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PROPERTY RIGHTS IN CONTEXT: PRIVATIZATION'S LEGACY FOR CORPORATE LEGALITY IN POLAND AND RUSSIA

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The general statement that institutions for development ought to be appropriate to their circumstances is almost a truism. Nevertheless, as the other contributors to this symposium have shown, it is a truism that is too easily overlooked, and one that bears repetition. Peter Evans cautions against the trend to "institutional monocropping", and endorses Amartya Sen's call for participatory approaches to development to prevent an abstractly understood "growth" from substituting for other, more locally relevant goals. Stephan Haggard notes that Asian countries have found a variety of institutional arrangements to encourage domestic investors' confidence and to promote growth, confounding arguments linking specific institutional forms to growth outcomes. Gerárd Roland argues that the uncertain state of social-scientific knowledge of what makes institutions appropriate demands a cautious approach, based on diversity, experimentation, and maintaining reversibility of institutional change when possible.

The present article likewise endorses the position that institutions need to be appropriate to their circumstances if they are to foster development, but its focus is far narrower. I concentrate on the argument that institutions promote development in part through the predictability they offer investors. Among institutions, I concentrate on laws related to joint-stock corporations. And I argue that it is only when such laws adequately depict the circumstances in which they will be applied—that is, the motives for which actors will invoke them—that they can make the security of property rights predictable.[1]

Arguments linking the security of property rights to investment have a lineage dating back at least to the 18th century, but they have received new prominence recently in the huge literature in the New Institutional Economics, corporate governance, and related fields. Elaborations of these arguments also form the basis of what has been termed the "new" law-and-development movement, which promotes the strengthening of legal institutions as a path to growth.[2] One aspect of securing property is guarding against state expropriation; research has focused especially on the role of representative and federal institutions in reassuring investors that their property rights are secure from state incursions.[3] A sec-

[1] As becomes clear below, my argument is heavily influenced by Arthur Stinchcombe's reading of the legal realist Karl Llewellyn . For a related argument advocating fitting corporate law to the kinds of conflicts it is called on to resolve, see Pistor 2001.

[2] Rose 1998. Cf. Messick 1999; Upham 2002. On the older law-and-development movement, which was closely linked to modernization theory, see Tamanaha 1995.

[3] North and Weingast 1996; Olson 2000.

ond aspect, and the focus of the present paper, concerns how law can lend predictability to relations among non-state actors, such as buyers and sellers, firms and investors, or aspiring con-artists and their innocent prey. It is easy to suppose that consistent and impartial enforcement of the law, rather than anything specific about its content, is the key. Enforcement should work to cow the shifty, and thereby embolden the thrifty, who invest and trade. Unpunished malfeasance should have the opposite effects.[4]

On this view, it is state capacity to ensure impartial and consistent enforcement of commercial law that underpins the predictability businesses need to invest and promote growth. Despite its surface plausibility, this argument is incomplete. The significance attached to enforcement capacity is relativized once it is realized that behavior *compatible* with law can be inspired by a number of motives, of which fear of legal punishment is only one. Many businesspeople refrain from illegal deceit, as a number of scholars have noted, because they desire to reap the rewards of a reputation for fair dealing.[5] More generally, there may be extra-legal costs that deter violations of the law. By the same token, the magnitude of the gains available from violating the law are an obvious stimulation to violate it.[6] Even a small chance of mild punishment might deter a violation that yields little benefit. This point is obvious enough when one compares the prevalence of violation of two different laws in the same jurisdiction. That drivers will exceed the speed limit more readily than they will drive on the wrong side of the road does not primarily reflect the greater severity and probability of legal punishment for the latter. The concept of "state capacity to deter violation of the traffic laws", which superficially seems extremely specific, is actually too general to capture the reasons people obey or violate particular traffic laws.

When comparing similar laws in different jurisdictions, however, this point is easy to overlook. In this paper, I compare conflicts over property rights in corporations in Russia, where they have been quite prevalent and severe, with those in Poland, where they have been rarer and less intense. It is easy to assume that these distinctions represent more effective enforcement of corporate governance law in Poland than in Russia. I argue, by contrast, that the situation-determined rewards to the winners in corporate governance conflicts in Russia where far higher than those in Poland. As a result, the impulses the Russian legal system was trying to control were more intense; and it does not make sense to blame only comparatively weaker enforcement for the failure to bring these impulses under control. Metaphorically, violating corporate governance law in Poland was more

[4] For an example pertaining to Russian corporate governance, see Fox and Heller 2000, 1725.

[5] Klein 1997 includes many relevant papers.

[6] This is a problem with game-theoretic accounts of law-conforming behavior, which seem invariably to model the potential material payoffs to violating the law as the same in all circumstances. See, for instance, Cooter 1997.

like driving on the wrong side of the road, whereas in Russia it was more like speeding. It was not law enforcement alone that made the difference to the prevalence of the behavior. To speak of a general state capacity to enforce contracts and defend property, without considering the value of the rights the state is protecting, is just as senseless as speaking of a state capacity to deter violations of the traffic laws. The argument about how situational incentives (costs and benefits of violating the law in some specific instance) contribute to law-compatible behavior is expressed in Figure 1.

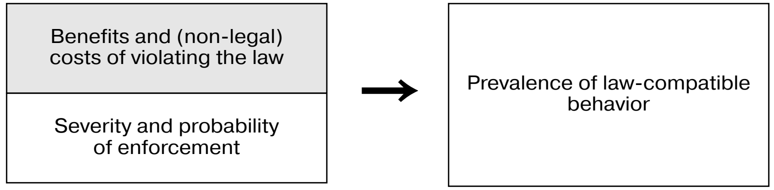

Figure 1

Traffic laws, however, are a poor metaphor for the laws securing property rights. Property rights are rights to invoke the state's backing to compel people to behave in certain ways: to pay debts, to allow shareholders to participate in the governance of a corporation, to refrain from trespass, etc. One can violate a traffic law all by oneself, on a deserted road; but property rights are claims people assert against one another. Thus, the relevant decision is whether to contest property rights claimed by someone else, either via litigation or simply by taking actions that negate these claimed rights. It is the chance of having one's way in such a contestation, through prevailing in court or simply by the other side conceding the rights in question, that must be weighed against costs and benefits (see Figure 2).[7]

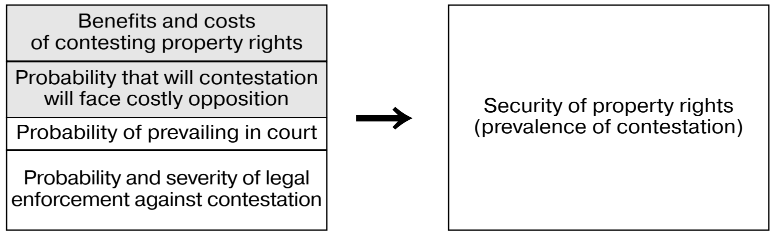

Figure 2

[7] For the fundamental insight that the turn to the law is shaped by a bargaining context, including the sorts of factors discussed here, see Commons 1957.

