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Interim Report **IR-01-006**

Russian Property Rights in Transition

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7 March 2001

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Abstract

Property rights are an important political and economic issue in Russia. A weak property rights system is a significant hindrance for economic growth and transition in Russia. This report aims at showing that the problems in creating a new property rights system are institutional. Formal rules are complicated and blurred, because of the lack of consensus in society. Informal institutions prevail and, in spite of the privatization of enterprises, the same elite as before benefits.

The privatization of enterprises made managers the owners of former state enterprises and enabled them to keep things going in the same manner as before. The relations of the new economic elite with the governmental sector maintained monopolistic markets. Financial markets are still weak and because of the bank crisis of 1998, banks become bankrupt and the markets change into an even more monopolistic direction. The government can choose who stays in business.

Restructuring has not occurred even in spite of the economic boom caused by oil prices and devaluation. It will take a long time before Russia gets rid of the virtual economy with artificial prices and barter trade. Transaction costs for legal trade are too high and keeps the gray market going as well.

Land and natural resources are still mainly state property. The land reform, which started with agrarian reform, made land transferable. Enterprises can buy land and family farms are a legally available form of agricultural production. However, the agrarian reform did not transform the Russian countryside to become more productive. There is no proper infrastructure for family farms and the state supports joint stock companies, which are the former state or collective farms.

There are regional differences depending on the interests and opinions of regional authorities. The obstacle for building a uniform system of land law is legislative chaos. In the absence of political consensus a new federal land code has not been passed. Regional legislation differs from region to region. There is still a battle going on between the regional and the federal levels on the ownership of natural resources. Even if reorganization is going on, the state management of natural resources has remained quite unchanged. Forest management is the best example of maintaining the old institutions in spite of the privatization of forest enterprises.

Acknowledgments

This report was written within the institutional framework study of the Forestry Project at IIASA. The interest within the project towards the development of the legal framework in Russia made this study possible. I would like to express my gratitude to those who contributed to the completion of this paper, namely Sten Nilsson, Counselor to the Director and Leader of the Forestry Project, Lars Carlsson and Mats-Olov Olsson, who all helped me with their valuable comments. I am also grateful to other members of the project who, together, form an encouraging working group.

I also owe gratitude to my family, who has supported me in taking advantage of the opportunity to concentrate on my work at IIASA.

About the Author

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Russian Property Rights in Transition

Soili Nysten-Haarala

1 Introduction

1.1 Property Rights in Legal Studies and Institutional Economics

Property rights have a great influence on the economy. The political nature of property rights is clearly visible in transforming economies. They are one of the most significant political issues in Russian transition, and unclear property rights is an obstacle for sustainable economic growth in Russia. However, neoclassical economics takes property rights as a given ready-made system. Property law is built on the assumption of the existence of a ready-made clear and precise system of property rights as well. Law is supposed to be neutral. Different property rights, such as ownership, leasing, possession or use, lead to a different set of legal rights and duties that do not depend on who is the holder of the right.

The Russian environment constitutes a problem for such a standpoint because the property rights structure is not yet clear. It is vague and in a constant stage of transition. The socialist planned economy excluded private ownership of natural resources, industry and commerce. It is now disputed to what extent private ownership should be returned and for what kind of property. This struggle is escorted by informal privatization. Those, who are in a good position to do it, privatize "loose" state property either informally or formally for themselves. The lack of order in privatization has serious negative effects on the development of the Russian economy and society. The developing property rights system lacks credibility. It is therefore necessary to go beyond the legal system of property rights to understand property rights in transition.

