not precipitate a synchronous transformation of the socioeconomic system are not considered revolutions here. These phenomena are re-

→ Sigmund Neumann, "The International Civil War," World Politics 1 (April 1949), 333–34. The term revolution is problematic, laden with normative assumptions. Most scholars of revolutions, including Marxists, political conflict theorists, and functionalists, subsume this basic description within their definitions of revolution. Disagreements arise when other features, such as class conflict, violence, or individual relative deprivation, are added to the definition. For discussions of the different definitions of revolutions, see Theda Skocpol, States and Social Revolutions: A Comparative Analysis of France, Russia, and China (Cambridge: Cambridge University Press, 1979), chap. 1; Charles Tilly, "Revolutions and Collective Violence," in Fred Greenstein and Nelson Polsky, eds., Handbook of Political Science, vol. 3 (Reading, Mass.: Addison-Wesley, 1975); and two very useful survey articles, Lawrence Stone, "Theories of Revolution," World Politics 18 (January 1966); → Jack Goldstone, "Theories of Revolution: The Third Generation," World Politics 32 (April 1980).

7 For a broader, more diffuse definition of revolution that includes such events, see Charles Tilly, European Revolutions, 1492–1992 (Oxford: Blackwell, 1993).
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lated to revolutions in that they are abrupt and often lead to the reorganization of the polity.\(^8\) It is the assumption of this essay, however, that regime changes that do not include the reorganization of the socioeconomic system—and, first and foremost, the reallocation and reordering of property rights—have outcomes that differ from those of regime changes which involve reordering both systems, the political and the economic. Similarly, evolutionary changes in the structure and distribution of property rights are also not considered revolutions. Aspects of modernization can serve as the long-term causes of revolutions, but constitute a class of events that is analytically distinct from rapid and simultaneous changes in both polity and economy.\(^9\)

While events may look simultaneous in the broad sweep of history, successful revolutions have a characteristic sequence: change in the state comes first, followed by change in the economy.\(^10\) An autonomous and effective state is a necessary condition for carrying out revolutionary economic transformation.\(^11\) Paradoxically, therefore, even if


\(^9\) In choosing this definition, my purpose is not to engage in the philosophical debate about what constitutes a "real" revolution. Rather, I more modestly seek to assign an operational definition to the phenomenon to be explained and to delineate the universe of cases that can be compared. Guided by this definition, other cases of revolution would include the French Revolution, the Russian Revolution, all successful twentieth-century communist revolutions (China, Vietnam, Cambodia, Mozambique, etc.), all successful anticommunist revolutions (Poland, Hungary, Czech Republic, Nicaragua, etc.), and Iran. This definition also excludes such cases as the American Revolution, the revolutions of 1848, the Mexican Revolution, or successful national liberation struggles (India, Ghana, Zimbabwe, etc.) in which the basic ordering principles of the economic system were not changed. On the importance of this definitional exercise for the scientific method, see Ernest Nagel, *The Structure of Science* (New York: Harcourt, Brace and World, 1961).

\(^10\) Unlike structuralists, this article distinguishes between revolutionary situations and revolutionary outcomes to underscore the idea that not all revolutionary situations ended in revolutionary outcomes. See Charles Tilly, *From Mobilization to Revolution* (Reading, Mass.: Addison-Wesley, 1978), chap. 9; idem (fn. 7), chap. 7; and Samuel Huntington, *Political Order and Changing Societies* (New Haven: Yale University Press, 1968), 266–67.

the goal of economic transformation is to stimulate market forces and eliminate state planning, a strong state is still needed to extract the state from the economy.

The state is the set of government institutions that define and implement national policy. In postcommunist Russia these institutions have included the president's office, the government or Council of Ministers (the prime minister, deputy prime ministers, ministers, and so forth), the Supreme Soviet, and the Congress of Peoples' Deputies, as well as the administrative offices, ministries, bureaucracies, and Soviets subordinate to these three bodies. State power has two main components: autonomy and capacity. State autonomy refers to the state's ability to define independent preferences. State capacity is a measure of the state's ability to implement preferences. The degree of consensus within the state is a key determinant of its ability to define preferences independently of leading economic interests groups. The effectiveness and cohesiveness of government institutions are key determinants of the state's capacity to implement these preferences. State power must also be measured in relation to the strength of the leading interest groups in society. The ability of the state to define in-

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12 On the distinction between state, government, and regime, Stephanie Lawson, "Conceptual Issues in the Comparative Study of Regime Change and Democratization," *Comparative Politics* 26 (January 1993); Robert Fishman, "Rethinking State and Regime: Southern Europe's Transition to Democracy," *World Politics* 42 (April 1990). In this essay, the term government (pravitel'stvo) has an even more specific connotation. It refers to the Council of Ministers, headed by the prime minister and deputy prime ministers, appointed by the president but approved (until its dissolution) by the parliament.

13 Of course, many other important institutions such as the army or police are also part of the Russian state. Listed here are only those institutions that have figured prominently in the politics of privatization.


15 Some states define independent preferences but cannot implement them, while others have the capacity to implement independent preferences but do not.


18 Theda Skocpol, "Bringing the State Back In: Current Research," 19; and Rueschemeyer and
dependent preferences and then implement them depends not only on the internal coherence and capacities of the state but also on the relative intensity, organization, and consensus of societal actors affected by the implementation of the state’s actions. Whereas strong states can define and implement policies that challenge the preferences and undermine the interests of leading social interest groups, weak states cannot.

This hypothesis about the necessity of state power for economic transformation is derived from a set of theoretical assumptions about institutions and institutional change during revolutionary periods. Economies are structured, organized, and facilitated by economic and political institutions.¹⁹ Economic institutions establish norms, rules, and procedures for economic actors and organizations, to the end of decreasing uncertainty, reducing transactions costs, and thereby facilitating economic activity.²⁰ Certain institutions cannot be created or enforced by individual economic actors.²¹ These political and economic institutions in turn stimulate the development of certain kinds of collective actors, organizations, and social groups.²²

During periods of stasis or evolutionary change, economic and political institutions can emerge spontaneously among actors who derive mutual benefit from them.²³ For revolutionary economic transforma-

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Evans, “The State and Economic Transformation,” 68, both in Evans, Rueschemeyer, and Skocpol (fn. 11). To argue that state and societal power are relational is not to make a tautological statement about their variance. On the contrary, as the discussion below demonstrates, values of strength can be assigned to each independently, after which their causal relation to each other can be observed.


²³ This is the rational choice or positivist version of neoinstitutionalism. This essay does not take issue with this theoretical explanation for institutions under the conditions these theorists generally assume. On the contrary, in discussing the evolution of property rights under the Soviet system, this essay draws upon many of the insights from this perspective. It argues that conditions for the spontaneous emergence of collectively beneficial institutions do not exist during periods of revolutionary upheaval. For evolutionary or static approaches to institutions, see F. A. Hayek, “Notes on the Evolution of Systems of Rules of Conduct,” in Studies in Philosophy, Politics, and Economics (Chicago: University of Chicago Press, 1967); ➔ Armen Alchian, “Uncertainty, Evolution, and Economic Theory,” Journal of Political Economy 58 (April 1950). For positivist statements about neoinstitutionalism, see Terry
tion to occur, however, economic institutions of the ancien régime must be consciously and deliberately destroyed, while new economic institutions and a supportive environment for them must be created. In such contexts, these institutions do not change of their own accord; they are changed—with the state the entity that must make the changes.

Impetus for this institutional destruction cannot be expected to come from social groups that benefited from the ancien régime. On the contrary, the demolition of old institutions threatens the interests, if not the very existence, of these collective identities. Social groups of the old order will therefore organize to resist fundamental economic transformation. By contrast, individuals or collective actors that did not benefit from the previous institutional structures can mobilize extrainstitutional or antisystemic organizations—for example, liberation movements, united fronts, or guerrilla armies—to challenge the existing polity and economy. Such a confrontation creates a revolutionary situation in which opposing social groups make competing claims for sovereign authority.