Benefits and costs of contesting property rightsSecurity of property rights (prevalence of contestation) Probability that will contestation will face costly opposition Probability of prevailing in courtProbability and severity of legal enforcement against contestation

A simple state-capacity argument for the prevalence of secure, which is to say uncontested, property rights focuses on laws, courts, as well as enforcement: With clear laws applied evenhandedly and without corruption, those mulling illegitimate contestations will not embark on them, especially if unsuccessful contestations are punished. Again, this superficially plausible argument, presented in the unshaded cells, ignores the value of the property rights that the state is seeking to protect (which affects the issues shown in the shaded cells). Just as law-compatible behavior stems from the joint effect of enforcement and extra-enforcement considerations, the failure to contest property rights (allowing them to be secure) stems from the joint effect of legal and extra-legal considerations. Were I to form a corporation tomorrow to capitalize on the commercial implications of my social scientific research, I doubtless could be sure that no one would contest my ownership of this corporation, even if the legal system's ability to defend property was notoriously weak: why steal something of such risible value?

This situational argument suggests that when the benefits to contesting property rights are high, the pressures on the legal system intensify accordingly. High stakes increase the temptation to devote large funds to suborning judges. More interestingly, a high payoff to successfully contesting property rights sets lawyers to work scouring statutes for ways to render property rights less secure. This search can yield "loopholes" that might have remained undiscovered absent the strong incentives to find them. A loophole, as explained more fully below, can be defined as a legal provision that can be turned to purposes not explicitly or implicitly envisioned in the provision's language. Thus, when the rewards to contesting property rights are great, the demands on the drafters of legislation are higher. If they are to exclude the possibility that rules will serve to destabilize property rights, they must have a detailed understanding of the circumstances in which rules will be applied, and the purposes to which actors will seek to put them.

Thus we have reached the thesis set out above: the capacity of laws to lend security to property rights depends on their intersection with the situations in which they are applied, not merely on state enforcement capacity or the acontextual "quality" of laws. Below, I seek to sustain this argument with evidence from Russia and Poland. In Russia, privatization was carried out in a way that strongly discouraged negotiation both among stakeholders in state-owned enterprises (i.e., managers, employees, suppliers, and customers) and among potential shareholders of the corporations created from them. Division of property thus became a zero-sum game, with large rewards for displacing other claimants. These large rewards led to frequent contestation of property rights. In Poland, by contrast, privatization and the transition to corporate form generally could occurred only after potential shareholders and stakeholders had reached a bargained agreement. The allocation of property rights was part and parcel of a larger accommodation about the future of the firm—a positive-sum game, and one in which contesting property rights would risk the gains from cooperation. Polish privatization involved a number of variants capable of encompassing the specifics of these accommodations, unlike Russia which practiced something very much like "institutional monoculture" in its privatization format. Thus, the two cases illustrate nicely how extra-legal context affects the security of legally guaranteed property rights, and how security of property rights requires flexibility in fitting them to the circumstances in which they will be asserted.

The next section discusses the Russia-Poland contrast and some alternate theoretical approaches to understanding it. I then set out in somewhat more detail the contextualized version of legal certainty described above. There follows evidence on the contrasts between privatization and corporate property in Poland and Russia. The conclusion draws some implications for the politics of building a law-governed economy, analyzing the early 21st-century experience in Russia.

The Poland-Russia Contrast: Enforcement Approaches

In the years after the collapse of the Soviet Union, Russia became notorious for weak shareholder property rights. Experts involved in writing the laws on corporate governance subsequently found themselves describing how easily these laws were subverted, and even publicly admitted to fears for their physical safety were they to return to Russia. Russia, they concluded, "needs a serious, top-down effort to control corruption, organized crime, and self-dealing [by corporate insiders]", and even "selective renationalization and reprivatization".[8] The state of corporate legality in Poland, by contrast, draws far more flattering academic depictions.[9] Surveys of practitioners by the EBRD, as well as other systematic cross-country comparisons, have generally rated Poland far above Russia in terms of the effectiveness of its commercial and corporate law.[10]

Explanations for this divergence vary. Gérard Roland argues that Russia experienced "state collapse:" a feedback loop between weakening state capacity to enforce the law and weakening incentives to obey it. He suggests this spiral was set off largely by poor policy choices, made under the influence of the "Washington consensus", choices that Poland managed to avoid.[11] Glaeser,

[8] Black, Kraakman, and Tarassova 2000.

[9] For instance, Glaeser, Johnson, and Shleifer 2001.

[10] Pistor, Raiser, and Gelfer 2000.

[11] Roland 2000.

Johnson, and Shleifer link Poland's success to "strict enforcement of securities law by a highly motivated regulator".[12] Because it is easier to assign proper incentives to regulators than courts, they argue Poland has fared better than its neighbor, the Czech Republic, which had weaker laws and, more significantly, relied on weak courts to enforce them. They do not engage the Russian case, though elsewhere two of the authors present a state collapse model on which Roland draws.[13] Perhaps they would endorse the statement that state collapse is a sufficient cause of weak corporate legality, but not the only one.

A somewhat more intricate theory stresses the timing of the creation of regulatory capacity relative to privatization. When privatization outstripped the capacity to regulate corporations, outsider shareholders unable to realize their rights, while giving insiders the chance to secure their position for the long term before regulations were enacted.[14] Black et. al. argue that in Russia, the absence of effective regulation, rather than raising the rewards for a good reputation, instead fostered the spread of majority owners willing to flout minority property rights, since such owners were able to extract more from the firms under their control.[15] It was the prevalence of such unscrupulous majority shareholders that prompted their strongly worded, enforcement-oriented remarks quoted at the outset of this section. Good enforcement earlier, they contend, would have avoided these problems, which now can be solved only through especially vigorous regulatory and enforcement activity. Thus although Black et. al. discuss incentives to contest property rights, they conceive them quite generally as the desire of majority shareholders to expropriate minority shareholders portion of the profits, which must everywhere be reined in by enforcement.

Alternative Approaches: Law in Relational Context

A second family of approaches to the security of property rights looks not to enforcement, but to the pattern of share ownership created by privatization. Russia (like the Czech Republic) privatized most of its industry through a program of "mass privatization", in which citizens received nearly free vouchers to use to purchase shares of privatized firms at auction.[16] A number of authors have argued that mass privatization impaired subsequent corporate governance by putting shares in too many hands, and in this and other ways exacerbating the classic Berle-Means dilemmas of separation of ownership and control. Kogut and

[12] Glaeser, Johnson, and Shleifer 2001, 853.

[13] Johnson 1997.

[14] Pistor 1997; Spicer, Kogut, and McDermott 2000, 635—636; Black, Kraakman, and Tarassova 2000.

[15] Note that this argument portrays the division of firm revenue as a zero-sum process.

[16] Lieberman et al. 1997 describes mass privatization and surveys its implementation in various countries.

Spicer argue that the diffusion of shares to many holders, coupled to the absence of markets to trade them encouraged the notorious Czech "tunneling" of property out of privatized firms. The lack of capital markets that could transfer ownership legitimately left tunneling as the only way to connect supply and demand for assets.[17] Many mass privatization programs anticipated governance problems related to the dispersion of ownership, and tried to address them by encouraging the formation of new institutional investors as intermediaries.[18] However, as Ellerman points out, the commissions of institutional investors relative to the capital stock of the firms they own are small; collusion with management may be simpler and more lucrative than emulating the shareholder activism of CalPERS on the banks of the Danube or the Volga (not to mention the Enisei or the Ob').[19]

These analyses, which consider the circumstances under which isolated shareholders can assert their property rights, and in which strategically placed actors may wish to contest them, avoid the danger of assuming that enforcement alone explains the security of property rights, and point the way to a broader investigation of the context in which law is invoked. They reflect the venerable but important insight that law is always applied to social situations it cannot aspire to exhaustively define. Legal definitions of situations regularly do not include sociologically relevant circumstances. Law can recognize one party as a debtor, another as a creditor, but these terms do not necessarily capture all aspects of their interactions. A firm that sells goods on credit becomes a creditor, its customer a debtor. The seller-customer relationship may counsel forbearance on collection of the debt, even when the creditor-debtor legal relationship does not mandate it. In other words, legally defined relations can, potentially, be *embedded* in other kinds of social interactions, to use the term that Mark Granovetter and Margaret Somers have adapted from Polanyi. Somers' own formulation is perhaps more instructive: law is applied in a "relational context" that includes relationships not encompassed by legal categories.[20]

If the relational contexts into which law is inserted are distinct, the same written law can have distinct and unpredictable effects. Somers illustrates this point by comparing the effects of identical rules on labor regulation in different parts of 17th century England characterized by different social structures.[21] In a similar vein, but closer to present concerns, David Skeel shows how virtually identical bankruptcy codes in the United States and Japan in after World War II came to have radically different implications for debtors due to differences in pat-

[17] Kogut and Spicer 2002.

