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**ULTERIOR PROPERTY RIGHTS
AND PRIVATIZATION**

“Even God cannot change the past”
Agathorn, 4 C BC

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Ultior Property Rights and Privatization:

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Agathorn, 4C. BC

Privatization looks as a most complicated integral part of transition from command to market economy. We see the process as a clear assigning of property rights to non-state subjects by one or another method. The real goal of privatization is an effective market economy. Restrictions on methods and speed of the process are by nature political and social. At a certain level large-scale privatization would help to set new market rules of the game, especially competition, and to create the new entrepreneurial class.

The experience of privatization in East European countries in 1989-1991 have given plenty of examples of complexities. Social costs happened to be much higher than expected and associated structural crises more severe. Privatization basically lagged after stabilization and price liberalization. The process will take 5-6 years even in the East Germany and much more time in other countries of the region. A clear political goal, public support and efforts of legitimate governments were not enough to speed up the process or avoid disputes over methods of privatization, especially in the case of the state industrial enterprises.

Privatization became an integral part of radical market-oriented reforms in East European countries from the very beginning in 1989-1990, but with one exception, the USSR. New political forces came to power in East European countries to start systemic changes and especially change the ownership structure. The political goal of perestroika in the USSR was different from the systemic changes in neighboring countries. Till 1990 the forces that led the evolution of Soviet society sought revitalizing the centrally planned system by introducing market elements or industrial democracy. It was the obvious contrast to other East European

countries which had undertaken the same unsuccessful experiments in the 1970s and 1980s. So the old bureaucracy tried to reform the command system without real systemic changes which would jeopardize its social status. It prolonged the period of seeking and redefining the true purpose of reforms in the USSR.

The case of the Soviet Union was and stays quite different to other countries of the region. Systemic changes in the USSR develop by other ways and means, led by other political and social forces. The purpose of this chapter is to describe the real path of the country's transformation and political and social lessons of reforms in 1989-1991. Spontaneous privatization in the USSR has also different features relative to neighboring countries. Studying the program of social and psychological feasibility of privatization in the USSR gives a certain explanation of Laws of Privatization of the USSR and Russia approved in early July of 1991 (Izvestiya, 8 August, 1991, p. 3).

Lessons of 1989-1991

Public discussion and policy of the union government before the autumn of 1989 were concentrated mainly on macroeconomics, structural policy and industrial democracy. From the summer of 1989 there were some attempts to draw the master plan of market-oriented reforms made by the Ryzhkov-Abalkin government. These programs were focused on price policy, stabilization and in a minor extent on destatization (razgosudarstvlenie).

Decentralization of decision-making led to the wage-price pressure, barter trade, repressed inflation and budget crisis unexpected by the government but easily predicted on the basis of East European experience. The rising strength of republican authorities resulted in a shift of power of economic decision-making from the Union Gosplan to republican gosplans, but not to enterprises. Besides, a crisis of the old federal structure and national problems complicated all issues of ownership in the country.

No program of 1990-1991 and none of the main political leaders gave a clear definition of

the purpose of systemic changes in the USSR or privatization in particular. The market economy was proclaimed a political goal of the central government in the autumn of 1989, but no major program of transformation has been put in action by the summer of 1991. The term 'private property' came into practical use by one of presidential speeches only in August of 1990 (Pravda, 19 August 1990, p. 2). Destatization and privatization have been extensively discussed by Soviet economists since September 1990. But only the '500 days plan' considered it as an important political goal for the government and put this part of the transformation plan in to its regular place. Still at least until May-June of 1991, all official programs of reforms (and legal acts introduced) reflected the lack of vision of the emerging society. The main objective of privatization - the creation of a competitive market economy – was overshadowed by other political goals and problems: social justice, redistribution of real political power and control over enterprises between the central authorities and republics. Bureaucracy, monopolies and injustice seemed to be the main problems absorbing the reformers, who hoped to promote greater economic efficiency and social justice. Specific details of privatization such as prices, goals, and speed were largely left uncertain.