This condition of dual or multiple sovereignty is resolved only when one side—the ancien régime or the revolutionary challengers—(re)captures the state. If the revolutionaries seize the state, this institution then becomes the principal instrument for destroying old institutions and creating new ones. Endowed with few or no resources from the past system, these revolutionaries rely on the state to destroy old economic institutions and then construct or facilitate the construction


25 This conception is consistent with the path-dependent approach to institutions and institutional change.


of new institutions in support of a new economic order. The set of political institutions constituting the state must, however, also be reconfigured in order to be a useful tool of socioeconomic transformation. First, states that have just fallen to revolutionary challengers are weak, whatever their constitution. Second, and more importantly, states designed to support and be supported by one form of socioeconomic system do not have the capability to first create and then sustain a new socioeconomic order. “Capitalist” states cannot make “socialist” socioeconomic systems; “socialist” states cannot create the conditions for the emergence of a “capitalist” socioeconomic system.

This formulation regarding the process of economic transformation provides an important component missing from both liberal and Marxist (but not Leninist) theories of revolutionary change, and it challenges the neoliberal orthodoxy concerning economic reform in the former communist world. Both Marxist and liberal theories of socioeconomic transformation locate the engine of change within society. Marxist theories identify the cause of revolution as the contradiction between the forces of production and the relations of production: revolutionary change results when class-based upheavals from below dislodge the ruling class. Liberal approaches also identify the causes of revolutionary change within society—whether individual relative deprivation, demographic changes, competing interest groups, or modernization. In this conception, revolutionary change is often treated as a temporary albeit sometimes necessary historical event on the road to greater modernization of the socioeconomic system.

Neither liberal nor Marxist theories of socioeconomic transformation treat the state as an independent variable influencing political and economic outcomes. According to Marxist theories, the state either

30 Karl Marx, “Critique of Political Economy,” reprinted in Lewis S. Feuer, *Marx and Engels: Basic Writings on Politics and Philosophy* (Garden City, N.Y.: Doubleday, 1959), 43–44. Even Theda Skocpol, despite her focus on the state, argues that social revolutions “are rapid, basic transformations of a society's state and class structures: and they are accompanied and in part carried through by class-based revolts from below.” Skocpol (fn. 6), 4.
32 To the extent that they represent either perspective, Huntington (as liberal) and Skocpol (as Marxist) are the two most important exceptions. Neither author, however, devotes much attention to the role of the state in bringing about a revolutionary change in the socioeconomic system. See Huntington (fn. 10); and Skocpol (fn. 6).
represents the interests of the dominant class (instrumental Marxism) or defends the underlying mode of production (structural Marxism). For liberals, the state is the arena in which competing social groups vie for allocation of resources. The outcome of this competition is “simply the resolution of a vector of forces emanating from a variety of different groups.” In either conception, the state cannot be the engine of change; it can only be the custodian or the manifestation of the status quo.

Both perspectives may succeed in identifying potential preconditions for revolutionary change—situations that may lead to revolutionary moments and the formation of antisystemic, revolutionary movements. Neither, however, offers an adequate explanation for how societal conditions that precipitate revolutionary situations can lead to revolutionary outcomes, that is, to actual lasting change in a given socioeconomic system. To account for the process of making revolutionary change, the state must be understood as an independent variable. In every twentieth-century revolution, whether communist, capitalist, or Islamic, revolutionaries have first seized the state and then used it to bulldoze a new socioeconomic order into place. To accomplish this revolutionary project, the state had to be sufficiently autonomous relative to the dominant (though not necessarily the majority of) societal

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33 Structural Marxists or neo-Marxists do treat the state as autonomous. In their conceptions, however, the state is autonomous so that it can defend the existing mode of production and not just the specific interests of individuals or collectivities from the dominant class. See Nicos Poulantzas, Political Power and Social Classes (London: New Left Review, 1975).

34 Krasner (fn. 25), 225.

35 This essay is not about the “causes” of revolution, a subject beyond the scope of this essay. Without challenging or endorsing either Marxist or liberal theories of revolution, I nonetheless argue that neither model can explain revolutionary outcomes without bringing in the state as an independent variable.

36 Theoretically, spontaneous societal forces could lead to the revolutionary transformation of a political and socioeconomic system. Similarly, a revolutionary transformation implemented by social groups outside of the state is conceivable. Empirically, however, neither of these theoretically possible modes of revolutionary change has occurred. Beginning with the model of the French Revolution and then codified by Lenin’s writings on the strategy of revolution, all successful revolutionaries have seized control of the state as a means to implement or facilitate the organic process of socioeconomic change. See Lenin (fn. 28); and Immanuel Wallerstein, Revolution as Strategy and Tactics of Transformation (Working paper, Fernand Braudel Center for the Study of Economics, Historical Systems and Civilizations, State University of New York at Binghamton, 1992).

37 Huntington’s distinction between Western and Eastern revolutions highlights the fact that Eastern revolutions (i.e., peasant guerrilla movements) tend to begin the process of economic transformation within the territories they control before they actually seize the state apparatus in the capital. It is my contention, however, that the “state” in these liberated territories is in fact effectively controlled by the guerrilla movement at the time of economic transformation. Moreover, national economic transformation is only undertaken once the capital has fallen. See Huntington (fn. 10); Terence Ranger, Peasant Consciousness and Guerrilla War in Zimbabwe (Berkeley: University of California Press, 1985); and Basil Davidson, The People’s Cause: A History of Guerrillas in Africa (Essex, England: Longman, 1981).
groups to define a new set of preferences and policies, and powerful enough to act against the interests of leading social forces of the ancien régime.\(^{38}\) This conception of the state’s role in economic transformation departs from neoliberal theories and policies regarding transitions to market economies. Orthodox neoliberals fear strong states,\(^{39}\) believing that they use their power to intervene, distort, and prey upon the market. Neoliberals thus favor minimalist governments.\(^{40}\) If the state can only be extricated from the economy, they contend, markets will work: competition will occur, prices will adjust, and resources will be rationally allocated.

Neoliberal economists underestimate the role states play in market economies in providing those institutions that facilitate transactions but are not created by market forces. More importantly, however, neoliberal economists fail to appreciate the critical role of the state in transitions that require the creation of conditions for the emergence of a market economy in a system previously organized according to non-market principles.\(^{41}\) Preexisting institutional arrangements that distort free-market competition will not naturally disappear once prices are freed.\(^{42}\) These lagging institutions will continue to distort prices and impede the organic emergence of markets and market institutions until they are deliberately dismantled. Regarding the case of privatization in particular, the neoliberal perspective has failed to account for the fact that property rights had de facto already been allocated according to nonmarket norms and principles during the Soviet era. As explained in the following section, directors of state enterprises were the primary beneficiaries of this Soviet system of property rights. When the Soviet Union collapsed in the fall of 1991, these directors and their claims to property rights were still in place.

\(^{38}\) During revolutionary situations the internal organization of states changes, as do states’ capacities. Not surprisingly, the imperative to achieve socioeconomic change has often led to the emergence of more centralized, more powerful regimes. See Alexis de Tocqueville, *The Old Regime and the French Revolution*, trans. Stuart Gilbert (Garden City, N.Y.: Doubleday, 1955); Skocpol (fn. 6).


\(^{41}\) The danger, of course, is that a state which is capable of destroying the old institutional order is also strong enough to destroy or distort the new institutional order. This dilemma, as it relates to Russia, is discussed in the conclusion.

II. SOVIET PROPERTY: INSTITUTIONS AND OWNERS

The organization and structure of societal groups that Russia inherited from the Soviet regime were neither “weak” nor “flat.” Soviet civil society was small, nascent, and only starting to emerge before the collapse of the USSR in 1991. Social groups or special-interest groups located within the state, however, were organized, cohesive, and powerful. These interest groups did not wither, disband, or weaken when the Soviet state formally collapsed. Rather, they became autonomous units located somewhere between state and society. Two years after the dissolution of the Soviet state, Russia’s postcommunist civil society was still dominated by social units constructed according to the organizing principles of the Soviet regime.

Regarding property, directors of state enterprises constituted the most important and well-defined special-interest group. Well before the collapse of the Soviet regime, the Soviet institutional arrangements governing property rights allowed directors to appropriate many of the rights associated with ownership. Agency theory, derived from analyses of complex organizations in capitalist economies, helps to illuminate how this transfer of property rights occurred.

In the Soviet economy as originally designed under Stalin, the Party/

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45 Failure to make this distinction between social units organized outside the state and social units still within the Party-state has resulted in a great deal of confusion in assessments of the strength of Soviet (and now Russian) society. Those who understood these within-regime social groups to be the equivalents of units of civil society erroneously portrayed the Soviet Union as a pluralist regime, for example, Jerry Hough, The Soviet Union and Social Science Theory (Cambridge: Harvard University Press, 1977), 8. Equally inaccurate, however, were descriptions that treated the Soviet regime as a unitary actor in which these within-regime social groups were considered insignificant, nonautonomous actors. Because the lines between state and society were so blurred, neither approach to Soviet state-society relations (often politicized in American domestic debates) was very useful.