[18] Lieberman 1997.

[19] Ellerman 2001.

[20] Somers 1993.

[21] Somers 1993.

terns of corporate finance.[22] Skeel, like Mark Roe, Katharina Pistor, and other scholars, emphasizes that systems of corporate governance are indeed *systems* that go beyond the law on the books to the actual configurations of ties between investors and corporations.[23] Absent some knowledge of these configurations, the role of law—which statutes actors will invoke, for what purposes, with what expectations—is impossible to judge.

Predictability of law in relational context

Suppose it is the case that property rights guaranteed by particular legal provisions—say, the rights of minority shareholders as understood by these shareholders—are rarely challenged. This would imply that in almost all the situations to which the relevant provisions apply, the character of the extra-legal considerations is such that they do not overwhelm the disincentives to contesting property rights rooted in the legal system itself. That a bounded set of laws is able effectively to regulate a large set of situations indicates that the situations themselves have a predictable form, to which the laws are appropriate.

Arthur Stinchcombe's recent work on legal certainty, based on a penetrating interpretation of the legal realist Karl Llewellyn, suggests that such a state of affairs results from a "trajectory of improvement".[24] Llewellyn argues that statutes implicitly or explicitly depict "situation-types" involving a specification of relevant actors and their motives.[25] In considering whether a given situation ought to be brought under a legal provision, judges weigh how adequately the provision depicts the motivations of the actors involved. When the motivations implied in legislation fail to match those operative in practice, judges often experience the outcome of applying the provision as unjust. In Weberian terms, formal rationality gives an unwelcome substantive result; Llewellyn describes this as a violation of the "fireside equities", i.e., of the judge's intuition for what a fair decision would be.[26]

However, and crucially, Llewellyn does not view formal rationality as absolutely constraining. In fact, it is very rare that an unambiguous, deductive argument from law on the books to a decision on the case at hand is possible. Judges, or at least those working in a common-law system, have a number of accepted, authoritative ways of distinguishing a case at hand from some unwelcome precedent, or of relating it to a more congenial one. They therefore are reg-

22 Skeel 1998.

23 Roe 1996; Pistor 2001; Milhaupt 2001.

24 Stinchcombe 2001, 35—41.

25 I have not been able to locate a precise definition of situation-type in Llewellyn as of this writing; my definition as "actors and motives" is abstracted from his uses of the term on 212, 271—272, 426—428 and elsewhere.

26 Llewellyn 1960, 274.

ularly in a position to make a "choice among [a] plethora of correct doctrinal possibilities".[27]

Because the letter of the law offers so much flexibility, judges can often find a way of presenting their sense of substantive justice as consistent with the law. However, Llewellyn does not feel this threatens unlimited arbitrariness or decisions governed solely by "fireside equities". For he also believes that judges are effectively socialized to make decisions that apply to more than the case at hand. Faced with recurrent situations (situation-types) in which the most obviously applicable law leads to an unjust outcome, they will try to exploit the flexibility of appeals to legal authority to forge a new, just rule under which the situation-type can be brought. Indeed, Llewellyn asserts that situation-types generally embody some "immanent law" or "singing rule" which talented judges can uncover.[28]

To see how the trajectory of legal improvement works in practice, consider Llewellyn's discussion of the abuse of legal remedies for failure of a shipment of goods to conform to specification. The situation-type (recall that this refers to relevant actors and their motivations for invoking a law) is one where a buyer and a seller have agreed to a transaction where the seller undertakes to deliver goods of a specified quality and the buyer agrees to pay a definite price. The law makes provision for the buyer to refuse delivery when the goods are not as promised. Refusal of delivery is allowed in order that buyers may be confident they will get what they pay for. However, courts saw a number of cases in which buyers chose to claim that goods did not conform to quality for a different reason: the price of the goods in question had gone down. Because the law offered no straightforward way to disallow non-acceptance of goods on such motivations, judges sought other, technical grounds to disallow them (as Llewellyn puts it, they were "trump[ing] the sharper's ace" by invoking a legal rule irrelevant to their real concerns, just as the buyers were).[29] Fireside equities were driving decisions: as one appeals-court judge put it in an opinion on such a case, "it would seem at least possible that [the decisions in lower courts] were influenced not a little by their natural desire to prevent purchasers on a rapidly falling market from escaping from a bad bargain, by taking advantage of a variation from the terms for which they in fact cared nothing".[30]

This example illustrates nicely how when applying a legal rule to a situation, one is also offering a depiction of the motivations of the parties that may or may not be accurate. When a rule is invoked for reasons other than the motivations implicitly or explicitly embodied in it, we are tempted to term the rule a "loop-

27 Llewellyn, 1960 #788@129; 75—76.

28 Llewellyn 1960, 122.

29 Llewellyn 1960, 123.

30 Quoted in Llewellyn 1960, 123n158.

hole" or "technicality". In the sort of cases just discussed, buyers were exploiting non-conformance to the agreed terms as a loophole to avoid their agreed-upon obligations. Llewellyn implies that judges can react to loopholes in one of two ways, which one can term loophole-plugging and loophole-closing. Loophole-plugging involves the use of various case-specific technicalities to render a decision in line with a judge's sense of substantive justice. [31] Loophole-plugging does nothing to increase legal certainty in the situation-type occasioning the use of the loophole, since it remains difficult to predict which rules will be relevant in making a decision. Loophole-closing involves recognizing that a particular loophole is being used in a situation-*type*, rather than just a particular case, and devising new rules whose application in the situation-type will lead to a fair outcome.

Loophole-closing does increase legal certainty, by fitting rules to the circumstances in which they are invoked, and producing substantive results that accord with most judges' sense of the fireside equities. Indeed, Llewellyn asserts that situation-types generally imply some "immanent law" or "singing rule" with these features, a rule which talented judges can uncover.[32] As Stinchcombe's pellucid reading suggests, legal certainty (or "reasonable regularity", the phrase Llewellyn prefers) obtains once "hard cases" stop reaching the stage of appeals, since what generates appeals are precisely those cases in which the desire of judges for a substantive outcome has to be backed up by vulnerable legal reasoning.[33] Paradoxically, then, it is judges' flexibility in relating cases to precedents that allows them to create new rules for situation-types that other judges will accept. In the example considered above, Llewellyn does not say how, or whether, judges came up with a rule that made it clear that buyers could not use nonconforming goods as an excuse to return to the market for a better price, but this would have been the final stage in his process.

