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## Workplace Democracy and Human Development: The Example of the Postsocialist Transition Debate

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In the 1990s, a debate raged across the whole postsocialist world as well as in Western development agencies such as the World Bank about the best approach to the transition from various forms of socialism or communism to a market economy and political democracy. One of the most hotly contested topics was the question of the workplace being organized based on workplace democracy (e.g., various forms of worker ownership) or based on the conventional employer–employee relationship. Well before 1989, many of the socialist countries had started experimenting with various forms of “self-management” operating in more of a market setting, Yugoslavia being the most developed example. Thus one “path to the market” would have been to push those experiments all the way to some Western form of employee ownership or worker cooperatives operating in a full market environment. Alternatively, all these decentralizing experiments could be condemned as “vestiges of communism” to be eradicated by renationalizing all the decentralized firms and then privatizing by some alternative means.

In this essay, I will first review some of the human development arguments made for workplace democracy by social philosophers.<sup>1</sup>

Then I will contrast this with the way the issue of workplace democracy actually played out in the postsocialist debate.

## Democracy and the Development of Human Capabilities

### *Human Development and the Democratic Franchise*

There has been little disagreement in the past about the detrimental effects of subordination and servility on human development, such as the capacity for self-government. But there have been two opposite responses to this little-doubted relationship. In the civic republican tradition of political theory (e.g., Simon 1994; Skinner 1998), if servility and subordination retarded the capacity for self-governance, then steps should be taken to reduce those causes, such as through the broad distribution of sufficient property to undergird economic independence (e.g., the homesteading laws in the development of the American frontier).

But often social philosophers would take the property distribution as a historical “given” and then advocate restricting the political franchise to those who were not subordinate as evidenced by some minimum amount of property.<sup>2</sup> The reasoning was that without some amount of property, a person would have to be dependent on and subordinate to another person, so that the subordinate would not qualify as an independent decision maker in social affairs.

The subordinate position of employees (or “servants” in the older parlance) and women was given as a reason for the denial of the voting franchise.<sup>3</sup> For instance, Immanuel Kant held that to be “fit to vote, a person must have an independent position among the people.” The person must “by his own free will actively participate in a community of other people.” Thus Kant distinguished between “the *active* and the *passive* citizen,” where “the latter concept seems to contradict the definition of the concept of citizen altogether”: “Apprentices to merchants or tradesmen, servants who are not employed by the state, minors (*naturaliter vel civiliter*), women in general and all those who are obligated to depend for their living (i.e., food and protection) on the offices of others (excluding the state)—all of these people have no civil personality” ([1797] 1991, 126, sec. 46).

For women, the legal framework for subordination was not the master–servant relation but domestic law based on the concept of *paterfamilias* and the coverture marriage contract: “By marriage, the husband and wife are one person in law: that is, the very being or legal existence of the woman is

suspended during the marriage, or at least is incorporated and consolidated into that of the husband; under whose wing, protection, and cover, she performs everything; and is therefore called in our law-French, a *feme covert*, and is said to be under the protection and influence of her husband, her baron, or lord; and her condition during her marriage is called her *coverture*” (Blackstone [1765] 1959, 83, section on “Husband and Wife”). A female was to pass from the cover of her father to the cover of her husband (with the present-day vestiges of the bride taking the husband’s family name instead of the father’s and the wedding ceremony where the bride’s father “gives away” the bride to the groom)—always a *femme covert* instead of the anomalous *femme sole*. The identity fiction for the *baron–femme* relation was that “the husband and wife are one person in law,” with the implicit or explicit rider, “and that one person is the husband.” A wife could own property and make contracts, but only in the name of her husband.

Today, the democratic franchise is formally universal in the Western democracies without regard to property ownership, employment status, or marital status. The old coverture marriage contract, which denied any independent legal personality to the “*feme covert*,” has been abolished. The master–servant relation, however, has not been abolished, although it has been modernized with industrial and labor legislation to the employment relation of today. Since the employment relation has not been abolished and since work in the nondemocratic context of the employment relation remains the principal outside-the-family activity for most people, the effects of that economic activity on human development are a topic of more than historical interest.