According to Hohfeld (1919) rights can be understood as a combination of duties and claims, the content of which is what a right-holder can claim and what a duty-bearer should respect. It is not the resource itself that is owned it is a portion of the rights to use a resource that is owned (Alchian and Demsetz, 1973). Modern property law regards property rights as relations between the different right holders and analyzes the legal positions and consequences in these relations.[1] The concept of property rights is

[1] Especially in Nordic legal studies, property law is seen as dynamic relations not just as stable absolute rights vested on things, as property law used to be according to the German Roman law-based tradition. Modern property law focuses on the protection of third parties in dynamic transactions with the help of analyzing the relations between different right holders and duty bearers. In Finland, the analytic tradition to cut legal relations into different pieces of rights and duties was started by Zitting (1951).

wider in new institutional economics than in law because it attempts to go beyond the legal system. Property rights are relations among people concerning the use of things (Furubotn and Pejovich, 1972). Property rights specify relations among those who have various rights and duties to honor the rights, as well as mechanisms that are available to make the duty bearers comply with the rules. The property rights system includes the rights themselves, the formal and informal institutions that create the structure, and economic transactions including decisions concerning the exchange and accumulation.

Law and the legal system of property rights are the formal institutions. Even if modern property law sees property rights as relations, it concentrates on the formal legal effects of regulating these relations (Zitting, 1951; Aarnio, 1989). Informal institutions are excluded from legal studies, limiting law to neutral legal analysis.[2] Laws are important on the condition that people expect that they are followed. When legal institutions are weak or incomplete, property rights are informal. Rights, which have been enforced informally, e.g., through self-help can, however, become legal in the course of time.

Leblang's (1996) statistical study of 106 countries showed a correlation between strong economic growth and strong property rights. The study was made using the measure of economic freedom, which Raymond Gastil and Lindsay M. Wright developed, as a proxy for strength. Leblang's study proves that countries with a strong property rights system seem to have growth rates almost twice those of countries with weak property rights. Whether a country has a democratic regime does not seem to have an effect on economic growth once its property rights system is taken into account. According to Leblang, it is the commitment of the political regime to property rights that count and indirectly influences economic growth.[3]

According to Riker and Weimer (1993; 1995) four characteristics of property rights systems seem to be especially relevant to economic behavior:

- clarity of allocation,
- cost of alienation,
- security from trespass, and
- credibility of persistence.

These characteristics affect the efficiency with which an economy uses its available assets. The credibility of persistence is also important for dynamic efficiency and political stability (Weimer, 1997).

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[2] In Nordic countries with a strong influence of legal realism, the courts are allowed to use obvious real facts in their legal analysis ("reella övervägande") but cannot, however, ground their decision completely on such facts without the support of other more official legal sources (see, Aarnio, 1989).

[3] The linkages between strong property rights and economic growth have been studied a lot. Arbitrary seizure of property rights has always had serious effects on declining economic growth (Torstensson, 1994), but the effect of the choice between state or private property is difficult to show even though countries with private property rights have shown better economic growth rates. The connection between democracy and economic growth is also complicated and it can only be shown that the most successful countries are democratic and that they are the richest (Hellivell, 1994).

De jure allocation of rights to commodities and assets is typically precise. However, it is very seldom complete. *De facto* patterns of use complete the allocation, sometimes superseding *de jure* allocations. Since *de facto* alienation is typically imprecise, it prevents alienation and diminishes the security from trespass and credibility of persistence. Therefore, neoclassical economics assumes a clear and precise allocation of private property rights to all commodities and productive assets. It is a precondition for Pareto efficiency of competitive equilibrium within a market economy. Markets fail to achieve Pareto efficiency when private property rights are not clearly defined. A typical example of failure is the so-called tragedy of the commons, when open access to natural resources causes inefficient over-consumption and under-investment follows. The use of private assets is generally more clearly allocated and therefore more efficient in terms of neoclassical economics. The reason is that it is assumed that principals using state-owned property have weaker incentives to specialize in monitoring than private principals (De Alessi, 1983; Lott, 1987; Vining and Weimer, 1990). There is also a considerable amount of empirical literature supporting this assumption (see, Vining and Boardman, 1992).