Figure 3 diagrams the "trajectory of improvement".[34]

Note that there is no necessity to the trajectory of improvement. The intellectual possibility for such a trajectory—leaving aside all practical matters—depends on the recognizing that particular loopholes are being invoked on similar motivations in similar situations. Thus, stability in the workings of a legal rule depends on regularity in the sort of situation in which it is applied, regularity in terms of the motivations of the parties. *By itself* a rule on what allows a buyer to reject a seller's shipment as not up to snuff does not create predictability for the seller—if the market situation determines how intensively the buyer will look for grounds for rejection, or the kinds of remedies the buyer will seek. How much

[31] Compare on "bad law".

[32] Compare Llewellyn 1960, 274 on "bad law".

[33] Llewellyn 1960, 122.

[34] Compare Stinchcombe 2001, 93—96, 99, especially on the link to Weber.

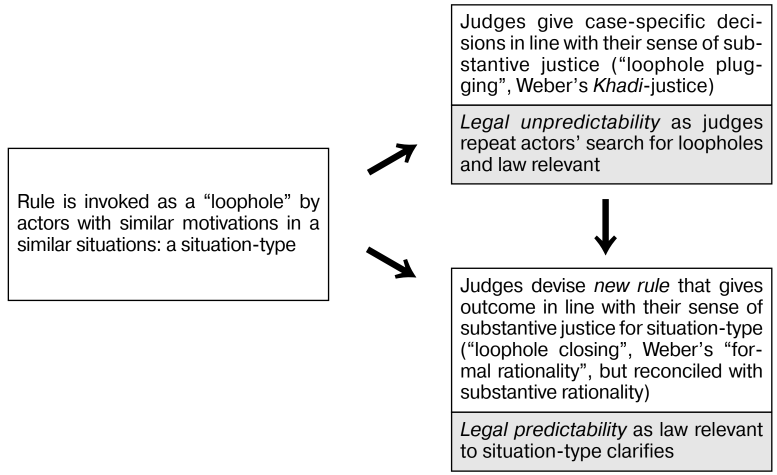

Figure 3

certainty the rule gives depends on how stable the market situation is, and how well the law is able to recognize and sanction efforts to exploit a technicality for commercial advantage. In some circumstances—such as purchases of unique goods not elsewhere available—the rule's predictability might well be completely adequate. The legal craftsmanship that Stinchcombe and Llewellyn extol, the fitting of laws to the situations in which they will be applied, depends on those situations themselves having a predictable form.

Privatization in Poland and Russia

If we take the overwhelmingly shared impression that legal certainty of shareholder rights in Poland has been far greater than that in Russia as accurate, the forgoing suggests we look to the different contexts in which shareholder property rights were exercised to explain why. The privatization programs in Russia and Poland "embedded" the corporate law governing privatized enterprises differently, an outcome that reflects distinctions in how these programs reacted to the existing relational context of state-owned enterprises. The programs had different ways of addressing the interests of stakeholders: those in existing, ongoing relationships to the enterprises subject to privatization, for whom these relationships constituted a form of property or investment which they wished to preserve. In Poland, the dominant forms of privatization allowed stakeholders to achieve negotiated, locally appropriate recognition of their stakes as part of the privatization process. Importantly, these negotiations involved structuring the relational context in which the post-privatization property rights would operate.[35] Russia's privatization employed the shortcut of converting stakeholders to stockholders according to standardized procedures.[36] The allocation of property rights to stakeholders thus was detached from discussion of the substantive character of their relations, and indeed promoted fragmentation of these relations.[37] At the same time, Russia's privatization offered outsiders a share of ownership in privatized enterprises, without providing for (indeed, discouraging) pre-privatization negotiation between outsiders and insiders. The upshot was an allocation of property rights carried out without a simultaneous restructuring of relational context. This disjuncture created, for reasons explained below, massive incentives to contest the legal events possession of corporate stock authorized.

For these arguments, I offer two sorts of evidence. First, I describe the course of privatization in Poland and Russia, demonstrating that the ability of stakeholders to achieve negotiated, locally appropriate legal recognition of their stakes existed in Poland, but was absent in Russia. Second, I demonstrate that the pattern of conflicts over property rights and the evolution of the legal situation in Russia are consistent with a poor match between the laws relevant to stockholder property and the practical situations in which it was embedded, distortions created by the form of privatization. All evidence, including the pattern of legal change, indicates that such conflicts were far more infrequent in Poland. Most dramatically, the form of corporate acquisitions differed drastically between the two countries. In Poland, corporate acquisitions took the form of negotiated purchases of shares. In Russia, however, corporate acquisitions, with great regularity, involved intense conflict in the legal arena and around it.

On the eve of privatization, it would have been hard to predict that privatized enterprises would have such distinct relationships to the law in the two countries. In both Poland and Russia, crucial choices regarding the form of privatization were made in an extraordinarily difficult economic atmosphere in which the state seemed to have little real control over the enterprises it nominally owned. Reforms in the 1980's had destroyed what coherence the planned economy had attained, leading to a loss of both macroeconomic and microeconomic control mechanisms. The macroeconomic context involved roaring inflation, fed in part by a disorganized banking system in unsteady transition from its status as an organ of accounting and planning under the command economy. On the microeconomic level, in both countries, industrial enterprise insiders—workers and

[35] For important insights on this point, in the context of a discussion of implications for entrepreneurship and restructuring, see Spicer, Kogut, and McDermott 2000.

[36] It can be viewed, therefore, as an instance of the "institutional monoculture" Peter Evans critiques elsewhere in this symposium.

[37] Cf. the contrast between Poland and the Czech Republic in Spicer, Kogut, and McDermott 2000 and McDermott 2001.

managers—had gained substantial autonomy from higher-level planning and management agencies. This autonomy was regularly used for what has been termed "nomenklatura" or "spontaneous" privatization, in which state managers transferred assets and cash-flows to new legal entities. An effective summary of the situation was that the state "did not really own the assets it needed to privatize" and "various 'stakeholders,' including the managers, the employees, and the local governments, exercised substantial control over the allegedly public assets and could stop privatization if they wanted to". [38]

What differentiates the two cases is the *reaction* to these circumstances of macroeconomic and microeconomic disarray by the liberals in charge of economic policy at the transition's outset. Roughly speaking, Polish reformers focused more on the macroeconomy, and found themselves in a long political stalemate over privatization to restore microeconomic control. Privatization went forward slowly, effectively on a case-by-case basis, with stakeholders granted a de facto veto over how privatization occurred. Veto rights were not property rights, however: reformers were not willing to "to support preferential privatization to... inside groups associated with the Communist regime".[39]

Russian reformers, quite aware of the Polish impasse on privatization, made the opposite choice.[40] When plans to privatize without insider preferences met political opposition, reformers created a program that would neutralize the resistance of stakeholders by turning them into stockholders. Even with outsiders excluded, they argued, stockholders would have an interest in maximizing the value of their property, which would manifest itself in firm restructuring and political support for capitalism. Fast privatization would also help make the end of the planned economy irreversible.

Aside: What explains privatization policy choices?

All causal regresses must stop somewhere, and the primary purpose of this paper is to consider the *effect* of these policy choices on legal interactions surrounding the corporate form. However, it is worth devoting a few words to what explained the distinct choices Russia and Poland made on privatization. Of particular import appears to have been different perceptions of the impact of privatization on *macroeconomic* control, stemming from different historical experiences of the breakdown of the planned economy's money-control mechanisms in the two

[38] These quotations, referring to Russia, are drawn from Boycko, Shleifer, and Vishny 1995, 13; for similar pictures see Clarke and Kabalina 1995; McFaul 1995; Radygin 1995. On the parallel situation in Poland, see Orenstein 2001; Levitas 1994.