The central government had lost a lot of time pondering over radical market reform before the social interests of different states were defined though it was not ready or competent enough to move in this direction anyway. Privatization had become an ever more difficult task both socially and politically (Vanous, 1990 p. 4). National and republican movements were characterized by negative attitudes to the old system and the central authorities, but less by positive goals such as a market economy.

At the first stage of the turn to market (autumn of 1989 - spring of 1990) privatization was not discussed publicly at all. At that time supporters of a market economy were mostly concerned about the low quality of the first versions of the law on joint stock companies (for example), Grigoriev, 1990a). Several articles on the significance and problems of privatization were drafted at first in February-(by Yavlinskii et al,1990; Aleksashenko and

Grigoriev, 1991). Assessments of the situation by Western and East European economists and their program suggestions of that time (Bauer,1990; Dhanji and Milanovic, 1990; Grosfeld, 1990; Hinds, 1990; Nuti, 1990; Vanous, 1990; Yarrow 1986 and 1990; and others) were known to only a handful of Soviet economists.

The official programs were concentrated mostly on the corporatization and destatization at least till August 1990. Only in the '500 days plan' and the parallel governmental programs did privatization found its regular place. The '500 days plan' contained two types of privatization: the slow and the quick ones (Hewett, 1990, p. 152). It reflects the attempt to consider this process as a double-purpose weapon: both an instrument for systematic transformation and for stabilization (Perekhod k rynku, 1990, chs. 1 and 4). Dispute over the fate of '500 days plan' in the autumn of 1990 gave very specific impulses to the process of privatization, changing its meaning both to the central government and to the public, and probably rendering privatization inevitable.

Public debates on the road to the market economy led to the more substantial concerns about type of privatization. A lot of popular academic economists and journalists were afraid of the nomenklatura privatization for political reasons. Numerous articles claimed that the only just procedure is the free distribution of national assets by one or another system, mainly by vouchers (Belova, 1990; Bogomolov, 1990; Bunich, 1990a,b; Piyasheva, 1990; Smirov, 1990 and some others). Technical problems and the consistency of this approach, including the creation of a real control of owners over management and the decision-making process, were not even discussed.

Criticism of the voucher system appeared in particular, the rationality of the exchange of up to 110 million coupons for securities of thousands enterprises which had not-yet been turned into joint-stock companies was -questioned (Anulova, 1990, Grigoriev, 1990c and 1991; Grigoriev and Yasin,1991; Kachanov, 1990; Nekipelov, 1990). Through debates public opinion began to influence the reform process. As in other East European countries the

discussion changed the approach to privatization. But in contrast to Eastern Europe, the emphasis was moved to people's enterprises or to the total redistribution of property, when the East European reformers gathered increasing doubts about this approach.

The main lesson of all programs of transformation to the market economy in 1990 was that the public support was insufficient to any of them. Even the most popular, the '500 days plan' drafted by Shatalin-Yavlinskii group, was not defended by any massive social and political force or recognized as their own plan (except for the democratic mass media probably). It reflects the absence or weakness of social forces backing the radical market reform. The reform plans came from the top as a rational way to solve practical economic problems. The market was justified by leaders to the general public as a sort of economic necessity or an instrument to achieve welfare quickly and easily.

Intellectuals and technocrats had not enough influence in the society, which was characterized by a strong populist and egalitarian mentality. Populists embattled the old bureaucracy but lacked a vision of a real market economy. The new entrepreneurial class was too weak to offer significant support to any program but remained in a defensive position. The lack of consensus on the transition and the resistance of old bureaucracy to any systemic changes led to the delay of reform. Relative political stability in the center was reached at the expense of long-term interests of the society and of radical reform from the top. No full-fledged program of privatization or feasibility study was worked out. From the autumn of 1990 until the summer of 1991 the inevitability of transition to a market economy did not mean the necessity of real privatization neither to most people nor to the nomenklatura.