### *Human Development and Democracy in John Stuart Mill*

The concept of deliberative democracy (e.g., Elster 1998) distinguishes itself from the concept of democracy simpliciter by emphasizing the importance of public discussion and active citizenship. Yet much of the modern literature shows the aforementioned inattention to the economic relations of subordination, which in the minds of earlier democratic theorists (such as Kant) were important enough to preclude active citizenship (and even the right to vote). But this was not always so; some earlier theorists of deliberative democracy were well aware of the connection.

The concept of deliberative democracy is older than the phrase. In the nineteenth century, the concept was often treated under the name “government by discussion.” While a thorough intellectual history could go back to Socrates

and Aristotle, for present purposes one could list more recent contributors such as Tocqueville, John Stuart Mill, Walter Bagehot, James Bryce, John Dewey, Ernest Barker, A. D. Lindsay, Frank Knight, James Buchanan, Bernard Crick, Charles Lindblom, and Jürgen Habermas. Some commented on the relevance of the economic–political connection, and some did not.

The towering figure in the nineteenth century was John Stuart Mill. Mill's contribution to government by discussion is best known from his books *On Liberty* and *Considerations on Representative Government*. In *Considerations*, Mill argues that political institutions should be judged in large part by the degree to which they “promote the general mental advancement of the community, including under that phrase advancement in intellect, in virtue, and in practical activity and efficiency” ([1861] 1972, 210). Indeed, a defect of a representative government may be that it does not bring “into sufficient exercise the individual faculties, moral, intellectual, and active, of the people”:

As between one form of popular government and another, the advantage in this respect lies with that which most widely diffuses the exercise of public functions; . . . by opening to all classes of private citizens, . . . the widest participation in the details of judicial and administrative business; as by jury trial, admission to municipal offices, and above all by the utmost possible publicity and liberty of discussion, whereby not merely a few individuals in succession, but the whole public, are made, to a certain extent, participants in the government, and sharers in the instruction and mental exercise derivable from it. (Mill [1861] 1972, chap. 6, 262)

Mill saw representative government as an “agency of national education” and mentioned “the practice of the dicastery and the ecclesia” in ancient Athens as institutions that developed the active political capabilities of the citizens ([1861] 1972, 211, 233).

In his *Principles of Political Economy*, Mill considers how the form of work would affect those capabilities and how the workplace association could become a school for the civic virtues if it progressed beyond the employment relation: “But if public spirit, generous sentiments, or true justice and equality are desired, association, not isolation, of interests, is the school in which these excellences are nurtured. The aim of improvement should be not solely to place human beings in a condition in which they will be able to do without one another, but to enable them to work

with or for one another in relations not involving dependence.” Previously those who lived by labor and were not individually self-employed would have to work “for a master”: “But the civilizing and improving influences of association, . . . may be obtained without dividing the producers into two parties with hostile interests and feelings, the many who do the work being mere servants under the command of the one who supplies the funds, and having no interest of their own in the enterprise except to earn their wages with as little labor as possible” (Mill 1899, bk. 4, chap. 7, 275). One halfway house in this direction would be various forms of association between capital and labor: “The form of association, however, which if mankind continue to improve, must be expected in the end to predominate, is not that which can exist between a capitalist as chief, and workpeople without a voice in the management, but the association of the labourers themselves on terms of equality, collectively owning the capital with which they carry on their operations, and working under managers elected and removable by themselves” (Mill 1899, bk. 4, chap. 7, 280–81). Under this form of cooperation, Mill sees an increase in the productivity of work since the workers then have the enterprise as “their principle and their interest”:

It is scarcely possible to rate too highly this material benefit, which yet is as nothing compared with the moral revolution in society that would accompany it: the healing of the standing feud between capital and labour; the transformation of human life, from a conflict of classes struggling for opposite interests, to a friendly rivalry in the pursuit of a good common to all; the elevation of the dignity of labour; a new sense of security and independence in the labouring class; and the conversion of each human being's daily occupation into a school of the social sympathies and the practical intelligence. (1899, bk. 4, chap. 7, 295)

Mill brings us back to the basic question about the political–economic connection: “Each human being's daily occupation” is what sort of school? Is it a school for being a good “employee” or a school for being a good member of a democratic association?