46 Much of the information in the following section was derived from extended interviews (more than twenty hours each) with Nikolai Ryzhkov and Vitalii Vorotnikov, two industrial directors who later worked in state ministries and finally the CPSU Politburo. In 1985 Ryzhkov became prime minister of the USSR. The interviews were conducted during the summer of 1992 as part of the Hoover Archives Oral History Project on the former Soviet Union. Interviews conducted by the author between June 1992 and July 1993 with directors at the following large state enterprises also inform this section: in Moscow Oblast—Tsagi, Troitsk, Khrunichev, Almaz, Vypeim, Impuls, Mikron, Machinostroenie, SPARc; in St. Petersburg—Svetlana, Ferrite, Leninetz, Arsenal, and Klimov Works; in Saratov—Saratov Aviation Plant, Saratov Electrounit Production Amalgamation, SEPO; in Nizhni Novgorod—Ulyanov Works; and in Ekaterinburg—START, Ural Electromechanical Works, Nevynsk Mechanical Works, Uralkhimmash, Egorshinsky Radio Plant.
state (hereafter referred to simply as the state) owned all assets. The state de jure claimed all basic property rights of ownership—the right of use, the right to profits from that use, and the right of transfer. Like owners of large properties in capitalist economies, however, the Soviet state had to delegate some of these rights to agents in order to make these assets productive. In the case of large state enterprises, the state (the principal) relied on directors (its agents) to represent its interests in the use of this set of assets.

The Soviet state’s ability to monitor the performance and control the behavior of directors weakened over time, as the economy became more complex, the role of the security police declined, and corruption spread. Since principals in the Soviet system were huge centralized bureaucracies of the state, individual apparatchiks within these ministerial labyrinths had neither the knowledge nor the incentive to exercise the state’s property rights over individual firms. With state ownership of all enterprises, “the depersonalizing of property becomes extreme.” Because profit levels were set arbitrarily and uniformly, the state as owner—or more specifically the bureaucracies of the state as owner—attached little importance to maximizing these profits. Moreover, measurements in the planned economy were extensive, not intensive, creating easy opportunities for shirking and withholding information.

In addition to being unable to monitor agents’ activities, the principal also had weak incentive mechanisms for motivating agents to act in the principal’s interests. The state did establish production targets, bonus schemes, and the opportunity for advancement within the state

51 For instance, the weight of the truckload of meat was more important than the quality of the cuts. A director of a meat factory could therefore fill his production quota with fatty, bony products while setting aside choice cuts for his own personal use. Directors of meat factories then consumed, bartered, or sold these choice meat cuts. See Vitaly Naishul, The Supreme and Last Stage of Socialism (London: Centre for Research into Communist Studies, 1991). On shirking Æ Armen Alchian and Harold Demsetz, “Production, Information Cost, and Economic Organization,” American Economic Review 62 (December 1972).
hierarchy for successful directors. Nonetheless, throughout the Brezhnev period, actual decisions regarding five-year plans, industrial output targets, and even output goals for individual enterprises were increasingly made at lower and lower levels in the agency chain.\textsuperscript{52} As Vitaly Naishul has explained:

Enterprises (during the Brezhnev era) made requests for resources, which accumulated as they moved up the administrative ladder until they reached an agency authorized to assign production tasks to producers. Then, tasks were distributed among manufacturing enterprises, which responded with new requests for necessary supplies, so that the planning cycle repeated itself over and over again. Brezhnev-era economic planning started\textit{ from the bottom up}, not from the top down as under Stalin; its nature was not directive, but iterative or cyclical.\textsuperscript{53}

The main instrument of control for the principal in the command economy—the plan—was captured by agents who had superior knowledge about the operations of their individual enterprises.

Directors, as knowledgeable agents for indifferent principals, began to acquire de facto property rights over their entities.\textsuperscript{54} First, they assumed rights to consumption. Because the principal could not monitor all production at the enterprise level, directors had opportunities for personal consumption and exploitation of resources and could also control consumption by other enterprise employees.\textsuperscript{55}

Second, directors made profits. By hiding revenues or skimming extra production, directors supplemented their personal wealth at the expense of the principal.\textsuperscript{56} An extensive black market offered irresistible opportunities; and there were no market inhibitors to shirking.\textsuperscript{57} Moreover, under Gorbachev a series of reforms allowing small enterprises and cooperatives further enhanced the directors' opportunities to derive profits from state assets.\textsuperscript{58} In accordance with these

\textsuperscript{52} Author interview with Nikolai Ryzhkov. According to Ryzhkov, who worked in Gosplan during the last years of the Brezhnev regime, the Politburo took less than forty-five minutes to approve the annual plan for the entire Soviet economy.


\textsuperscript{55} Directors also controlled the construction of and access to social assets of the enterprise, such as vacation homes, kindergartens, housing, sports facilities. These assets often reflected the personal tastes of the enterprise directors.

\textsuperscript{56} Ratchet effects on production goals and worker performance standards provided agents with these margins of opportunity. John Litwack, "Ratcheting and Economic Reform in the USSR," \textit{Journal of Comparative Economics} 14 (June 1990).


\textsuperscript{58} "Zakon Soyuza Sovetskikh Sotsialiticheskikh Respublik o Kooperatsii v SSSR," \textit{Ekonomicheskaya Gazeta} 24 (June 1988).
new laws, entrepreneurial directors set up parasitic cooperatives, collectively owned entities, lease agreements, and joint ventures, which became profit centers feeding off the assets of large state enterprises. All profitable transactions with outside contractors, and especially foreign contractors, were channeled through these small enterprises, leaving profits offshore with little or no benefit to the state enterprise as a whole. Directors thus reaped profits from property without bearing the risks or liabilities associated with total ownership. Directors of Soviet enterprises never acquired the third right—the right to transfer property or the right of alienation. But then in the socialist economy, even the principal (the state) could rarely exercise this right. The system, that is, had only one de jure owner, making transfers within the Soviet Union meaningless.

Workers constituted a possible alternative claimant to property rights in the Soviet system in competition with the directors. The paternalistic relationship that evolved between directors and employees within enterprises, however, militated against the development of competing interests between these two social groups. The lack of a labor market, the absence of representative, sectorally based trade unions, and the direct provision of many social amenities (housing, kindergartens, medical treatment, vacation homes) by the enterprise gave the directors tremendous control over workers. Additionally, trade union bureaucrats at the enterprise worked closely with their directors to ensure worker discipline. At the same time, directors and workers were united in their common struggle against the central authorities to lessen their production quotas and shirk on yearly and five-year plans. In this institutional setting workers made no claims to


60 Overhead and many externalities of these small firms were paid, directly and indirectly, by the state. Government subsidies (i.e., artificially low prices for inputs, extremely low caps for wages, free rent, or negative interest rates on credit lines) were critical to these schemes. In extreme cases, resources transferred from the state to enterprises at low or negligible costs were simply laundered by directors through these cooperatives and joint ventures.

61 Sales of Soviet assets abroad was the one instance when this right was available to the state.


property rights that competed with their directors. In sum, Soviet institutional arrangements governing property rights had created well-defined interests and had clearly delineated collective identities and social groups. Well before the drafting of Russia's privatization program, directors had effectively privatized many of the property rights of state enterprises. They therefore had real interests to protect against Yeltsin's attempt to reallocate property rights through privatization. Their campaign to defend these interests was buoyed not only by their powerful position vis-à-vis other societal groups regarding issues of property but also by the state's increasing inability to define and implement a countervailing property rights system.