[39] Orenstein 2001.

[40] At the time Russia's privatization program was being designed, conventional wisdom was the Czechs' voucher privatization had successfully avoided the privatization stalemate dogging Poland. For the Russian reformers' close attention to the Eastern European experience, see: Rosett and Liesman 1995; Anonymous 1992; Boycko, Shleifer, and Vishny 1995, 83.

countries. In all planned economies, macroeconomic control was dependent on serial successes in microeconomic control. Because wage payments were a major channel by which money entered the economy, controlling what enterprises could pay their workers was a crucial part of the task of macroeconomic management. Loss of control over wages, in a context of fixed prices, led to repressed inflation in the form of shortages and queuing for goods.[41]

Reforms in both Poland and Russia undermined the institutions the state had traditionally used to control wage payments at the enterprise level, worsening shortages. In the USSR, economic authorities reacted with new tax-like measures to rein in salary payments, but enterprises were able to find ways around these restrictions by exploiting their new autonomy to open semi-private businesses. In the last 18 months of the Soviet Union, however, the focus of the macroeconomic dilemma shifted from wages. The Russian Federation and other republics seeking to limit the USSR's authority took increasing control over tax flows and the banking system, leaving the USSR government to rely on monetary emission to finance its expenditures. Thus, state incoherence fueled by the localist agendas of republic leaders replaced failing wage control as the key source of macroeconomic instability.[42]

In Poland, there was no parallel conflict inside the planned economy's fiscal and monetary administration, and those responsible for economic policy located the roots of the country's huge inflationary difficulties in excess wage demands. Leszek Balcerowicz, who designed the Polish reforms implemented from late 1989, made controlling wages a critical part of his program. One reflection of this concern was the *popiwek*, a punitive tax on high salaries (a measure quite similar to the wage control efforts in the USSR). Privatization policy was a second. Balcerowicz believed that privatized firms would naturally rein in wage appetites, as long as workers were denied a substantial share in ownership.[43] Indeed, privatized firms were exempted from the *popiwek*.

Russian reformers, by contrast, felt that privatization's benefits would obtain even with insider owners, and that general macroeconomic restriction could be implemented afterwards.[44] (Compare Balcerowicz: "privatization first, stabilization later would have given neither".).[45] They did not seek to establish wage control in industry. And when push came to shove, Gaidar made it clear he was willing to make temporary sacrifices on stabilization policy to achieve privatization aims.[46] These intellectual differences, although they clearly stem in part from the Russian reaction to the Polish experience, probably also reflect the different ways in which the planned economy decomposed in the two countries.

[41] On the close relationship between macroeconomic and microeconomic control in planned economies, see Grossman, University of California Berkeley. Center for Chinese Studies., and University of California Berkeley. Center for Slavic and East European Studies. 1968; Woodruff 1999, 36; Gregory and Tikhonov 2000; Peebles 1991.

[42] Woodruff 1999, 56—78.

[43] See Balcerowicz's remarks in Blejer and Coricelli 1995.

[44] Boycko, Shleifer, and Vishny 1995, 64; Gaidar and Pohl 1995; cf. Gaidar 1992, which analyzes the politics of inflation but draws no links to privatization.

[45] Bléjer and Coricelli 1995.

Privatization in Russia

Whatever the roots of their decision, Russian politicians, with the aid of outside advisors sophisticated in economics, designed the country's rapid and comprehensive initial wave of privatization (1992—1994) with several aims in mind. First, they felt that enterprises' managements were engaged in destructive asset-stripping, and wanted to forestall this by giving managers some *de jure* control, so that there would be an incentive for enterprise adjustment. Second, they wanted to offer incentives to "stakeholders" within the enterprise to support privatization, or at least not oppose it, by giving them privileged access to shares. Third, reformers hoped that despite the imperfections of economic legislation and the weakness of its enforcement, the new group of private property owners would become a constituency for property rights, pushing the state to strengthen them.[47]

They did all they could to make privatization a rapid process. Once the privatization law was passed in the summer of 1992, presidential orders soon followed implementing the distribution of vouchers for use at auctions of property, and mandating legal transformation of enterprises into corporations. Over 22,000 enterprises were registered as corporations by June 1994; of these, nearly 15,800 had been privatized.[48]

Russia's privatization law offered three options for privatization, each of which gave insiders what have been called "colossal" benefits, but no detailed say over the shape of the process.[49] The most popular option, chosen in 73% of cases, was "Option 2". This allowed workers and managers to purchase 51% of the shares, at 1.7 times their largely meaningless "book value", determined mechanically by reference to Soviet-era nominal values. In another 25% of cases, "Option 1" was chosen; this option gave 25% of the stock as nonvoting shares to the workers, with another 10% available at around a third less than the book value.[50] Internal distributions of shares were also conducted as voucher auctions. Thus, the distribution of shares among stakeholders reflected not the substantive character

[46] Gaidar and Pohl 1995.

[47] Boycko, Shleifer, and Vishny 1995.

[48] Boycko, Shleifer, and Vishny 1995, 98, 106.

[49] Radygin 1995, 43.

[50] Boycko, Shleifer, and Vishny 1995, 75, 78; Radygin 1995, 39.

of their stakes, but the number of vouchers they could mobilize. Since insider stakeholders in these auctions were competing with one another for a fixed number of shares, explicit negotiations that would link shareholding to the nature of stakes were practically out of the question. Naturally enough, managers' control over firm cash flows gave managers excellent chances in these internal auctions.

Having chosen to give controlling blocks of stock to insiders they felt were extremely unlikely to do a good job of restructuring, the privatizers focused on making sure that shares could be traded after privatization, and opening the road to at least some outsiders. Where Polish insiders that had privatized their firms through leasing-style arrangements regularly formed "closed" joint-stock companies, with existing shareholders eligible to buy further shares, this corporate form was practically eliminated as an option for privatizing Russian firms.[51]

The fate of the shares not distributed to insiders varied. In general, the official intent was to have 29% sold at public voucher auctions, with the remaining 20% (under Option 2), held for future sale by the state.[52] Voucher auctions were a major way that outsiders could acquire stock; efforts of insiders to rig auctions to their own benefit and block outside purchasers were notorious, but not always successful.[53] Remaining state shares were slowly parceled out in a variety of ways over time, including via "investment tenders" that linked their purchase to a commitment of additional investment in the firm.[54]

No form of privatization pursued in Russia involved discussion of the allocation of property rights between suppliers and customers, or of how to maximize the value of enterprises as "going concerns". Indeed, the procedures for privatization promoted isolation of stakeholders from one another, and conflict between them. Internal auctions transformed stakeholders into competitors. And because of the extremely cheap distribution of control in each privatized entity, privatization's design had a fragmenting effect: more valuable subunits of "going concerns" had every reason to split off if they could. Even existing integrated enterprises experienced intense conflicts over whether subdivisions would be privatized jointly or separately, as some subdivisions had the legal right to do. Participants in longer supply chains had even fewer chances to come to a negotiated decision about the degree of their legal integration. Efforts at joint privatization of technologically linked enterprises, forwarded by descendants of Soviet sectoral ministries and production associations, were resisted by privatization authorities, who could usually count on the backing of individual enterprises that would prefer to be privatized alone.[55]

[51] On Poland, see below; for Russia, see Boycko, Shleifer, and Vishny 1995, 75. Very few firms found a way around this ban.

[52] Radygin 1995, 64; Boycko, Shleifer, and Vishny 1995, 75, 78.

[53] Radygin 1995, 67.

[54] Radygin 1997.