#### *Human Development and Democracy in John Dewey*

John Dewey was the towering figure in deliberative democratic theory in the first half of the twentieth century. From his earliest writings in 1888

to his mature years, Dewey saw democracy as a norm applicable to all spheres of human activity, not just to the political sphere. In *Reconstruction in Philosophy*, Dewey argued that democracy “is but a name for the fact that human nature is developed only when its elements take part in directing things which are common, things for the sake of which man and women form groups—families, industrial companies, governments, churches, scientific associations and so on. The principle holds as much of one form of association, say in industry and commerce, as it does in government” (1948, 209). After World War II, Dewey repeated what he said about social reorganization after World War I: “It is so common to point out the absurdity of conducting a war for political democracy which leaves industrial and economic autocracy practically untouched, that I think we are absolutely bound to see, after the war, either a period of very great unrest, . . . or a movement to install the principle of self-government within industries” (in Ratner 1939, 422). Social-economic arrangements are to be judged by how they hinder or help the development of human capacities: “Discovery of individual needs and capacities is a means to the end, but only a means. The means have to be implemented by a social-economic system that establishes and uses the means for the production of free human beings associating with one another on terms of equality” (Dewey, in Ratner 1939, 430). But the widespread acceptance of political democracy as a norm did not automatically lead to the idea of “free human beings associating with one another on terms of equality” being applied to other spheres of life: “After democratic political institutions were nominally established, beliefs and ways of looking at life and acting that originated when men and women were externally controlled and subjected to arbitrary power, persisted in the family, the church, business and the school, and experience shows that as long as they persist there, political democracy is not secure” (Dewey, in Ratner 1939, 402–3). And when the “methods of regulation and administration in vogue in the conduct of secondary social groups are undemocratic, . . . there is bound to be an unfavorable reaction back into the habits of feeling, thought and action of citizenship in the broadest sense of that word” (Dewey, in Ratner 1939, 716).

Perhaps the most important of the secondary social groups is the one where most adults spend most of their time:

For illustration, I do not need to do more than point to the moral, emotional and intellectual effect upon both employers and laborers of the existing industrial system. . . . I suppose that every one who

reflects upon the subject admits that it is impossible that the ways in which activities are carried on for the greater part of the waking hours of the day, and the way in which the share of individuals are involved in the management of affairs in such a matter as gaining a livelihood and attaining material and social security, can not but be a highly important factor in shaping personal dispositions; in short, forming character and intelligence. (Dewey, in Ratner 1939, 716–17)

And while “democratic social organization make[s] provision for this direct participation in control: in the economic region, control remains external and autocratic” (Dewey 1916, 260): “Control of industry is from the top downwards, not from the bottom upwards. The greater number of persons engaged in shops and factories are ‘subordinates.’ They are used to receiving orders from their superiors and acting as passive organs of transmission and execution. They have no active part in making plans or forming policies—the function comparable to the legislative in government—nor in adjudicating disputes which arise. In short their mental habits are unfit for accepting the intellectual responsibilities involved in political self-government” (Dewey and Tufts 1932, 393–92). This brings us back around to the point of factual agreement between Mill and Dewey, on the one hand, and Kant, on the other; “every one who reflects upon the subject admits that” spending the “greater part of the waking hours” as a “subordinate” in the employment relation does not foster the human capabilities for self-government. The difference is that Kant took it as a sufficient reason to deny the democratic franchise to the individual while Mill and Dewey drew the opposite conclusion that the ideal of democracy should be applied to the workplace.

## Workplace Democracy in the Postsocialist Transition Debate

### *The Privatization Debates*

Since democracy in “what people do all day long” would seem to have such beneficial effects on human development, one might think that it would be a widely held goal in the Western democracies. Sometimes it is recognized as a goal that is unfortunately rather hard to obtain without revolutionary changes in the historically given property distribution. But the historical pattern of state property ownership was no longer a given in the postsocialist countries, so here finally was a historical setting to foster the application of democratic ideals in “what people do all day long.”

But that is not how the transition debate played out. Western advisory institutions, both national and international, uniformly opposed or ignored any opportunity to broaden the scope of democracy beyond what was considered “normal” in the Western economies. In the remainder of this essay, I will outline the contours of that debate with a focus on the World Bank as the primary standard-setting advisory institution.