III. THE DECLINE OF SOVIET AND RUSSIAN STATE POWER

The Soviet regime consolidated by Stalin was one of the strongest states of the twentieth century. Under Stalin, the Soviet state set the creation of socialism (in one country) as its primary objective and then used coercion, violence, and mass murder to accomplish the task. Stalin's USSR was the paradigmatic totalitarian state.64

This state no longer existed in August 1991. While still totalitarian in structure, the Soviet state had atrophied and weakened considerably throughout the Brezhnev years. Gorbachev's reforms further weakened the capacity of the state to define and implement policy goals.65 Under Gorbachev the main administrative agent of the Soviet system, the Communist Party of the Soviet Union (CPSU) lost its "leading role."66 No new institution emerged to fill the void. Gorbachev revived the USSR Congress of People's Deputies and then created the Soviet presidency in an attempt to fill the vacuum. By the time of their creation, however, new political entities and movements with alternative claims to sovereignty had already mobilized.67 Beginning in the fall of 1990, Boris Yeltsin and Democratic Russia directly challenged the sovereign authority of the Soviet regime on Russian territory. It was a revolutionary challenge that gradually undermined the will and power of

64 On the definition of authoritarian and totalitarian states, see Carl Friedrich and Zbigniew Brzezinski, Totalitarian Dictatorship and Autocracy (Cambridge: Harvard University Press, 1961); and Juan Linz, "Totalitarian and Authoritarian Regimes," in Greenstein and Polsby (fn. 6).
66 In February 1990 Article Six of the Soviet Constitution was amended to remove this phrase.
the Soviet state. The absolute failure of the August 1991 coup attempt starkly exposed how weak the Soviet state had become.

In the wake of the aborted August putsch, Yeltsin assumed control of a set of Soviet/Russian institutions that had the appearance of a strong state. He seemed invincible—his dramatic stand against the putsch imbued his Russian government with more power and authority than any other institution in the Soviet Union. He used this sudden surge of political power to undermine many key components of the Soviet regime. He banned the CPSU, assumed control of several Soviet institutions and subordinated them to the authority of the Russian state, and then abolished political institutions that competed with existing Russian institutions, including first and foremost the Soviet Congress of People’s Deputies and the Soviet presidency. Finally, in December 1991 Yeltsin signed an agreement with his counterparts in Ukraine and Belarus that effectively dismantled the Soviet state.

At the time, these revolutionary changes in the state order met little resistance. Institutions that perhaps could have launched an assault against the Russian president, such as the Soviet army or the KGB, were still in a state of paralysis and disarray after the coup. Social movements opposed to Yeltsin’s sweeping actions were dwarfed in size, organization, and popularity by social movements like Democratic Russia, the united front of political parties and associations that supported the Russian president and his neoliberal economic reform plan. Russian political institutions seeking a future in the postcommunist era did not dare to challenge the hero of the coup at this stage. Most importantly, the Russian Congress of People’s Deputies granted Yeltsin the power to rule by decree in November 1991, which gave him near-authoritarian de jure power.

At this critical juncture Yeltsin had considerable leeway to construct a new state order. Not constrained by a pacted or negotiated transition, nor obliged to maintain Soviet political institutions, Yeltsin and his team were presented with a window of opportunity. Like many other revolutionary leaders during such transitions, he could have established a harsh authoritarian state—disbanding all political institu-

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69 Between August and December 1991, the distinctions between Soviet and Russian state institutions were blurred. When Yeltsin moved into the Kremlin in December, most formal Soviet institutions in operation on Russian territory were either abolished or subsumed by the Russian state.
70 On the importance of such political transformations for successful revolutionary outcomes, see Theda Skocpol, “Social Revolutions and Mass Military Mobilization,” World Politics 40 (January 1988).
tions not subordinate to the president’s office, suspending individual political liberties, and deploying coercive police units to enforce executive policies. Or he could have moved to consolidate a democratic polity—disbanding old Soviet government institutions, adopting a new constitution codifying the division of power between executive, legislative, and judiciary as well as federal and regional bodies, and calling new elections to stimulate the development of a multiparty system.

Yeltsin did neither. He and his advisers chose not to undertake fundamental political reforms and instead relied on Yeltsin’s own personal charisma and authority to sustain the state in carrying out its program of economic transformation. Within the top echelons of the executive branch of government (an institution itself only created in June 1991) Yeltsin did undertake several minor organizational modifications to enhance executive power. And in the regions Yeltsin also created new institutions such as presidential representatives and heads of administration to enhance executive branch autonomy and power. More striking to contemplate, however, are the decisions and actions Yeltsin did not take. He did not push to adopt a new constitution, although a first draft of a new fundamental law produced by the Supreme Soviet Constitutional Commission (chaired by Yeltsin) had been circulated as early as October 1990. Further, the new regime did little to institutionalize its popular support in society: Yeltsin did not establish a political party; nor did he call for elections to stimulate party development. And despite repeated pleas from Democratic Russia, he refused to call new elections in the fall of 1991 and postponed regional elections slated for the winter. Finally, he did not dismantle many Soviet-era governmental institutions, including most importantly, the Supreme Soviet and the Congress of People’s Deputies.

Eager to avoid Gorbachev’s perceived mistake of fixating on politics to the neglect of economics, Yeltsin’s team concentrated on radical economic reform. Consequently, unlike other revolutionaries at the moment of seizing the state, Yeltsin and his new team did not focus on

71 Skocpol (fn. 6).
73 Polling by Democratic Russia indicated that with Yeltsin’s backing the organization would win a majority within the Congress of People’s Deputies. At the time, Democratic Russia was the only legal party or social movement of national status. Having just organized Yeltsin’s electoral victory in June 1991 and then spearheaded the popular resistance to the coup in August, leaders of Democratic Russia were quite certain of their next victory. Author’s interviews with Democratic Russia leaders Vladimir Boxer, Victor Dmitriev, Yuri Afanasiev, Ilya Zaslavskii, Mikhail Schneider, and Lev Ponomarev, Moscow, October 1991.
74 “It’s the economy, stupid” was the overriding theme of the new Russian government in the fall of
transforming the political system. Like their advisers from the West, the Russian team of economic technocrats saw politics and political reform as a nuisance and distraction from the more important task of creating a market economy.75

This approach proved costly. Decisions, or the lack thereof, taken by the Yeltsin government after the coup further weakened an already feeble state. Fractures within the Russian state unfolded between different levels of government and also between different branches of the central government. With no constitutional delineation of rights and responsibilities between central and local authorities, regional governments seized the moment of Soviet collapse to grab greater political and economic autonomy. In March 1992 two autonomous republics, Tatarstan and the Chechnya, declared their independence from the Russian Federation. Negotiations over a Federal Treaty dragged on without resolution into the summer of 1993, prompting several Russian oblasts to make their own declarations of independence complete with flags, customs agents, and threats to mint new currencies.76

The stalemate between different branches of the central government proved even more dire. Soon after ceding decree power to Yeltsin in November 1991, the Russian Supreme Soviet and the Russian Congress of People’s Deputies began a campaign to reassert their authority

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1991. There were other factors, however, that dissuaded Yeltsin from undertaking political reform. First, Russia emerged from the August 1991 events with few political institutions, good, bad, or otherwise. While imperfect, the Congress and soviets at other levels had at least the appearance of a legislative organ. Sunk political costs in this set of institutions mitigated against the creation of new ones. Second, Yeltsin and most of the other “democrats” made a strategic decision in 1989 and again in 1990 to participate in elections to these institutions. While disputed at the time within the democratic camp, this strategic decision served to legitimate the soviets as organs of Russia’s nascent governmental apparatus. Third, the subsequent participation of Yeltsin and most of his revolutionary entourage in these soviets also bolstered their institutional standing. Yeltsin made his political comeback as a people’s deputy. Only two months before the coup Yeltsin was still chairman of the Russian Congress. Fourth, the critical symbolic role played by (in) the Russian Congress of People’s Deputies in resisting the coup added yet another barrier to abolishing the institution. The defense of the White House was the defining moment of the resistance to the coup. During the three dramatic days in August, emergency laws passed by the Congress in contradiction to decrees issued by the Soviet Emergency Committee gave Russian citizens, both civilian and military alike, an option for their loyalty. Thus, disbanding the Congress and closing down the White House would undermine the whole coup resistance experience as a nation-defining moment. Finally, at the time the Congress and other soviets did not appear to pose a threat to Yeltsin’s autonomy. Given that the Congress voted to give him virtually unlimited powers, Yeltsin assumed that this set of institutions would continue to support him. Uncertainty about what newly elected deputies might do was in fact one of the arguments used against holding new elections. To cement this relationship, Yeltsin urged that his (then) dependable ally, Ruslan Khasbulatov, become chairman.

75 Gennadi Burbulis, former deputy prime minister and secretary of state (Public lecture, Institute of History, Moscow, February 5, 1993).
as the “highest state organs.”  