[55] Boycko, Shleifer, and Vishny 1995.

Not all large firms underwent voucher privatization. Most notoriously, some of the most valuable energy and metals-producing firms were sold for a pittance to Moscow-based bankers, in an effort to build a coalition that would back Yeltsin's re-election as president in 1996.[56] As in voucher privatization, allocation of property rights happened without negotiation between stakeholders. The situation was programmed for conflict between outsiders with no stake in the firm beyond their stockholdings, and insiders whose de facto control was threatened. Though in most cases in the outsiders were indeed able to consolidate the control they had won through the loans-for-shares plan, it was in no case a trivial task.

Privatization in Poland

Privatization in Poland did not set the stage for long-running insider-outsider conflict centered around stock ownership. Polish Communists had retreated from their claim to domination in the face of economic pressure and popular mobilization by the Solidarity workers' movement. Although it was intellectuals close to Solidarity who launched the economic reforms, they rejected the movement's longstanding advocacy of worker control.[57] This led to sharp conflicts in the Sejm, Poland's parliament. In 1990, the upshot was a compromise privatization law that provided for three forms of privatization (although no provisions were made for implementing one of these, mass privatization for free vouchers distributed to citizens).[58] Some privatization was also carried out using socialist-era bankruptcy provisions.[59] It wasn't until 1993 that legislation implementing mass privatization was enacted, at a time when the original reformers had already been voted out of office. Implementation did not begin until 1995.[60]

The hallmark of the most widespread privatization methods in Poland was a *simultaneous transformation of legal form and social substance*.[61] In other words, changes in legal status were directly connected to negotiated reorganizations of the social environment in which law would be implemented.[62] Particularly important was that in the vast majority of cases commodification of stock was permitted only on terms acceptable to insiders. Furthermore, when outsiders did

[56] This interpretation may be considered undisputed, since it has been offered by Anatolii Chubais, who designed and managed the auctions. MK-Daily, 23 September 1998, 2; as translated by the Federal News Service, supplied by DowJones News Retrieval.

[57] Orenstein 2001.

[58] Orenstein 2001.

[59] Blaszczyk et al. 1999, 3—5.

[60] Blaszczyk et al. 1999, 3—5.

[61] Cf. McDermott 2001.

[62] For a key early perspective on this joint transformation, see Levitas 1994, who argued that enterprise insiders "are trying to wean themselves away form the state by simultaneously redefining the ownership structures of their firms, their productive profiles, and the markets in which they expect to function".

receive an opportunity to buy into privatized firms, this was done either on terms decided by insiders or in a way that gave outsiders an overwhelming dominance in shareholding. Because there were so many ways privatization took place, space considerations prevent a full review. However, a couple of examples give the flavor.

Direct privatization. This method of privatization encompassed roughly a third of all privatized enterprises. Although it consisted in three subtypes, around two-thirds of these privatizations took the form of installment purchases (usually termed leases) of the assets of the former SOEs. The SOE was legally dissolved, and its assets transferred to a new company formed by the SOE's employees, who had to commit to buy at least 20% of the assets. After all the payments had been made, the assets became the property of the new company.[63] The procedure was voluntary, and could *only* happen after a vote of the employee council.[64] The valuation placed on SOE assets was regularly such that it was beyond the means of the company's employees, meaning that outsiders had to be involved. However, it was the newly organizing firm that both located buyers and determined "which of these buyers to let into the process... [Outsiders were] usually drawn from the network of the firm's suppliers and buyers".[65] The approving authorities included the SOE's "founding body", often an arm of local government, which brought another stakeholder into pre-privatization negotiations.

Survey research suggests that the nearly 90% of new enterprises formed in this way employed corporate charter provisions restricting the sale of shares to outsiders. These restrictions did not block them, however, from issuing new shares to allow additional outsiders to buy into the company—presumably, when this was a legal form that suited both bodies.[66]

Mass privatization. Poland's version of mass privatization involved a complex two-tier procedure in which Poles were given certificates for shares in 15 newly created investment funds, which in turn were allocated shares in the 512 state enterprises (about 11% of all privatized enterprises) participating in this program. For present purposes, the important point is that participation in the program was subject to veto either by management or by the employees council. Though of course this did not preclude subsequent conflict between insiders and outsiders,

[63] Kozarzewski, Krajewski, and Majak 2000, 38. Some leasing arrangements apparently did not terminate with property transfer, though it is unclear how many. Kozarzewski, Krajewski, and Majak 2000, 38. See also Levitas 1994, 107—108.

[64] Kozarzewski, Krajewski, and Majak 2000, 38. This changed after passage of a new law that came into force in 1997; which allowed outsiders to initiate privatization, and also tried to promote the inclusion of more outsiders in the new joint-stock company created out of the dissolved SOE. However, by this point at least 80% of all direct privatizations had been accomplished. Blaszczyk et al. 1999, 307; Dabrowski 2001, 140; Kozarzewski, Krajewski, and Majak 2000.

[65] Levitas 1994, 108—109; McDermott 2001.

[66] Kozarzewski and Woodward 2001, 22.

the procedure left high-visibility, government backed outsiders with a dominant share of the outstanding stock.[67]

Privatization's legacy for corporate legality

State socialism built an economy of idiosyncracies.[68] As the system approached its demise, each enterprise operated according to an accretion of particularistic bargains with planners and ministerial supervisors over such things as norms for material use and allocation of capital to different purposes. This diversity of local situation, of production and its organization, of course persisted after privatization. Nevertheless, the distinct forms of privatization in Poland and Russia did produce characteristic patterns in the relationship between corporate stock as a legal form and the social substance underlying it—the day-to-day routines and interactions that make a firm a "going concern".

In Poland, all evidence suggests that insiders' veto on privatization generally meant that stock became subject to anonymous, commodity-like transactions only when insiders felt that they had something to gain from it. There was regularly an option to privatize as a closed corporation with nonfungible shares, which many employee-manager buyouts adopted. True, some firms' poor financial situation left them faced with an unpleasant choice between outright liquidation and a bank-led reconciliation plan that could involve a reassignment of property rights through debt-for-equity swaps. But even in such cases the deals were negotiated on the basis of mutual gains for creditors and debtors, not as a zero-sum division of property.[69] Property rights became alienable only when insiders were will to accept the legal consequences.

In Russia, by contrast, the alienability of shares was something achieved only through tenacious efforts by central government officials over the objections of enterprise managers.[70] Outside shareholders represented a threat to the nearly total control managers had over enterprise finances.[71] Stakeholder-shareholders (i.e., workers) could be kept in line through their other dependencies.[72] But outsiders were simply new claimants for the firm's earnings, who could conceivably be backed by the courts or bring other resources to bear. Given the extremely cheap valuations the privatization process put on Russian firms[73], managers had every reason to purchase as many shares as they could to secure their control over

[67] Blaszczyk and Woodward 2001.

[68] Woodruff 2000.

[69] McDermott 2001.

[70] Boycko, Shleifer, and Vishny 1995, Radygin, 1995 #783; Frye 1997.

[71] Boycko, Shleifer, and Vishny 1995, 117.

[72] Clarke and Kabalina 1995.

[73] Boycko, Shleifer, and Vishny 1995, 117—120.

their enterprises. Surveys in the immediate aftermath of privatization suggested that insiders in the median firm controlled 52% of the stock, and that general directors, on average, aspired to have 69% of the stock controlled by insiders.[74] They also took other measures to prevent outsiders from acquiring stock or exercising the legal rights it was supposed to afford. Thus, unlike in Poland, fungibility of stock resulted not from acquiescence of the firm's *de facto* owners when they were able to turn it to their advantage, but over the objections of these owners. The value corporate stock would have, were its ownership indeed to secure the specified legal rights, far exceeded its value in the marketplace.