One of the early models of privatization was the Czech model of voucher privatization (Schwartz 2006). Vouchers were distributed to all citizens, but it was expected that individuals would only invest the vouchers in mutual-fund-like voucher funds in return for shares in the funds. The funds would, in turn, use the vouchers to buy shares in the companies being privatized at state-run voucher auctions. But the voucher funds were run by fund-management companies that could be completely owned by a few individuals or even by state-owned banks (e.g., in the Czech case). The voucher funds were supposed to be “controlling owners” that would supply “corporate governance” to the privatized companies. The companies were called “privatized” since their shares were predominantly held by the voucher funds, which in turn were “owned” by millions of private citizens.

After some initial resistance and little real debate, the World Bank quickly succumbed to a public relations image of the Czech privatization scheme. The reality showed little resemblance to the rhetoric as the voucher plan was adopted in most of the postsocialist countries. For instance, the investment funds were in fact controlled by fund-management firms that had negligible ownership interests,<sup>4</sup> so the net effect was the “tunneling” of assets out various “back doors” to the benefit of the fund managers and their colleagues. Such was the scheme promoted by international finance institutions (IFIs) and academic experts in the institutional design for “private property market economies.”

#### *Agency Chain Arguments*

At the time, there were some counterarguments against the predominant idea of voucher privatization (Ellerman 1993; Kornai 1990; Murrell 1992, 1995; Weitzman 1993). One counterargument was via the notion of agency chains.<sup>5</sup> Long agency chains are very difficult to police and maintain. Information economics emphasizes the “asymmetric information” and monitoring failures in principal–agent relationships.<sup>6</sup> The longer the agency chain, the more the asymmetry and the greater the chances for

opportunistic behavior. It took most of the twentieth century to develop the array of watchdog institutions (e.g., accounting/auditing firms and the Securities and Exchange Commission) to police long agency chains in the West, and a glance at runaway executive compensation in America, not to mention the ENRON-like scandals and the recent (2008) financial collapse, shows the continuing problems in making the system work.

Voucher privatization was part of a larger program of “shock therapy” that advocated “jumping over the chasm” from socialism to the market all in one leap. It was a “Bolshevik” methodology applied to reverse the effects of Bolshevism, so the “shock therapists” were also called *market Bolsheviks* (Reddaway and Glinski 2001). The market Bolsheviks tried to legislate and install institutions such as stock markets, watchdog agencies, and publicly traded companies as if all that could be done practically overnight. Voucher privatization, which threw most medium and large-sized companies into the stock market, was an extreme “pathological” example of trying to legislate well-functioning long agency chains.

Market economies start with short, not long, agency chains—indeed, they start with the identity of principal and agent in owner-operated firms and farms. The decentralization that is part of building a market economy in transitional countries needs to similarly start with agency chains as short as possible, not as long as possible. In the Czech-style “model” of voucher privatization with investment funds generally preferred by the Western advisers, the principal–agent “layers” in the long agency chain were:

1. the millions of citizen-shareholders of voucher investment funds, who were to control
2. the boards of the funds, which were supposed to control
3. the fund-management companies, which were supposed to control
4. the boards of their hundreds of portfolio companies, which were supposed to control
5. the managers of the portfolio companies, who were supposed to control
6. the middle managers and workers, who were supposed to actually produce something that people were willing to buy.

Historians may find it hard to believe that the “experts” in IFIs and in elite academia actually thought that such agency chains could be legislated and “installed” and would then work reasonably well in economies after

seventy years of communism. And today, the comic book version of the Russian debacle that is promulgated for public consumption is not the farcical nature of trying to legislate five-linked agency chains overnight. Instead the story is that “it didn’t work as planned” because of the rapacious managers and state officials who did not respect property rights. Thus the fault lies not in the architects of the absurdly designed chicken coop but in the rapacious nature of the foxes.