In socialist economies, with large amounts of state and common property, less clear allocations of use rights than in market economies is typical. This fact is usually interpreted as causing inefficiency (Kornai, 1990; Moore, 1981). In post-communist countries, the collapse of the central political and economic planning institutions makes the allocations of use even less clear. This fact can provide an explanation for the immediate economic decline of post-communist countries (Olson, 1992).

In a market economy, changes in technology, the distribution of wealth and consumer tastes require the reallocation of commodities and assets. The less costly it is to alienate property, the more effectively market forces can move commodities and assets to their most valuable uses. The costs of alienation are likely to be high for transferring *de facto* use rights. Black markets quickly develop for illicit commodities. Legal restrictions on the transfer of formal property rights may also hinder alienation and lead to inefficiency. Government policies can raise the cost of alienation in different ways. Several post-communist countries have placed restrictions on the sale of assets to foreign investors. Price controls, a lingering legacy of selected commodities in post-communist countries, raise the cost of alienation by pushing exchanges to black markets (Weimer, 1997).

The efficient use of assets depends on their security from trespass. Both formal and informal institutions affect security from trespass. Criminal and tort laws belong to formal institutions, but also social norms regarding respect for people, property and the rule of law support the efficiency of criminal and tort laws. Self-protection substitutes for effective institutional support for security from trespass. Security systems, hired guards, and violence against intruders make the assets more difficult and expensive to use.

Economic legality has not yet developed in post-communist countries. There are no traditions of independent courts. Judicial as well as enforcement capabilities are still inadequate to provide effective security from trespass through formal institutions. Networks of relationships, which developed during the communist regime, existed to exploit black-market opportunities. Such a situation facilitates the development of criminal organizations, which seek to corrupt public officials. This vicious circle

already existed in the former Soviet Union, and after the collapse of the communist system the "mafia" burst out thereby increasing corruption.[4]

Uncertainty about the persistence of property rights for natural resources encourages too rapid exploitation and discourages their preservation (Libecap and Wiggins, 1989). The greater the risk of losing existing property rights, the less likely the holders of those rights will be to consume the property as soon as possible. Investments are not made and economic growth does not appear. Governments play an especially important role in the credibility of the persistence of property rights. Economic historians have shown the importance of credible property rights for understanding the rates of growth in different time periods and regions (North and Thomas, 1973). Torstensson (1994), who studied 68 developed and developing countries, found a strong statistical and negative relationship between the rates of growth per capita and the index of risk of arbitrary governmental seizure of private property. According to his study the degree of state ownership, however, does not have a statistically significant effect on growth rates after controlling the risk of seizure. It is obvious that weak property rights contribute to weak economic growth. Weak property rights also seem to have a negative impact on the development of political democracy.

1.2 Aim, Method and Structure of the Study

This study focuses on a holistic view of the transformation of the Russian property rights system. Development of the formal legal system is dependent on the political and economic situation and especially on the interests of those who can affect the development. Positive law in itself cannot guarantee an efficient transformation to a market economy, if informal institutions do not support it. Formal legal rules and independent courts to implement them are, however, important to make the new property rights strong and effective. Their role should, however, not be exaggerated, because it is both formal and informal rules that constitute the level of the rule of law. This level is dependent on the values of society, on which both political and economic circumstances affect.

The aim of this study is to explain how the Russian property rights system is developing and why it is still weak and does not contribute positively to economic growth.

Since law is supposed to be neutral and only systematize a ready-made formal system of property rights, no theory from legal studies can be used to study property rights in transition. There are a lot of institutional theories, which can be used for explaining the transformation of property rights in post-communist countries. The influential groups of society are of great importance. Interest groups continuously struggle for power and influence (Olson, 1992). Institutionalists also emphasize path-dependency, which is due to the interests and mentality vested in institutions (North, 1992).

[4] According to opinion polls, Russians seem to think that either most officials (53% of the respondents) or almost all (36% of the respondents) are corrupt. They also think that compared to Soviet times corruption has increased a lot (52% of the respondents) (Rose, 1998:37).