The contrasting histories suggest that Russian privatization set the stage for regular, systematic splits between corporate stock's specific legal value and its public market value, whereas Polish privatization did not. Thus, the stronger corporate legality in Poland ought to be linked not to the capacity of its state to mobilize revenue for relevant law enforcement, but to a privatization process that achieved legal certainty by bringing situation-type and legal regulation into alignment. Further evidence for this proposition is supplied by focusing on aspects of post-privatization legal developments in Russia that reflect fissures between situation-type and legal regulation. Although it is more difficult to prove the absence of a phenomenon than its presence, I also offer brief contrasts to Poland that suggest the absence of parallel developments there.

Russia: Exploiting the legal definition of value as a loophole

I present two examples of the way that the situation-type created by privatization—a fissure between insider and outsider shareholders, with the former unwilling to share net revenues or sell their stakes in the firm at low prevalent prices—prompted a search for loopholes. These loopholes had the effect of resolving conflicts by forcing one side to surrender stock in return for legally determined, but inadequate, compensation. The first example is a case history that illustrates in some detail the use of such a loophole to resolve contestation over property rights. The second example chronicles the emergence of an industry devoted to debt-for-equity takeovers, which used bankruptcy law to contest the property rights of manager-shareholders unwilling to sell.[75] I then turn to the pattern of legal change.

Case: The Conflict at the Volgograd Factory of Drilling Machinery.[76] This conflict, which centered around a factory with around 30% of the Russian market for oil-drilling machinery, pitted minority shareholders with 43% of the outstanding stock against majority shareholders with 51%. The majority shareholders, who controlled the factory's management, were a Volgograd-based banking group

[74] Blasi, Kroumova, and Kruse 1997, 193—194.

[75] For discussions, see Radygin 2002; Deriabina 2002; Volkov 2002.

[76] Based on press reports and the text of relevant laws available from the Emerging Markets database at www.securities.com.

called NOKSS. The outside shareholder, initially, was the United Machinery Group (known by its Russian acronym as OMZ), a holding company that controlled much of the rest of oil-drill market. OMZ, having acquired its shares apparently through door-to-door purchases from workers who had received them in privatization, spent more than a year trying to reach an arrangement with management and the majority shareholders regarding representation on the firm's board and division of its profits. Eventually, OMZ turned over 40% of its shares to MINFIN, a company specializing in aggressive efforts to enforce legal claims. MINFIN, for unclear reasons, split these shares among two smaller partnerships.

Russian corporate law allows minority shareholders controlling more than 30% of outstanding stock to call an extraordinary shareholders meeting; the quorum for such a meeting's decisions to be binding is 50%. Representatives of the majority shareholders failed to appear at the scheduled meeting (held on the morning of January 1st, 2001). In the event that a quorum is not present, the law allows calling of a second meeting twenty days later, with a quorum of only 30%. MINFIN called such a meeting, and elected a new general director and a new chairman of the board. The new general director (a business-school student, as was the chairman of the board) did not try to take control of the factory's day-to-day operations, though he did make an effort to enter the plant grounds and was stopped by security. He also asked for the plant's seal (required for binding documents). Denied, MINFIN had a new seal produced, and tried, at least formally, to win control over the firm's bank accounts.

The majority shareholders declared the MINFIN-organized shareholders' meetings illegitimate, claiming they had not been properly notified. They then took two further, more dramatic actions. One of these was to arrange for the arrest of the alternative general director and board chairman for "forging" the company's seal on official documents. The arrest was carried out by Volgograd policemen, who traveled to Moscow to make the arrest and then transferred the two students to pretrial detention in Volgograd. They were fairly quickly released with a pledge to appear for trial.

The second action proved to be of more enduring significance. According to law on joint-stock companies, companies' board of directors were allowed to take decisions on stock splits or on stock consolidations. The majority shareholders used this provision to carry out a consolidation of the company's nearly 190,000 outstanding shares into four shares. Because the two MINFIN partnerships held less than 25% of the shares each, they were not entitled to one of the four new shares in the company. Instead, the law specified compensation based on the *board's* determination of reasonable value for the outstanding shares.[77] The board

[77] The price was supposed to be that a "uncoerced buyer" would pay; evaluation was supposed also to "take into account" public quotations of the stock's price—none in this case—as well as what an uncoerced buyer would pay for the entire outstanding capital stock. The latter provision appears designed to

paid the minority shareholders around $400,000. By contrast, MINFIN had some time earlier publicly offered $7 million for an additional 25% of shares in the company (whose annual sales were around $30 million). The two shares actually issued in the consolidation went to the existing majority shareholders, who then started proceedings to convert the firm into a private partnership. MINFIN then pursued suits and regulatory appeals contesting the consolidation, losing in the local courts, winning once in at a higher-level court in Moscow, and finally losing on a second appeal. It continued to claim (to no apparent avail) that the board taking the consolidation decision was not legitimately elected. The majority shareholders were left with full control over their property.

On the backdrop of this well-reported story, and prodded by the influential head of OMZ, the Duma passed with some rapidity a law replacing the compensation provision with "fractional shares", with proportional voting rights, in cases of consolidation. However, before it came into effect, a number of other firms carried out similar consolidations on similar motivations. It's worth noting that this provision of the law had been on the books since early 1997, but seems to have first been exploited in this way in 2001. The notion that this was simply a "loophole" in a poorly drafted law is thus too simple. If the pattern of motivations were different, this provision of the law might be entirely unoffensive. It was particular circumstances—the particular struggle over the control bonus—that led to the *search* for this loophole.

Debt-for-equity takeovers. The minority shareholders in the case just described announced their willingness to purchase the firm in question, but they were not able to come to an agreement on the price. This situation was very typical. Firms intent on industrial acquisitions—especially the largest Russian business groups—found pursuing them through stock purchase very difficult. This led to a search for loopholes that would force insider shareholders to part with their shares.

Acquisition specialists found a solution in exploiting the secondary debt market to as a mechanism to achieve debt-for-equity hostile takeovers.[78] Would-be acquirers bought up the outstanding loans of a target firm from its creditors. Because they were not entrenched insiders, creditors were willing to sell. Acquirers then used the court system to try to enforce these debts in a way that would give them control over the assets of the target—ideally, by compensating debts with "undervalued" stock, though the mechanisms were many. Thus, these were debt-for-equity hostile takeovers.

Because assets were the target, creditors would often seek ways to prevent targeted debtors from paying off their outstanding obligations, since this would leave

capture the possibility of an undervaluation due to the presence of a control bonus, but it did not offer any detail on how this control bonus was to be calculated.

[78] For discussions of the prevalence of these mechanisms and examples of their use see Radygin 2002; Deriabina 2002; Volkov 2002.

the creditor only with money and not the more valuable assets. Legal provisions designed to protect minority shareholders—by giving them the right to challenge certain company decisions—were one way that hostile acquirers could prevent loan repayment from taking place. Another was to push the target firm into bankruptcy proceedings, during which it would be run by a court-appointed administrator, who could often be convinced to interfere with the repayment of debts that had led to the bankruptcy in the first place.