#### *De Facto Property Rights Arguments*

Counterarguments were also stated using the notion of de facto property rights. Neoclassical economics tends to follow Ronald Coase and to emphasize the importance of establishing clear formal property rights (and then perhaps the market will do the rest). And the cartoon picture of the transition used by IFIs and allied experts is one that hammers away on the importance of respecting “private property rights.” Never mind if the “clear-cut private property rights” are the ownership of junk shares in voucher investment funds on the tail end of many-layered agency chains. And never mind that in the U.S. economy (i.e., the experts’ implicit mental model) there was a “separation of ownership and control” for most of the twentieth century so that the top managers who command the heights in this paradigm “private property market economy” do so on the basis of their organizational role (not unlike party officials) and de facto control of the board—*not* on the basis of their private property rights (Berle and Means 1932). Neoclassical cartoons tend to ignore such troublesome aspects of reality.

Progress has been made on this question recently in Hernando de Soto’s book *The Mystery of Capital* (2000). Although this was little noticed by those who wrote blurbs for his book jacket, including Ronald Coase, de Soto does not just argue for formal property rights but, rather, for the formalization of de facto property rights. That’s a horse of another color. After all, all the land occupied and farmed by peasants or occupied and used by slum dwellers already has formal owners; it is not part of some “commons.” The idea is that by using and improving these assets (formally but absentee owned by others), people have established certain de facto property rights that give them the capability to sow and reap. Any “reform” that would take away those de facto property rights (and the capabilities they represent) to assert absentee formal property

rights would in fact be disempowering and antidevelopment. To promote market-driven development, the reforms should find out ways to formalize some socially acceptable approximation to those de facto rights so that the people then encounter the market and the private property system as something that empowers them—rather than the opposite.

Now transpose this argument over to the transition economies. In the decentralizing socialist reforms over the years and decades before 1990, workers, managers, and local communities had developed a range of de facto property rights (or “use rights”) over their enterprises. Central planning never worked well, and as it got worse, forms of decentralization took hold in varying degrees across much of the socialist world. These reforms included the Yugoslav self-management system, the enterprise self-management councils of Hungarian “goulash” or reform communism, the Polish Solidarity-dominated self-management committees, and the Gorbachev perestroika reforms to increase enterprise self-accountability. One way or another, in often bizarre ways, people learned to do things in a twilight half-centralized and half-decentralized system. They developed de facto property rights that represented their capabilities to actually get a few things done and that embodied some nascent version of workplace democracy.

When the spell of communism was finally broken in 1989–90, the alternative to institutional shock therapy and market bolshevism—the counterfactual—would have been to formalize the nearest approximation to the de facto property rights that would be accepted as socially fair and thus continue the decentralizing thrust going “straight to the market” (e.g., through the lease buyouts discussed later). If that alternative approach had been taken, then people would have encountered the market as something that would recognize and formalize the capabilities they had already developed and would allow them to do even better.

Instead the market Bolsheviks designed the so-called market reforms with the exact opposite purpose to deny the de facto property rights accumulated during the “communist past,” to righteously wipe the slate clean by re-nationalizing all companies of any size, and to start afresh with formal property rights deliberately unrelated to the previous “vestiges of communism.” Sometimes these “ideal reforms” were compromised in getting legislation passed, but by and large, the “reforms” were successful in denying the de facto property rights acquired during the earlier decentralizing reforms. For instance, outside of a small elite, most Russians encountered

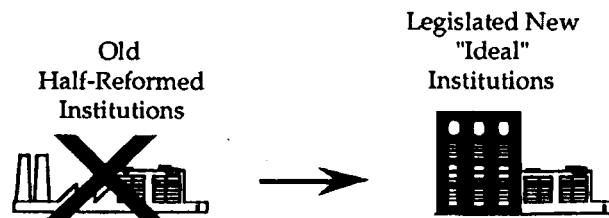
the market not as something that strengthened their capabilities and empowered them to do more but as something that took away what they were capable of doing and left them in a position where the rational choice was to grab what they could in the face of a very uncertain and uncontrollable future (see Black et al. 2000).

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

Moreover, this analysis and critique is not just “hindsight.” The following was written in 1992 and published in 1993:

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

#### “BIG BANG” INSTITUTIONAL CHANGE



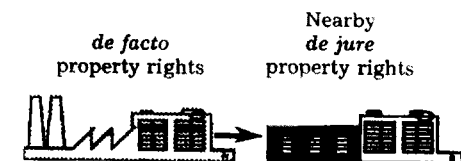
The old *de facto* property rights embodied in the half-reformed institutions would not be recognized in any significant way, and the new *de jure* property rights would be legislated by the new “revolutionary” democratic government.