Ulterior Private Property Rights

The economic system of the USSR on the eve of major market reform is often described as dominated by state ownership and the nomenklatura control over the decision-market process. Central planning caused a complicated system of privileges of the nomenklatura. A certain

rank in the hierarchy meant certain legal (and illegal) incomes, cheap state services, housing, dachas, etc. It gave a lot of access to expensive health care, recreation facilities and so on at low subsidized prices or free.

Rights to make economic decisions carried authority. Control of state property or flows of investments, goods and financial resources may be considered as riskless rents assigned to positions in the bureaucratic pyramid. But by our opinion the high social status, secure jobs and salaries as well as some life-time options' for relatives and friends were much more important than any official or invisible privileges.

In legal terms all state property belonged to the people of the country, Thus, privatization could be considered as selling or returning property to the people, as occurred in the East European countries these years. High-level members of the nomenklatura were dismissed, but managers of enterprises mostly stayed. New leaders - technocrats or populists - had nothing to do with the vested interests of the old bureaucracy. In the USSR, on the contrary, all levels of management of the economy are still controlled by the nomenklatura. Therefore, the many changes of top managers and staff of ministries and enterprises did not liquidate these rents in 1985-1990. Quite the opposite, the proliferation of barter trade, inflation and the total shortage of goods led to more opportunities to receive this kind of managerial incomes by reallocating resources.

From this perspective we may look on the collision between the law and the black market as a conflict of rent-seekers of the command economy and profiteers. Here we are talking about a segment of the black market which in a regular market economy is called small enterprises and wholesale and retail trade. The same type conflict has arisen between the old command system and new economic agents, such as cooperatives, joint ventures and small enterprises. The contradiction between the command system and the emerging market economy appears to be a conflict between rent-seeking and profit-seeking motivations. But a certain part of the black marketers made their profit by using opportunities offered by the

command system and its distorted prices.

It is a puzzle why the Ministry of Finance and various authorities repeatedly issue orders or even legal acts against businesses' speculation. At first it might be seen as an attempt to prevent the development of new forms of ownership and entrepreneurial stratum, but after a turning point (say by the end of 1990) the purpose was rather to slow the development of this stratum in order to give the nomenklatura time to adjust to the coming market

The domination of the rent-seeking agents was a cause of the stagnation of the economy. The only way to make a career was to become part of nomenklatura. But it meant avoiding entrepreneurial risks. Each level of bureaucracy had different responsibilities and managerial risks. The higher the position someone held in the bureaucracy, the greater his social safety regardless of the actual results of his activity. Without proposing a theory of nomenklatura rent, we may suggest that there were at least three large groups of bureaucrats; managers of industrial and procurement enterprises; officials of district, regional or republican territorial-authorities; and officials of central planning, distribution and managerial offices, including ministers. It is necessary to distinguish between clerks (with little influence and legal rent) and decision-makers. Each level of the bureaucracy has different rights and rents. Economic rights are as real as rents, but they are not secured in legal terms. We suggest calling them 'ulterior property rights'. As the system changes it becomes more or less clear who controls what property by their attempts to secure this control.

The threat to the rent system has become increasingly clear in these years of burgeoning market-oriented reforms. It was undermining the social status and long-term rent perspectives for some branches of the nomenklatura: the staff of central command apparatus of the economic system, clerks at different levels in the procurement system and top enterprise management. Reactions of the ruling substratum to the changing environment in the Soviet economy differed with relation to their options to legitimize their rights to rents. The situation became even more complicated because of the lack of social consensus on the type of reform

in 1988-89, fast changes in economic policy and misleading statements by prominent politicians. For some branches of nomenklatura it was a last-ditch stand; others saw an opportunity to transform their actual rent rights into legal property rights. In many cases it appears to have been a question of unconscious rational behavior. The most important case concerns industrial enterprises. Ulterior nomenklatura rents are the result the ability of decision-makers in certain key positions to- allocate resources, including the supply of raw materials, imported equipment and consumer goods, as well as financial means. Under almost any type of privatization various elements of the apparatus are supposed to lose their sources of rent. So their basic interest is that legal acts on privatization are uncertain and that 'destatization' and corporatization of enterprises take place instead of privatization. And in any case, they are trying to control the-whole process by other means, especially by regulating procedures.