The search for legal mechanisms that could force debt-for-equity exchanges created an entire bankruptcy industry, devoted to facilitating hostile takeovers. These became a key basis for the rapid expansions of the biggest business groups after the August 1998 crisis, a time when high export commodity prices and weak domestic ones gave these groups an especially strong position. These hostile takeovers were sometimes quite hostile indeed. The high stakes attached to various legal events—such as payment or nonpayment of debt—created strong incentives to contest them. Sometimes, as these contests were pursued in different jurisdictions, conflicting rulings would be issued, creating a situation of multiple legal realities, often degenerating into physical confrontation as different parties tried to enforce their version of the legal facts.

The empirical developments just surveyed illustrate the distance between law and the situation-types in which it was being invoked. In the case of the conflict at the Volgograd factory, the legal provision for consolidation of shares of stock was turned the purpose of expropriating minority shareholders. In the debt-for-equities hostile takeovers, laws postulating a situation of creditors seeking to recover debts were likewise inserted into conflicts between insiders and would-be acquirers. The most dramatic illustration of the split between the law's implied situation-type and that of its practical application was the phenomenon of creditors seeking to avoid being repaid.

In both cases, a "trajectory of improvement" eventually became apparent. Unlike the common-law system considered by Llewellyn, where the institution of precedent can allow judges to forge new rules that are authoritative for other judges, Russia has a civil law, where judges are supposed to relate each case to codified laws. Thus, the fitting of law to situation-type must occur in the legislative process. With respect to the stock consolidation procedure, legislation replaced compensation with fractional shares. A similar trajectory of improvement unfolded in the case of debt-for-equity takeovers. In the fall of 2002, Russia passed new legislation weakening the rights of creditors and minority shareholders while strengthening those of owner-managers.[79] The new bankruptcy code, in particular, contained many provisions designed to hinder forced debt-for-equity exchanges. It forces creditors to try vigorous measures to collect debts before they

[79] See Andreev 2002.

can initiate bankruptcy proceedings, and allows firms in bankruptcy proceedings to exit them by repaying outstanding debts. Furthermore, management and the creditors must jointly agree on the bankruptcy administrator, from a list proposed by an independent association of qualified administrators, making it less likely that the administrator will be willing to shift assets from management. Related legislation regulating commercial courts now makes it harder for minority shareholders to interfere with management decisions than previously.

It was representatives of big business, *who had used debt-for-equity takeovers to expand*, that did the most to give the new laws the form they took. For instance, after vigorous public complaints by big business, President Putin vetoed the initial version of the bankruptcy bill, passed by parliament in the summer 2002, in order to eliminate provisions that might prevent firms from paying their debts when they were able to do so. Operating on the assumption that creditors *ipso facto* wish to be repaid would have left the door open to continuing use of debt to conquer equity.

The Polish contrast. Proving the absence of contested shareholder property rights in the Poland case is a more difficult task than documenting their prevalence in Russia. However, the available record of how firm acquisitions have proceeded displays no parallel conflicts. Consider the history of the Elektrim conglomerate, which until 2001 was one of the country's most prominent and successful business empires. Elektrim began as a state trading firm coordinating imports and exports for industries offering supplies and services related to electricity generation and transmission. After being privatized itself, Elektrim used its export revenues to fund a large number of acquisitions in Polish industries—at one point, it owned controlling or substantial stakes in over 100 firms. It was able to purchase dominant stakes in many of these firms through the privatization process, after offering wage, employment, and investment guarantees. More strikingly, it was able to use sales of minority stakes in enterprises it had acquired to fund further acquisitions.[80] This strategy would have been completely unimaginable in the Russian context, where majority owners scorned the desultory receipts available on the stock market, and would have had a hard time finding sufficiently large blocks of shares to purchase with these receipts in any event.

Other evidence also suggests that the situations of a large split between the market price of stock and its value to majority owners were infrequent in Poland. Indeed, a study of the premia investors pay for large blocks of shares on the Polish stockmarket reveals them to be "substantially lower than in well developed markets".[81] Debate over the recently amended bankruptcy law in no way echoed the Russian discussions of bankruptcy as a mechanism of property transfer. Instead, discussions focused on more familiar creditor-debtor issues, and

[80] Michaels 1995.

[81] Trojanowski 2002.

resolving collective action problems of creditors.[82] These developments all suggest that the characteristic situation in which Polish corporate and bankruptcy law operate does not involve the particular incentives to contest shareholders' property rights.

Conclusion

A recent defense of the Russian privatization program argues that manager hostility to outside shareholders, and their resistance to implementation of laws on corporate governance, was "in part ... the price the reformers consciously paid for getting privatization enacted. Imposing aggressive external governance on the managers of privatizing firms by government fiat would have undermined their support for the program".[83] Yet, this defense also claims that "Workers and managers ... *traded* their consolidated control over their enterprises for securitized, exchangeable, individual property rights. Moreover, they agreed to an allocation of at least some of these rights to outside investors through voucher auctions".[84] The emphasis on "traded" is added, to underscore the contradictory nature of this position. Managers, in particular, did view the transaction as a trade: they hoped stock would *secure* their control. Indeed, reformers' wager was that the political clout of outside shareholders would be sufficient to push the upholding of corporate legality.[85]

This wager misfired badly. Outside shareholders were not interested in the upholding of any *general* corporate legality. They were interested in the forced exchanges and contested legal events that would help the in the concrete context of concrete control struggles. By the same token, outsiders were not interested in the upholding of any *general* corporate illegality. Parallel remarks apply to insiders. Privatization created enormous and systematic incentives to contest property rights. These incentives pushed actors to scour the law for those places where it grasped the situation badly, and exploit them. The tendency to rely on imported law, drafted for other actors pursuing other ends, doubtless made this an easier task.[86]

Such situational attitudes to law highlight the unrealistic presumptions underlying "state collapse" models of legality. In assuming that actors can only embrace legality or reject it as a whole, such analyses of state collapse obscure the intricate local situations that give law its meaning and its appeal to contending parties. One cannot focus solely on the resources for law enforcement when actors are so eagerly seeking to turn the law against itself.

[82] More power to the creditors 2003.

[83] Shleifer and Treisman 2000, 38. For evidence of the extent to which corporate governance problems were anticipated, see Boycko, Shleifer, and Vishny 1995.

[84] Shleifer and Treisman 2000, 33.

[85] Boycko, Shleifer, and Vishny 1995, 128.

[86] For important contributions on borrowed law see Hendley 1997 and Pistor et al. forthcoming.

More broadly, an “institutional/evolutionary” approach ought to allow for the evolution of institutions. Roland scores the Washington consensus for its emphasis on creating irreversibility of reforms: “The relative irreversibility created [by mass privatization] has locked the Russian economy in an inefficient situation where interest groups who gained most from mass privatization (the famous oligarchs [parenthetical remark is Roland’s]) have become so powerful as to block further reform such as tax reform, government reform, stronger law enforcement, and stronger security of property rights”.[87] These words written in 2000, certainly appear anachronistic now, when the “famous oligarchs” have become among the most active promoters of all the values mentioned. Their promotion of these values relies, however, on the symbiotic relationship between standardization of the social situation and the predictability of the law analyzed above. The conquest of the entrenched insiders created by privatization is all but complete. The vast bulk of the country’s most valuable private enterprises are now subordinated, both de facto and de jure, to a handful of conglomerates run by Russia’s richest and most powerful. These empires grew based on their ability to disturb the flow of controllable legal events that constitutes the exercise of property rights. As the new owner-managers, they are not eager to see others repeat their accomplishments. And they have spent years learning just which parts of the law need a better fit to the nuanced social reality of their new control.

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Давид М. Вудраф

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роль наследия приватизации в формировании нормативно-правового регулирования в области корпоративного управления в Польше и России

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