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

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

These two strategies are posed as opposites. No country would adopt a totally pure strategy, and one country might use both strategies in different parts of its reform program. For instance, the privatization-by-liquidation program in Poland is based on

#### INCREMENTAL INSTITUTIONAL CHANGE



an incremental strategy while the Polish mass privatization plan originates from a Big Bang approach. The Czech voucher plan is a Big Bang strategy, while small business privatization in the Czech Republic (and in most other countries) is based on an incremental approach. Aside from the lease buyouts and other MEBOs [Management–Employee Buy-Outs], the Russian mass privatization program is a Big Bang program, while the Chinese reforms in agriculture and industry are the clearest example of a thoroughgoing incremental approach. (Ellerman 1993, 27–28)

#### *The Lease Buyout Counterfactual*

What are the forms of privatization that try to move to a set of formal property rights that are a socially acceptable approximation to the de facto property rights that resulted from the earlier reforms during the socialist era? In Stiglitz's *Whither Reform?* ([1999] 2001), the general strategy was called "stakeholder privatization." Look at the parties who actually have to cooperate in order for an enterprise to succeed regardless of the "ownership structure." This includes the workers, managers, and local authorities. It does not include voucher fund managers sitting in Moscow. Then "shrink-wrap" the ownership structure around those stakeholders to arrive at a minimal agency chain structure where the owners have to cooperate on a day-to-day basis.<sup>7</sup> In the above passage, the Polish privatization-by-liquidation (also called "Polish leasing") program, the Soviet lease buyouts, and the Chinese reforms in agriculture and industry (i.e., household responsibility system and township–village enterprises) were all picked out as examples of this strategy to strive for formal rights close to de facto rights and to minimize the distortions of information and effort involved in long agency chains and absentee ownership.

What was a counterfactual or alternative to the market Bolshevik program in Russia? If the logic (minimizing agency chains and building on de facto property rights) is sound, then the Soviet lease buyouts and related experiments seem to be the closest things to a counterfactual to grow out of the reform experience in the former Soviet Union.<sup>8</sup> As noted above, this option was argued for at the time and on the basis of roughly these arguments. Martin Weitzman also at the time gave a pragmatic argument for the worker ownership version of stakeholder privatization: "Under worker ownership, the workers themselves, or their agents, will have to control pay and negotiate plant shutdowns. The most acute 'us vs. them' stalemates may be avoided. Ownership is more concentrated relatively

close to management decisions and can put more immediate pressure on performance. Regulatory capture may be avoided. Hard budget constraints may be more acceptable. There is less opportunity for financial manipulation" (1993, 267). Note Weitzman's version of the minimal agency chain and "shrink-wrapped ownership" argument in his statement: "Ownership is more concentrated relatively close to management decisions and can put more immediate pressure on performance." Unfortunately, IFIs chose to promote privatization in the way that Soviet-expert Weitzman recommended as "How Not to Privatize."

Moreover, the IFI specializing in the region, the European Bank for Reconstruction and Development, not only was aware of the leasing option but sponsored a set of pilot projects to show how lease buyouts could be done using modern corporate forms (Lloyd 1993). The structure of these deals and a host of other examples were presented in a European Bank for Reconstruction and Development (1993) technical note, so all these ideas were known in the early nineties to those in IFIs who wanted to know.

The counterfactual is often caricatured as arguing that "institutional and regulatory reform should have preceded privatization." However, the point is that stakeholder privatization minimizes the need for institutions to police long agency chains so that the *appropriate* forms of privatization can go forward as those institutions are being developed and can, indeed, drive that institutional development.

Unfortunately, the "experts" do not seem to have understood the argument then—or now.<sup>9</sup> When experts have a quasi-religious faith in ersatz national or regional watchdog institutions enforcing long agency chains and fail to see how people will try to enforce their de facto property rights in their concrete day-to-day self-interest, then they seem to have "failed in their understandings of the core elements of a market economy" (Stiglitz [1999] 2001, 132).