Even after Yeltsin’s referendum victory in April 1993, the Congress continued to block executive initiatives, constrain ministerial power, and pass laws contradicting Yeltsin’s decrees. With no formal or even informal institutions to structure relations between the president and the Congress, the state virtually ceased to function. Yeltsin’s dramatic actions in September 1993 reflected the degree to which Russia’s government had stopped governing. As Yeltsin explained during his address announcing the dissolution of the Congress of People’s Deputies, “In the last few months Russia has been going through a deep crisis of statehood. All political institutions and politicians have been involved in a futile and senseless struggle aimed at destruction. A direct effect of this is the loss of authority of state power as a whole. . . . [I]n these conditions . . . it is impossible to carry out complex reforms.” As explained in the following section, this weak state was incapable of restructuring the Soviet property rights system.

IV. THE 1992 PRIVATIZATION PROGRAM FOR LARGE STATE ENTERPRISES

As initially defined by Deputy Prime Minister Yegor Gaidar and his team in January 1992, the ultimate objective of this privatization program was to create privately owned profit-seeking corporations that did not depend on government subsidies for survival. The architects of this program believed that if enterprises and enterprise managers had to generate profits to survive, they would rationalize the organization, use, and distribution of economic assets.Privatization accomplishes this more efficient use of resources by internalizing the costs and benefits of production for the individual enterprise. If the benefits do not

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77 The Russian Congress amended the Russian Constitution (the amended Soviet Constitution of 1977) to include this phrase, thereby de jure subordinating the office of the president to the Congress.


exceed the costs, privately owned enterprises must take action to redress the imbalance; this may include downsizing, unbundling (the splitting up of large assets), restructuring, or bankruptcy.\textsuperscript{81}

With respect to large state enterprises, this objective was to be attained by creating open joint companies owned by outside shareholders.\textsuperscript{82} As David Lipton and Jeffrey Sachs argued:

The shift to a West European ownership structure will require that enterprise governance . . . be placed squarely with a supervisory board (or board of directors) controlled by the owners of the enterprise. In essence, privatization requires first that certain ownership rights, now vested in the enterprises, and particularly in the workers’ councils, be eliminated so that property rights to an enterprise can be transferred to the real owners.\textsuperscript{83}

Outside shareholders were to be created through a mass voucher program.\textsuperscript{84}

This program was formulated with little reference to the Soviet historical experience and only marginal input from either societal forces or other branches of the government. Instead, Yeltsin’s team worked closely with Western advisers to draft a program informed by neoclassical economic theory and Western (especially American) practice. Moreover, the main authors of the program, Gaidar and Anatoli Chubais, deputy prime minister and chairman of the State Committee for Property (\textit{Goskomimushchestvo}, or GKI) were young economists with no experience in industry. Thus, the state’s aims and objectives of privatization were defined with little regard for societal interests.

Not surprisingly, therefore, the publication of this privatization program in early 1992 sparked immediate and heated debate. Lobbies for managers including, first and foremost, the Russian Union of Industrialists and Entrepreneurs (\textit{RUIE}) and its political affiliate, Civic Union, advocated that property rights of enterprises be transferred only to directors.\textsuperscript{85} \textit{RUIE} and Civic Union leaders argued that Yeltsin’s mass privatization program would not redistribute ownership but would simply concentrate ownership in the hands of those who already had money: former black marketers, the mafia, and foreigners.\textsuperscript{86} These “bandits”

\textsuperscript{81} Aslund (fn. 40), 80–81.

\textsuperscript{82} On the negative consequences of closed joint-stock companies from the government’s point of view, see the interview with Deputy Prime Minister Anatoli Chubais (fn. 2).

\textsuperscript{83} Lipton and Sachs (fn. 2), 35; emphasis added.


\textsuperscript{86} Grazhdanskii Soyuz, “Dvenadtsat’ Shagov ot Propasti” (Mimeo, 1992), 3; and author interview with Alexander Vladislavlev, cochairman of Civic Union, Moscow, July 1992.
would acquire vouchers and/or stocks from common Russian citizens, gain controlling interests in Russia's most valuable properties, and then sell the assets of these enterprises for a quick profit without reference to the long-term interests of the individual firm. To avoid such speculation, Civic Union argued that privatization should be left up to individual directors and workers, who knew their local situations best.87

The corporatist (rather than pluralist) system of interest mediation in postcommunist Russia endowed this directors' lobby with advantages over other kinds of social groups or aggregate citizen preferences. By contrast, the interests of mass-based groups (for example, consumers' organizations, associations for voucher holders) and individuals are best represented in electoral, parliamentary systems.88 As already noted, however, pluralist institutions for articulating interests and organizing representation (elections, party systems, and so forth) were not implemented or consolidated during the first two years of Russia's postcommunist polity. Without elections, the voice of individuals and mass-based groups could not compete with associations representing sectoral interests of powerful economic actors.89 During debate over the privatization law directors and their lobbyists were vocal in Congress and ubiquitous in the corridors of the executive government, while the interests of individual citizens were not represented.

In the absence of competitors, directors' lobbies, supported by alliances with old trade unions in such united fronts as Civic Union and the Russian Assembly of Social Partnership, and empowered by an institutional context propitious to their interest representation, presented a formidable political challenge to Yeltsin's original privatization formula. This increasingly resurgent societal challenge paralleled a decreasing coherence within the Russian state. After the first months of shock therapy, Yeltsin's authority had declined significantly, while the Congress of People's Deputies had reasserted itself as the Russian state's highest body. Because results of the Gaidar reform strategy were not (and could not be) immediate, doubts about the chosen course grew, not only in the Congress but also within Yeltsin's newly consti-

tuted cabinet. As battles over the privatization program began, Yeltsin and his government decided to avoid confrontation with the Congress and the directors' corps and instead opened their original privatization program to negotiation and concession. As Gaidar remarked retrospectively, "Beginning in May and June it was simply impossible to stand up to the pressure" of the industrial lobby.

The first presidential decree on large-scale industrialization (Decree no. 341) had already granted 25 percent of initially offered shares to workers. Workers were also given the opportunity to purchase an additional 10 percent at a 30 percent discount. Managers were allowed to purchase 5 percent of all shares at full price. All remaining shares were to be dispersed to individual citizens through a mass privatization program.

These concessions were not enough. Most significantly, the 25 percent share to the workers took the form of preferred (nonvoting) stock, making it possible for outsiders to gain a majority position with only 38 percent of the issued shares. Fearing this outcome, the directors' corps pressed for a second option whereby the workers' collective—an entity that includes both workers and managers—would be allowed to purchase a majority equity stake.

The liberals in Yeltsin's government, led most vocally by Anatolii Chubais, strongly opposed this idea. Chubais argued that privatization should serve the interests of all Russian citizens and not just those who worked at large enterprises. Referring to worker management

90 At the Sixth Congress in April 1992 the Russian Congress pressured the president to reshuffle his cabinet and add three industrialists (Victor Chernomyrdin, Georgii Khizha, and Vladimir Shumeiko) to balance the neoliberal team of Gaidar reformers. At the Seventh Congress in December 1992 the Congress successfully forced Yeltsin to remove his acting prime minister, Yegor Gaidar, and replace him with Victor Chernomyrdin.

91 See the remarks of Deputy Prime Minister Vladimir Shumeiko, in Pravda, October 29, 1992, in FBIS-SOV-92-213, November 3, 1992, p. 36; Alexander Zaichenko, "Governing without Power," DeViev Lyudi, 32, April 1993, p. 3; interview with Arkadii Volsky, Rossiiskaya Gazeta, October 31, 1992; and remarks by Boris Yeltsin in Nezavisimaya Gazeta, November 5, 1992, p. 1. The remaking of the privatization program, then, was not an entirely nonvoluntaristic outcome of the institutional forces left behind from the Soviet era. Rather, the state officials made "politically driven choices" from a set of choices defined by previous institutional arrangements. Outcomes, however, were not determined, because other responses, albeit costly ones, were available. See Stephan Haggard, Pathways from the Periphery: The Politics of Newly Industrializing States (Ithaca, N.Y.: Cornell University Press, 1990), 3-4, 34, 45.


94 See, for instance, the interview with Chubais, "Daravaya Sobstvennost' ne Delaet Chelovek Khozyainom," Izvestiya, February 26, 1992, p. 2.

schemes in Yugoslavia, Chubais also expressed fear that too much insider control of privatized enterprises would hinder efficiency and also dampen public interest in the government's voucher program.96

Despite these reservations, Yeltsin's government eventually acceded to the demands of the industrialists.97 Over one hundred amendments were added to Chubais's original privatization program, including two entirely new options, Option 2 and Option 3. Option 2 allowed workers' collectives to acquire 51 percent ownership, while Option 3 allowed for manager buyouts when effective management assumed responsible control of an ailing enterprise.