Additional complications are caused by the internal conflict of interest among different branches of nomenklatura, for example between central and local authorities or ministerial staff and managers of enterprises. A program of large-scale privatization should take their common or specific interests into account. Probably each branch is able to prevent or adapt any specific type of privatization to its interest, but each level or branch has its own way of securing its rights. Unlike in East Europe the old nomenklatura has mainly saved its positions at the central government. What is most difficult for them however is to convert ulterior rights into real ones. Now advantages of being at the center are turning out to be disadvantages and complicate the acquisition of a real hold on the property. It is much easier for the territorial branches of the nomenklatura which can exploit decentralization or even nationalistic tendencies.

Again unlike in East Europe, Soviet enterprise managers have not just been appointees of higher ranks of the nomenklatura. In most cases they were and are rather competent. Now some of them (regardless to competence) are trying to find a way to transfer state property to

their own 10 small enterprises. A variety of types of spontaneous nomenklatura privatizations (see, Grosfeld, 1990, p. 147) is the result of different mixtures of rights to make decisions. There are many ways and means of transferring state property into private hands.

The gap between the formal state or people's ownership and the real situation has been much wider than generally perceived. The existence of real control of property by certain economic agents concerns not only the industry but all kinds of property. Any attempt to transfer this nominally public property has regularly encountered resistance from previous (ulterior) controllers.

One of the most complicated cases is housing. Flats in urban areas (about half of all dwellings in the country) mostly belong to the state (actually to cities) or enterprises. Another half of dwellings already belongs to individuals. In practice the state was considered obliged to supply cheap or free housing and various services. Inhabitants were basically considered by regulation (and by themselves) as a party with rights to be supplied. In spite of all restrictions, inhabitants could exercise certain property rights – for example to take (illegally but almost open) money for their flats while formally exchanging them. This type of exchange was and is formally illegal but everyday practice is legitimizing it. In some regions the executing of rights to receive free flats from the state has historically been dependent on a certain price paid as a bribe. So a substantial part of the population considers flats as a kind of property. This view is an obstacle to privatization, especially when cities try to receive some funds through privatization. Most people see their flats as a source of rights partly comparable to property rights - not as an object for buy-out. Another issue in the housing sector is the stock of formal obligations of the state and many enterprises to people without suitable flats who are entitled to receive new ones for free. Besides these obligations may be considered as a hidden part of the state debt.

In retailing and catering, 'black' wholesale trade the existence of the illegal rent system is well-known. It may be considered as a system of ulterior property rights. Legal acts have

forbidden many forms of trade, which has led to large-scale corruption. The resulting profiteer rents actually implied ulterior private property rights. In many cases 'owners' have almost all regular property rights apart from the legal title. These rights are often distributed among different people and informally secured. The state has tried to fight this system as illegal but the result may be considered as 'a tie'. Most attempts to confiscate rights to rents or profits may be considered as small nationalizations. Is it good or bad from a moral point of view that actual owners of shops can exercise their right to the capital value and sometimes even liquidate or relocate their businesses. The rate of profit is very high because of inefficiency of the market, price distortions, unequal supply of goods by regions and great legal risks.

This situation complicates privatization of the distribution system. It is not a two-party game between the state and the people but a three-party game also involving informal owners. In order to execute any law on small privatization it is necessary to nationalize this type of property or to let actual rent-owners secure their rights. But it is impossible because no papers indicate any owners except the criminal reports and the public attitude to the informal owners is highly negative. Even transfer of the distributive system to employees is not a sufficient solution. There is a contradiction between trying to privatize property against the interest of the existing (illegal or partly illegal) entrepreneurial stratum and at the same time supporting the emergence of a new one. In certain cases conflicts arise between emerging legal profit-seeking business and the two 'old' parties, the rent-seeking bureaucracy and illegal business profiting from the old system of distorted prices, etc. The last two groups are potential losers in a competitive market environment (see also Koroblev, 1991).