There is also the argument that the stakeholder privatization option would have been too slow. In the World Bank, there was often the specious dichotomy of mass privatization (meaning vouchers) versus "case-by-case privatization," where the latter meant painstaking negotiation of each deal. Yet the lease buyout schemes were a form of "mass" privatization in the sense that each deal simply had to satisfy certain cookie-cutter requirements in order to go through. Polish leasing was not slow, and the ten thousand or so Soviet lease buyouts before 1992 when the door was shut indicate that they were also not slow.



Indeed, one of the “problems” with the lease buyouts is that they were too fast and too popular at the firm level, not that they were too slow. The stream might swell to a river. If the lease buyouts had not been stopped, then the market Bolsheviks feared that there would not be any good firms left to go into the voucher auctions. Thus the stream was dammed, and the waters were diverted into the Kremlin-preferred channel of voucher privatization.

### Concluding Remarks

The advanced Western countries often present themselves to the world as the great advocates of democratic self-governance as opposed to all the ways that people have been autocratically governed in the past and present. Moreover, democracy is often linked to human development, which is stifled and stunted by the servility and subordination of the subjects of autocratic rule. Philosophers of democracy such as John Stuart Mill in the nineteenth century and John Dewey in the twentieth century have emphasized that the implications of democracy for human development are immensely increased if it is practiced “for the greater part of the waking hours of the day,” that is, in the workplace, and not only in a vote cast every few years.

Some well-meaning advocates of democratic self-governance lament that the current property distribution in the West is not conducive to workplace democracy. In this context, the transition of many socialist countries to market economies and to some semblance of political democracy provided a natural experiment to test the Western commitment to extending democratic self-governance as a way of life. The historical pattern of state ownership was no longer taken as a “given.” Moreover decades of socialist reforms in the direction of decentralized markets had established de facto property rights on the part of enterprise staff so that the recognition of these property rights would have established some form of workplace democracy. Like the privatization of the housing stock to its occupants, this mode of stakeholder privatization would immediately create a stake in the market economy and would create (in Mill’s words) “a new sense of security and independence in the labouring class; and the conversion of each human being’s daily occupation into a school of the social sympathies and the practical intelligence.”

Yet the historical record is clear that the major Western advisory institutions promoted privatization schemes (principally voucher privatization)

with the deliberate intent to deny the de facto property rights established by decades of decentralizing reforms—with such rights characterized as “vestiges of communism.” Thus broad segments of the population in the former Soviet countries experienced the transition to “democracy and the market” as wiping away what little decentralized power they had acquired. It left them as the powerless subjects of the new political elites and economic oligarchs who filled the void left by the Western-promoted privatization programs that “wiped the slate clean” of people’s de facto property rights.

Perhaps Harvard economist (and head of the Council of Economic Advisers under President George W. Bush) Gregory Mankiw and the late Stanford economist John McMillan should have the last words. In McMillan’s book *Reinventing the Bazaar: A Natural History of Markets* (2002), he attributes the very different outcomes of the transitions in Russia and China to the shock therapy and market bolshevism in the case of Russia (and the former Soviet countries) and to the incrementalism and pragmatism in the case of China. IFIs and neoclassical economic advisers lined up behind the Russian strategy; the Chinese went their own way—having already learned the hard way about Bolshevik-style social engineering. McMillan writes, “Russia leaned on lawyers, economists, and bankers from the West for advice on how to privatize state firms, develop capital markets, and reform the legal system. . . . China by contrast called little on foreign consultants” (2002, 207–8, quoted in Mankiw 2003, 257). In a review of McMillan’s book, Mankiw spells out the stakes in this natural experiment: “If McMillan is right that shock therapy was the problem, then the economics profession must accept some of the blame. Our profession lent some of its best and brightest to the transition effort, such as my former colleague Jeffrey Sachs. Most of these advisors pushed Russia to embrace a rapid transition to capitalism. If this was a mistake, as McMillan suggests, its enormity makes it one of the greatest blunders in world history” (2003, 257).<sup>10</sup>

### NOTES

1. These sections will draw on Ellerman 2009.
2. Since the distribution of state-owned property was no longer “given” in the postsocialist transition, the transition debate is a particularly interesting case study about attitudes on our topic of workplace democracy and human development.
3. The older name was the “master–servant” relation, but aside from a few law books on agency law (e.g., Batt 1967) that use the “master–servant” language as a

technical phrase, that usage was slowly replaced in the late nineteenth century and early twentieth century with the modern terms of *employer* and *employee*.