To blunt the impact of these amendments, GKI officials incorporated several disincentives into these new options to discourage their selection.98 Nonetheless, almost two-thirds of the enterprises that submitted plans for privatization in 1992 selected Option 2.99 As Gaidar candidly lamented, "I cannot say that we are satisfied with the scheme adopted by my government, as two-thirds of privatized enterprises are controlled by workers' groups. This scheme was forced on us as compromise."100 Moreover, in addition to those enterprises that abided by the options outlined in the amended privatization program, many directors, especially those of very large enterprises, have used old networks, bribes, and their local influence to cut special deals with the


98 First, 25% of the shares were given away to workers in Option 1, and an additional 10% were sold at a reduced rate. Under Option 2 the workers' collective had to purchase all 51% of the shares at full value. For very large enterprises workers' collectives had no possibility of raising this initial capital outlay. The state, moreover, offered no special credit lines to workers collectives seeking to borrow these sums. Second, the nominal value of the enterprise as assigned in Option 1 was multiplied by 1.7 if they opted for Option 2. The GKI also discouraged adoption of this second option by regulating very closely the first, closed stage of subscription for shares. If 51% was not purchased by members of the workers' collectives after the initial period, the enterprise in question was immediately privatized according to Option 1. Finally, GKI regulations required that Option 2 or Option 3 be approved by two-thirds of the workers' collective. If a two-thirds majority was not garnered, the enterprise in question was automatically privatized according to Option 1. GKI officials, including Chubais himself, predicted that most enterprises would privatize according to Option 1. See remarks by Chubais quoted in Pravda, June 30, 1992, p. 2, in FBIS-SOV-92-132, July 9, 1992, p. 38.

99 Of the 46,815 enterprises that had been privatized by the end of 1992, 63.7% had chosen Option 2, while only 34.5% had chosen Option 1, the original privatization design. Less than 2% had chosen Option 3. "Obzor Investi i Privatizatsii," Kommersan', 7, February 15–21, 1993, p. 16; and "Chubais Schitaet Shto Glavaya Zadacha 1993 Goda—Perekhod k Kachestvennoi Privatizatsii," Izvestiya-FP, March 12, 1993).


Such high levels of insider ownership obstruct the realization of the original objectives of the privatization program. Given the magnitude of the agency problems at Russian enterprises, even outside owners would find it difficult to control their inherited directors.\footnote{Information asymmetries between new boards or shareholders on the one hand and old directors with decades of experience at the enterprise on the other will dramatically impede the rational and efficient use of enterprise resources. If a manager has been working for twenty or thirty years at a given enterprise, it is highly unlikely that this individual will immediately submit to the goals and interests of outside and unknown owners. Moreover, the very notion of incentivized, contractual relationships is alien to Russian economic organization. Contracts for directors designed to limit shirking and encourage profit-seeking behavior simply do not exist yet. See Christian Kirchner, “Privatization Plans of Central and Eastern European States,” \textit{Journal of Institutional and Theoretical Economics} 148 (1992), 15.} Without outside owners or at least a minority of shareholders who are outside owners, directors will be even further insulated from the discipline of market forces. They are subject to no real threat of divestment from shareholders. If the directors and workers are also the major shareholders, they have other welfare concerns—first and foremost job security—that take precedence over the goal of maximizing dividend returns on their shares.\footnote{The recent battle for control of Vladimir Tractor Factory is illustrative. The inside shareholders—the majority of owners in the Option 2 privatization—voted to retain their old director, Anatolii Grishin, who had forty years in the tractor business, over the other candidate, a young, Harvard-trained international banker, Iosif Bakaleinik. While Bakaleinik guaranteed high dividend returns to shareholders, Grishin guaranteed employment. According to Bakaleinik, the old managers coerced workers to support their candidate. One worker was fired for voting for Bakaleinik. Author’s interview with Iosif Bakaleinik, Washington, D.C., September 1993. See also Geoff Winestock, “Tractor Plant Picks the Devil It Knows,” \textit{Moscow Times}, June 26, 1993, p. 1.} The threat of outside takeovers is also very weak at enterprises in which insiders own 51 percent or more of all shares. Because boards will be comprised of either existing managers or people with little or no information about the enterprise, disciplinary action by boards of directors against management is also highly unlikely. The labor market for managers—another important disciplinary institution for managers in capitalist economies—is still very weak in Russia. Moreover, as directors assume greater ownership and control of their firm, they will have few incentives to leave it.
Insider control also impedes two other primary goals of privatization: unbundling and investment. First, unbundling, spin-offs, and restructuring are unlikely to occur when the assets subject to reorganization are not owned or controlled by outside profit seekers. According to a Russian government/World Bank report, “A central feature of the privatization program has been to leave any necessary restructuring to new private owners, on the assumption that they will know better than the Government what changes are needed.”\(^{104}\) If no new owners are created, however, restructuring will not take place. Management ownership will instead block or delay the downsizing and unbundling of oversized, overemployed enterprises. Second, as the World Bank warned, “Outside investors are likely to be discouraged if there is already an entrenched minority of shareholders.”\(^{105}\) Negligible levels of new investment in Russian enterprises confirm the World Bank’s forebodings.\(^{106}\)

**GOVERNMENT SUBSIDIES AND SOFT BUDGETS**

Another manifestation of the power of the directors’ lobby has been massive state transfers to enterprises. The problems associated with insider ownership frustrate but do not altogether block the development of privately owned profit-seeking enterprises. After all, employee-owned companies in developed capitalist countries still earn profits or at least remain solvent. If they do not, they go bankrupt. Fear of bankruptcy disciplines even the most opportunistic directors to maintain positive cash flows. Russian enterprise directors, however, have had another available option for survival: obtain government subsidies. This second option, the soft budget, has allowed enterprise directors to continue to operate without making decisions according to market principles.\(^{107}\) The combination of little or no pressure from outside shareholders for profits and no hard budget constraints has been a recipe for inefficient enterprise at the microlevel and rampant inflation for the economy as a whole.

The option of subsidies is of course only available if the state acquires. A strong state could withstand pressure and enforce a hard bud-

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\(^{107}\) Kornai (fn. 50), 142–45.
get constraint. A weak state cannot execute such austerity measures. Russia's first postcommunist regime launched its privatization program pledging to withstand demands for credit. Divisions between the Congress and the president, however, once again created opportunities for interest groups representing directors and workers to derail the original resolve of the Yeltsin government. Through the Congress, these interest groups succeeded in returning an ally, Victor Gerashchenko, to head of the Russian Central Bank in spring 1992.

Under Gerashchenko, the Central Bank began dispensing massive new lines of credit to ailing enterprises. The bank also approved interenterprise debt swapping, an indirect form of subsidization among enterprises. Along the same lines, the Congress also approved significantly higher budgetary allocations for enterprises than those requested by the Yeltsin government.

The combination of an undisciplined Central Bank and a soft Congress resulted in an explosion of state transfers to ailing enterprises. From January to July 1992 interenterprise debt jumped from 37 billion to 3.2 trillion rubles, an eightyfold increase. By the spring of 1993, state subsidies were estimated to be 22 percent of gross domestic product. Meanwhile, only one Russian enterprise has declared bankruptcy.

This enormous flow of state credits to support ailing companies, coupled with these giant interenterprise arrears, has postponed the introduction of hard budget constraints. The "neoliberal" wing of Yeltsin's government, headed by Deputy Prime Minister and Finance Minister Boris Fyodorov, has continued to warn enterprises that they can no longer rely on state subsidies. Thus far, however, the state has been too weak to make this threat credible. This continued level of

108 Until Yeltsin's ban of the Congress in September 1993, the bank was under the purview of the Congress, not the president.
112 Ickes and Ryterman (fn. 110), 331.
113 World Bank (fn. 3), v.
114 Boulton (fn. 3).
115 See the interview with Deputy Prime Minister Boris Fyodorov, in Kommersant-DAILY, April 28, 1993, p. 3.
116 Ministry of Economics of the Russian Federation, O Kriteriyakh Otsenki Program, Otrasei i Predpriyatiy, Nuzhdavushchikhsya v Gosudarstvenoi Podderzhki, Raspolozhenie Soveta Ministrov-Prvitel'stva Rossiskoi Federatsii, no. 519 (April 1, 1993).
state subsidy seriously undermines the very idea of private property. The regime’s inability to withstand short-term demands from enterprise directors undermines the broader, long-term goal of creating and sustaining a capitalist market economy.117

The Lack of Market-Supporting Institutions

The goals of the original privatization program have been further impeded by the state’s inability and/or unwillingness to create the new institutions necessary to support a market economy. The state’s failure to create these institutions has in part been the consequence of its neoliberal philosophy. Because of their militant belief in the power of the invisible hand, Gaidar’s team did not envision a role for the state in creating market-supporting institutions. Rather, these institutions were to form spontaneously. In Russia, however, this ideological perspective proved to be fundamentally flawed. Choked by the maze of nonmarket institutions still in place from the Soviet era, Russia needs a state policy that would create and nurture market-supporting institutions. The lack of attention to the role of the state in this process, coupled with the weakness of the state more generally, has resulted in a dearth of several key institutions critical for free enterprise.