Since most property in the country is under the control of different economic agents, the problem of ulterior property rights varies by branch.

A small-scale and large-scale privatization should have on its side one or another branches of the economic nomenclatura in order to be successful.

Spontaneous Privatization

The major economic problem of privatization in the USSR is the same as in other East European countries - the low level of capital accumulation or the inadequate level of personal savings in the relation to the value of assets of state enterprises. At the end of 1990, savings of Soviet households were equal to one quarter of the book value of fixed assets. Privatization in the USSR is under way, but unlike in Poland, Hungary and Czechoslovakia privatization is a complex mix of nomenklatura and popular forms of privatization.

The central ministerial branch of nomenklatura first became aware of the urge of privatization for several reasons. First, they perceived a real danger of losing control over the processes of the economy. Second, they had seen how their partners in East Europe had lost control. Their conclusions were obvious: to privatize the ulterior control to their own advantage. On the initiative from enterprises or on orders by Prime Minister Nikolai Ryzhkov, a lot of enterprises and ministries started establishing new bodies, concerns, associations and people's enterprises. This wave of nomenklatura privatizations meant a basic change in the attitude of this part of the nomenklatura: if privatization is inevitable let us enjoy it.

From that moment the nature of the political struggle had been changed. It was no longer a battle for or against privatization but a struggle for the control over privatization. Now it looks as if the nomenklatura has a good chance of getting its position in society successfully secured. The highest echelons of bureaucrats however often need to take intermediate steps in order to gain not ulterior but regular property rights. It is impossible to win against the interests of another group of people with substantial ulterior property rights, enterprise managers. In the autumn of 1990, they joined the opposition against the '500 days plan' because they did not believe in a quick transition and in particular they did not see their positions could be insured. From that time managers have played an ever more active role in politics and at the same time in privatization. Partly their activity has been disguised as the

establishment of 'people's enterprises' with very strong rights of the directors. In many cases, they adopted-practices-of their East-European colleagues; buying their own enterprises cheaply and creating joint ventures with foreigners. The increasing role of entrepreneurial activity has also been reflected in political and public organizations.

At the same time a widespread spontaneous privatization of flats and shops has taken off in both towns and villages. The biggest cities have tried to invent their own systems of privatization of flats, shops and services. Potentially it may lead to another problem, a great legal mess. There are too many privatization programs and ways and means of selling or distributing property. The establishment of a lot of collectively-owned people's enterprises may lead to a privatized but non-market economy.

While spontaneous privatization has spread in the country, its real place and scope are unknown. Two thousand commercial banks, numerous 'small' (private) enterprises and different associations are forming a market system but a good portion of them represent the nomenklatura. The evolution of society and the economic crises create an environment conducive to the establishment of new legal entities with very uncertain property rights. A few well-advertised 'model privatizations' of big enterprises are in fact corporatizations concentrating large bulks of the shares in the hand of ministries. Sometimes they are disguised as people's enterprises, the statutes of these corporations reveal the strengthening of the managers' control. A privatization program may mean both nationalization and re-privatization. The complications are obvious especially in the case of retail shops, if existing entrepreneurs are exchange for new ones in a situation of the very scarce trained human resources.

The main problem (leaving the problem of fairness aside) is that nomenklatura privatization delays the rise in efficiency, takes more time and prevents new entrepreneurs access to property. It will take time to change the mentality of rent-seekers into profit-seeking. More open privatizations in the interests of enterprise managers (insiders), especially

management buy-outs, at least for small enterprises, would be much more fruitful for society.