4. The voucher funds were typically restricted by law to owning at most 20 or 30 percent of a portfolio company, and the annual payoff of the fund-management companies was typically fixed at 2 percent of the value of the portfolio under management. Hence the “ownership interest” of the controlling fund-management firms was on the order of 2 percent  $\times$  30 percent = 0.6 percent, or six-tenths of 1 percent. This was not some “secret” design flaw discovered later; this was in the legislation of the voucher programs. Globe-trotting Harvard professors and World Bank experts could easily “do the math” to figure out that “owners” with a miniscule ownership interest did not have a big incentive to make investments to restructure and upgrade the assets since the overwhelming bulk of the increase in capital value would go to others. Yet the “institutional design experts” seemed surprised to later find in their voucher programs all across the transition economies that the fund-management companies had devised more efficient ways to “tunnel” funds out various “back doors” of the firms (Ellerman 2001; Schwartz 2006). The “experts” seemed to be so blinded by ideological blinkers that they could not anticipate or even recognize in a timely manner such obvious opportunities for asset looting.

5. An “agency chain” is a multilinked chain of principal–agent relationships. For instance, in the large publicly traded U.S. companies, the theory is that the shareholders are the ultimate principals who “supervise and control” the board of directors as their agents (in theory through board elections, but, in fact, dissidents tend to use exit—selling shares—rather than voice). The board, in turn, is supposed to select and supervise the top managers (rather than the other way around) in another link in the agency chain. Then the top managers supervise the middle managers and so forth eventually down to the workers on the office or shop floor.

6. For instance, managers have much more relevant information about what they are doing and about the company than their “principals,” the board members, and the shareholders.

7. “Shrink-wrapped ownership” is a metaphor denoting a structure where owners are those “stakeholders” who—independently of any formal ownership—have an “up close” functional relationship to the operations of a firm, which would include the staff and major suppliers (including finance) or customers and perhaps local authorities but not, say, absentee buyers of secondhand shares. The idea is to match ownership to function with the firm rather than treat “ownership” as a tradable commodity that can be bought by otherwise unrelated parties. By “firm” I mean the de facto firm that meets every working day, not the formal legal entity that meets once a year. The strikingly successful Chinese township–village enterprises function with a “shrink-wrapped” ownership/control structure even without Western-style formal ownership—much to the bewilderment of the Western experts.

8. In a lease buyout, the enterprise staff—who developed de facto property rights in the decentralizing reforms—were allowed to proceed “straight to the market” by purchasing the company with seller-supplied credit on an installment or lease-purchase basis. As in U.S. style leveraged buyouts, the installment payments are made by the company (not the individuals) to the seller. The lease buyouts worked best as medium-sized (or smaller) firms. But the Soviet dinosaurs typically needed to be busted up into a related set of medium-sized firms, so lease buyout “spin-offs” or “breakaways” could also be used to simultaneously restructure and privatize the large firms.

9. The failure of the “best and brightest” academic and bureaucratic economists to “understand” this mutual hostage argument surely derived in part from their fundamental antiworker animus. This was clearly shown in the behind-the-scenes arch paternalist view that “worker ownership” would just lead to workers destroying their own livelihood by stripping the assets of their own firms. They argued for strong absentee owners who would be “interested in maintaining the long-run health of the assets” and who would act as “asset advocates.” And then the elite advisers supported voucher investment funds—funds that, together with ENRON-style managers, showed their great devotion to assets by promptly tunneling them out of the firms. However, some Polish critics of the “Stiglitz perspective” (Dabrowski et al. 2001) allowed that “workers’ self-management played an important part in limiting the fall in output and the amount of criminal asset stripping in the state sector in Poland,” and thus they are “Not Poles Apart” on the short agency chain argument (Stiglitz and Ellerman 2001).

10. The other two Harvard expert advisers, Larry Summers and Andrei Shleifer, made more direct contributions to the Russian debacle than Jeffrey Sachs (now at Columbia University), but at the time this review was written, Shleifer was still a colleague of Mankiw’s at Harvard and Summers was then the president of Harvard University.

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