The state has also institutionalized a legal system to protect property rights, decrease transaction costs, enforce contracts, and ensure competition.118 However, the Russian state has devoted few resources to developing a court system capable of defending even investors or property owners, let alone consumers or workers. Contracts must be totally self-enforcing to work, because the state cannot enforce them. In the corporate legal context, laws on disclosure do not exist, general accounting procedures have not been codified, procedures for shareholder and proxy voting are ambiguous, and institutions governing the payment of dividends have not been established. Consequently, shareholders have little access to information about enterprises in which they have invested.

Some market-supporting institutions, such as banks, commodities exchanges, and even stock markets, have, however, begun to emerge spontaneously in Russia. But without a state capable of regulating

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these institutions, it is not certain that the institutions taking root will foster the development of privately owned profit-seeking firms. Unregulated stock markets may lead to ownership dominated by bankers and enterprise directors, not entrepreneurs. Within Russia's nascent stock markets, insider trading is the norm, not the exception. Unregulated commodity exchanges have already created incentives for producers of raw materials to export rather than sell domestically. While perhaps a logical market response to the current pricing system, such transfers out of the country arrest already declining domestic production. The Russian state has also not developed a strategy for demonopolizing the economy—antimonopoly commissions have been created at all levels of government, but they have little authority.\(^\text{119}\)

Perhaps most importantly, the Russian state has not created a system of social security. It has not established an effective retirement system, a welfare agency, a plan for job training, or unemployment compensation.\(^\text{120}\) Without such a social safety net, the Russian labor market has little fluidity.\(^\text{121}\) Workers still rely on their enterprise directors to provide all social services. Enterprise directors in turn can demand state subsidies to cover their wage bill, housing costs, retirement benefits, and so on. In effect, then, state transfers for wage bills in nonproductive enterprises serve as unemployment compensation from the state. If these monies were transferred through an institution independent of the enterprises, however, bankruptcies would be less socially explosive and unemployed workers might be encouraged to find new employment.\(^\text{122}\)

All developed capitalist economies have a complex network of institutions that supports and facilitates market functions. The invisible hand is aided by visible institutions. Guided by neoliberal philosophies about the market, Russia's first postcommunist government assumed that these supporting institutions would emerge spontaneously. They have not. As a result, the absence of market-supporting institutions has added yet another impediment to the development of profit-maximizing privately owned firms.

\(^{119}\) Author interview with Vladimir Boxer, deputy head of the Moscow Anti-Monopoly Commission, December 1992.


\(^{122}\) Bankruptcies, too, would of course release poorly utilized capital assets, and first and foremost real estate, on to the market. The rational allocation of these newly released assets would in turn create new jobs and thereby help alleviate the unemployment created by the initial bankruptcies.
V. Authoritarian and Democratic Counterfactuals

The Russian state launched its economic reform program with a clear blueprint for how to turn state-owned enterprises into market-driven privately owned firms. However, the hodgepodge of institutions that constituted Russia’s first postcommunist state—a hybrid of new institutions like the president’s office and old institutions like the Congress of People’s Deputies—had virtually no capacity to dismantle the existing set of institutional arrangements governing property rights. The emergence of a corporatist system of interest intermediation in parallel with, and in part as a consequence of, this weak and divided state provided the opportunity for mobilized and articulated interest groups like the directors’ corps to capture control of the Congress and thereby amend and influence implementation of state policy regarding privatization and private property rights.

Would a different configuration of Russian state institutions have led to a different outcome concerning the creation of private property rights? Two counterfactuals are worth exploring—an authoritarian state and a democratic state.

At the beginning of Russia’s reform process, many called for an authoritarian regime, believing that such regimes are better able than are other kinds of polities to carry out economic reforms. The economic miracles of South Korea, Taiwan, Chile, and China are often cited as examples of how to sequence political and economic reform; economic reform and growth first, democratization second. The revolutionary changes in France’s economic structure after 1789, in Russia’s after 1917, or in China’s after 1949 suggest that violent authoritarian regimes are capable of achieving radical economic transformation.

Had Boris Yeltsin dissolved the Congress of People’s Deputies and instituted an authoritarian regime, the politics of privatization would have been different. Without question, directors of state enterprises would still have tried to defend their interests by lobbying or threatening such an authoritarian state. Their ability to influence Gaidar and

123 See the essays by Igor Klyamkin and Adrannik Migranyan, in *Sotsializm i Demokratiya: Diskussionaya Tribuna* 2 (Moscow: Institut Ekonomiki Mirovoi Sotsialisticheskoi Sistemy, 1990). See works cited in fn. 16. The evidence for such a claim is inconclusive. Despite Yeltsin’s recent decisive actions against his opponents, the overall weakness of the Russian state still suggests that authoritarianism may no longer be a viable option. The last authoritarian attempt to restore state power—the August 1991 putsch—resulted in the dissolution of the Soviet Union. A similar move by Russian central authorities could precipitate the collapse of the Russian Federation.

his team, however, would have been much more difficult than gaining support in the Congress of Peoples’ Deputies, a body in which directors themselves constituted a sizable minority. Option 2 almost certainly would not have been incorporated in the 1992 privatization program, meaning that outsider investments would have had greater opportunities to take majority equity positions in privatizing enterprises. While agency problems would still have been acute, the demarcation between owner and employee would have been more clearly defined. Perhaps even more importantly, an authoritarian regime would have subordinated the Russian Central Bank to the Gaidar team of neoliberal reformers. Under these monetarists, it is unlikely that the Bank would have become the main provider of cheap credit to large enterprises.\textsuperscript{125} Faced with a less compromising set of state institutions, these directors might have resorted to extreme measures, such as strikes, riots, and even armed insurrection against the state. However, they might also have accepted the new rules and begun behaving like profit seekers.\textsuperscript{126}

The authoritarian option, however, would also have had several deleterious consequences for the creation of private property rights. Insulated from all societal pressures or control, leaders of an authoritarian state would have had few incentives to give up property rights to private owners. Instead, an authoritarian state might easily have returned to predatory rent-seeking behavior. Only the most ideologically pure would have been able to use this regime to divest the state of its revenue-generating assets.\textsuperscript{127} Finally, even if an authoritarian state succeeded in privatizing and/or creating private property rights, there is no guarantee that these rights could be protected, since a state strong enough to establish property rights is also strong enough to take them away.\textsuperscript{128}

Democratization, too, could have been an alternative path to enhancing Russia’s state capacities—however counterintuitive this may seem. When divisions of power between different branches of government and different levels of government are institutionalized, the state becomes more effective. States in which the rules of the game are clearly delineated can maintain high levels of capacity even in the face

\textsuperscript{125} In the Soviet system the Central Bank had not performed this role but only took on this function when enterprises had no other institution from which to receive state support.

\textsuperscript{126} This scenario, in fact, is one that might eventually play itself out in Russia.

\textsuperscript{127} On why such behavior would be irrational for regime rulers, see Margaret Levi, \textit{Of Rule and Revenue} (Berkeley: University of California Press, 1988), chap. 11.

\textsuperscript{128} Weingast (fn. 117).
of deep ideological differences between members of the polity.\textsuperscript{129} At the same time, unlike authoritarian regimes, states with institutionalized divisions of power are less able to make predatory interventions in the economy.\textsuperscript{130} From this perspective, then, the early adoption of a new Russian constitution—an act of democratization, not authoritarianism—may have been a critical step toward economic reform.