Social Feasibility

This side of privatization is especially complex in the Soviet Union. The social and psychological conditions of privatization in the Soviet union are quite different from East European countries. No social feasibility study has been prepared so far. Nobody was ready for such quick political and economic changes in the country, and the question was recently considered as purely academic. Still, some bits of information are available and provide a certain idea of limits on speed, forms and the near future of privatization in the country.

First of all in most of the country just a handful of old people have ever lived in a market economy environment. In many cases the population and even political leaders talk and think about numerous different types of a market economy. Therefore the acceptance of the idea of a market economy by most political movements does not mean a consensus on what should be done or what a future economy should look like. There is a considerable deviation in the interests within the prosperous strata of the population. According to estimations by Aleksandr Zaichenko only about 15 per cent of population lives at a standard of living that may be considered middle class. Half of these 15 per cent earn their living from the state-owned distribution system (as a rent and profit of the ulterior property), while the other half enjoys bureaucratic rent.

The public attitude to private property is still very uncertain. In public polls in the autumn of 1990 and the winter of 1991, we see a deep division in society on the key issue of transformation, the property question. The market economy is generally accepted but cross-checking reveals that just 12 per cent are full-fledged supporters, while 15 per cent are strongly against it, 30 per cent are unstable supporters, and 43 per cent did not define their position. At the same time, other polls show how people see themselves in terms of security; only 10 per cent feel secure, 37 per cent - more or less so and 18 per cent not at all (Shpilko,

1990, 1991).

The general acceptance of a market economy narrows down when more specific questions are posed. Half the respondents are against the free hiring 'man by man' or free pricing. The acceptance of private property varies greatly around the country. In one of the polls 44 per cent of respondents supported the idea of having the private property for enterprises, varying from 70 per cent in Estonia to 28 per cent in Uzbekistan. The discrepancies between different polls on the crucial issue of market reform and private property are generally great, suggesting fast changes. (Baldaev, 1990; Rutgaizer and Shpilko, 1990; Shashnov, 1990; Shiller, Boiko and Korobov, 1990; Shpilko, 1991; Urnov, 1991). Many people are very uncertain still. Mainly young, well-educated and prosperous people are backing the market reform. The support is growing fast but the situation is complicated by the economic crisis. The longer the delay of reform, the more dangerous look any changes. The vast deviation of opinions on the crucial questions persists. A study of the social feasibility of privatization is still a necessity for any serious program of system changes. It must take into account not only general political views in society, but the dynamics of the reform process by strata, especially by the branches of nomenklatura, by industries and by republics and regions of Russia. The lack of information both on public attitudes and spontaneous privatization contributes to the great social and political uncertainty.

Concluding Remarks

Currently, three simultaneous developments are occurring at different levels of society. One is the writing of programs and debates on types of market reform and privatization. The drafting of legal acts is visibly influenced by Western expertise and look very radical. Another trend is the growing populist threat to any reform, posing a major threat to economic transformation. A third development is spontaneous commercialization and privatization. A major market reform should take several ulterior property rights of different strata and the

psychological background of the situation into account. Otherwise the resistance to reform and its social costs may become extremely high.

The Privatization Law of the USSR, approved on 1 July 1991, offers opportunities to incorporate and buy out state enterprises without a clear definition of property rights. The Privatization Law of Russia, approved on 3 July 1991, is the result of the victory of one wing of populists over another. Formally both groups suggested the free distribution of vouchers to be exchanged for property to all citizens of republic. The wing that lost intended to give control to work collectives, while the winners wanted to distribute individual property rights to the whole population. These laws have closed the debate for the time being. Now the central problems of privatization will be the distribution of property between the Union and republics and the implementation of both these laws and laws on privatization of other republics, opening a new page in the radical reform.

At the time of approval of these laws no detailed program of privatization was ready. Uncertainty about goals and methods of privatization will affect the process for a long time. Presumably this situation is rather convenient for the old bureaucracy. It will be in charge of privatization and will try to use its control to preserve its social status and convert ulterior into legal property rights.

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