The Russian state’s ability to carry out radical economic transformation may also have been enhanced by a more pluralist system of interest intermediation. In the absence of elections, special-interest groups representing the directors’ corps had greater access to and influence over the state than did representatives of other interests. They especially were effective at influencing and controlling the Russian Congress of People’s Deputies. Deputies to the Congress were elected in 1990, before political parties existed, before the Soviet Union had collapsed, and well before economic reform had begun. They therefore represented neither the electorate (as demonstrated most conclusively in the April 1993 referendum) nor the new social and economic groups that emerged in postcommunist Russia (that is, entrepreneurial associations, independent trade unions, coalitions of directors of privatized enterprises, and so forth).\textsuperscript{131} Not surprisingly, this Congress emerged as one of the chief obstacles to revolutionary economic transformation.

Had Yeltsin actively pushed to democratize the Russian polity immediately after August 1991, the nature of the societal pressures within the polity might have been very different. Had there been elections for the Congress of People’s Deputies in 1991, for instance, resistance to Yeltsin’s privatization program might have been much weaker. In the fall of 1991 Democratic Russia was the only legal nationwide political organization. Given Yeltsin’s overwhelming popularity at the time, Democratic Russia could have won a majority of seats in the Russian parliament. A parliament controlled by Yeltsin supporters

\textsuperscript{129}This usually means that the procedures for decision making and execution are clearly delineated. For instance, the vote on U.S. military action against Iraq in the United States Senate was split almost evenly. Once the vote passed by its narrow margin, the American state implemented the policy decision coherently and effectively.

\textsuperscript{130}Weingast (fn. 117).

\textsuperscript{131}As privatization, whether insider or outsider, proceeds, the directors’ corps will have increasingly different interests as a result of the kind of assets they inherit. For instance, directors who become CEOs of potentially profitable enterprises will want to decrease state subsidies—the engine of inflation in the Russian economy—while those at unprofitable enterprises will have an interest in sustaining them. Compare, for instance, the platform of the Association of Privatized and Private Enterprises, a lobby organization chaired by Yegor Gaidar (\textit{Materialy Uchreditel’nogo Sazda}, April 2–3, 1993), with Civic Union’s program (\textit{Dokumenti Foruma Obshchestvennikh Sil}, Moscow, June 21, 1992).
would have been more sympathetic to the original privatization program and less willing to provide credits to state enterprises.

The relationship between democratization and economic reform may be more complementary than is often assumed.\(^{132}\) In revolutionary transitions, the people may be an ally for the state in its attempt to challenge entrenched interest groups formed under the ancien régime. In the Russian case the majority of citizens—unlike the directors’ corps—had little to lose from the breakdown of the old Soviet order.\(^{133}\) A political system that amplifies the role of the masses and squelches the voice of the old elite in state policy-making and policy implementation might prove more capable of undertaking radical economic transformation than even an authoritarian regime. More generally, a democratically elected state has greater legitimacy and authority than does an authoritarian regime to carry out painful economic reforms.\(^{134}\)

In other postcommunist transitions, it does appear that those regimes which initiated comprehensive democratic reforms early on (Poland, Hungary, Czech Republic) were more successful in undertaking real economic transformation than were those countries that did not try to or that had less success at consolidating a democratic polity (Romania, Bulgaria, Ukraine, Uzbekistan).

While the actual outcome regarding the creation of private property rights in either the authoritarian or the democratic scenario is difficult to imagine conclusively, both counterfactuals suggest that alternative configurations of state institutions would have led to a different evolu-

\(^{132}\) The correlation between democracy and capitalism is well established. The process for creating and consolidating both, however, is not. On the well-established correlation, see Seymour Martin Lipset, Political Man: The Social Bases of Politics (Garden City, N.Y.: Doubleday, 1960); and the review of this literature by Larry Diamond, “Democracy Reconsidered,” American Behavioral Scientist 35 (March–June 1992).

\(^{133}\) Even two years into what has been a very painful transition period, the majority of Russian citizens still support the transformation of the Soviet command economy. In November 1993 a nationwide poll of over two thousand people indicated that 45.9% of those surveyed thought a transition to a market economy was a correct course for Russia, while only 27.4% thought the opposite; Tsentr Sotsioekspress, Institut Sotsiologii Rossiskaya Akademiya Nauk, Zerkalo Mnenii (Moscow: Tsentr Sotsioekspress, 1993), 6. While voters in December 1993 were undoubtedly expressing their dissatisfaction with the existing government, the outcome of these elections should not be interpreted as a rejection of market reforms altogether. After all, no electoral bloc running in the December elections advocated a return to the Soviet system, whereas the biggest winner, Vladimir Zhirinovsky’s Liberal Democratic Party, hardly mentioned economic issues during the campaign. Significantly, Civic Union, the electoral bloc most closely associated with the directors’ corps, which had dominated the Congress of People’s Deputies for the previous two years, received only 1.8% of the popular vote. For an analysis of the December 1993 elections, see the symposium in the Journal of Democracy 5 (April 1994).

\(^{134}\) Pereira, Maravall, and Przeworski (fn. 42), 212; Dietrich Rueschemeyer, Evelyne Huber Stephens, and John Stephens, Capitalist Development and Democracy (Chicago: University of Chicago Press, 1992), 296.
tion of property rights in Russia. Even though this is only one case study, the outcome of the politics of privatization suggests that decisions or nondecisions made about the institutional design of the Russian state at its genesis in 1991 affected the subsequent path of economic transformation.\(^{135}\)

The drama of Russia’s attempt at socioeconomic transformation is certainly not over. These counterfactuals suggest that renewed state resolve to define policies to create free enterprise, coupled with new state capacities to carry out such a program, could eventually lead to the creation of a new system of private property rights in Russia. Although it would be very difficult if not impossible to wrest control of privatizing enterprises from insider owners at this stage, a newly united and determined Russian state could enforce hard budget constraints for these enterprises. By eliminating or strategically allocating credits, the state could still compel enterprises to search for markets and profits, irrespective of who owns the enterprise. A policy that enforces hard budget constraints without a social safety net will be politically explosive. Directors and workers who are also shareholders in bankrupt enterprises will lose twice, creating a very angry and potentially dangerous social force that could challenge the state. To alleviate these social pressures caused by the dislocation of restructuring and rationalizing of assets, the Russian state will have to devote increased resources to developing a social welfare system that includes, among other things, unemployment benefits and job retraining. Only through the establishment of this set of market-supporting institutions can the demolition of the old Soviet enterprise system and the creation of new efficient firms be accomplished.\(^{136}\) A renewed program for creating private property rights must consider not only the reorganization of old assets but also conditions for the creation of new assets. Facilitating market entry for new firms may be as important for the development of private property rights as the dismantling of those institutional arrangement that preserve old Soviet enterprises.

Only a Russian state with enhanced capacity to act against the interests of entrenched social groups from the Soviet regime will be able to implement the policies just described.\(^{137}\) Without a strong state, the

\(^{135}\) Krasner (fn. 25), 242; Putnam (fn. 25), 8; Kathleen Thelen and Sven Steinmo, "Historical Institutionalism in Comparative Politics," in Steinmo, Thelen, and Longstreth (fn. 23).

\(^{136}\) Barr (fn. 120).

\(^{137}\) Elections in December 1993 may have marked a positive step toward this end. While the composition of the State Duma, the new parliament, is as conservative as the Congress of People’s Deputies after this election, Russian voters also ratified a new constitution. So far, this new fundamental law has facilitated, regulated, and normalized relations between the president, the govern-
creation of private property rights will continue to be altered or delayed.

**CONCLUSION**

In reflecting on the processes of change in Eastern Europe, Claus Offe noted that "this upheaval is a revolution without a historical model and a revolution without a revolutionary theory. Its most conspicuous distinguishing characteristic is indeed the lack of any theoretical assumptions and normative arguments." This article has attempted to begin to fill this theoretical vacuum about revolutionary change in the former communist world. It has done so not by inventing a new revolutionary theory, but rather by positing a causal relationship between state power and revolutionary economic transformation, and then testing this hypothesis by tracing the relationship between Russian state institutions and the creation of private property rights. By highlighting the importance of institutions in the formation and organization of socioeconomic systems, this article has identified the kinds of critical changes needed to induce revolutionary economic transformation. By identifying the state as the primary instrument for destroying old institutions and creating (or providing the environment for) new institutions, this article has presented a causal explanation for revolutionary outcomes that stands in contrast to both Marxist and liberal theories of society-led change and that is at odds with the orthodox neoliberal approach to reform in transition economies.