If the government is assumed to be passive and only providing the framework for bargaining among affected parties, institutional change results from the realization of opportunities for changes in rules that are Pareto improving (North and Thomas, 1973). Changes are, in principle, Pareto improving but transaction costs may prevent parties from reaching an agreement, which could improve Pareto efficiency. The state may also be an important actor pursuing goals such as revenue maximization or electoral success through changes in formal rules. Then, changes in property rights follow to a great extent from changes in government interests (North and Thomas, 1973).

The distribution theories see institutional change as the byproduct of conflicts among interest seeking distribution gains (Knight, 1992; North, 1993). Bargaining among interested parties establishes rules that have distributional consequences. The rules reflect bargaining power among the participants. Knight uses the asymmetric power concept.

No theory can, however, encompass the whole situation of transformation. Institutional theories, however, can be tools in explaining the transformation of property rights. Unfortunately theories, which have developed in fairly stable market economies, are not able to explain all the special aspects that are connected with transition. The strength of institutional theories lies in their ability to explain broader cultural features, which are vested in institutions and can be strong elements in path-dependency.

The first part of the study focuses on the privatization of former state enterprises, which constituted the foundation for the current Russian economy. The privatization of enterprises thrust private property rights into the Russian economy. Since ownership and the running of companies is an important form of property rights, a brief analysis of the results of privatization on Russian companies and the framework in which they operate is included in the study. The analysis focuses on the results, especially economic efficiency of the change in the property rights system. This report focuses on the development of the framework of the system of property rights. Company law and rules governing the management of companies is a subject of another report.

The second part analyzes the development of property rights concerning immovable property. It touches on the problems of ownership and use of natural resources and the methods in developing them in Russian circumstances.

2 Socialist Property Rights and Reforms under Socialism

2.1 Socialist “Command Economy” and its Shadow Economy

Transition cannot be understood without knowing anything about its starting point. The socialist planned economy was an attempt to abolish both private property rights in production and distribution and the markets. Production was organized by a plan, which was prepared by Gosplan. Consumption then had to follow the plan, which was based on production. The economy had to fulfill 1-year, 5-year, 10-year and 15-year plans, which were all mixed together. Every level of the system demanded fulfilling the plan from the lower level and reported its own fulfillment to the upper level.

The fulfillment of the plans was assured with a system of administrative contracts. This system was created in the 1960s to bring in the civil law system beside the administrative system (Tolonen, 1976). During Khrushchev's era, a movement started among Soviet law scholars of bringing contract issues on a civil law basis and developing civil law. Socialist organizations (firms) started to conclude contracts according to the requirements given by the economic plan. These contracts could not be modified or adjusted. They were written in standard form that had to be followed. There was no freedom of contract. If an economic organization, e.g., a factory could not fulfill the contract, its contracting party, which was also tied up in the net of inflexible administrative contracts, could take the case to an arbitration court. The court then gave a decision forcing the factory to fulfill the contract or pay damages instead. It was a contractual system in name only, and the arbitration courts were courts also in name only. This change towards using contracts did not abolish the administrative system; it only gave a slight flavor of civil law. Actually enterprises committed themselves to the system instead of only acting according to commands. The idea of development towards civil law, however, continued its life in the minds of the next generation of lawyers.

Socialist enterprises were organized in a hierarchical way. There were tens of ministries governing tens of branches of industry. Some organizations were subjected to be under a State Committee. There was no competition, but both production and distribution were based on forced relations. Some branches of the economy were organized as "all soviet", some as republican and some as "all soviet"–republican. The most important branches of industry were administered as "all soviet", which means that they were lead from Moscow. Enterprises were all socialist enterprises. The state was the owner of these enterprises, but the managers administered them. The enterprise itself had the right to control and use the property of the enterprise including the land on which it stood (cf. Nysten-Haarala, 2001:14).

Besides socialist state ownership there were also the collective farms (*kolkhozes*), which were cooperatives but were run like state enterprises. They were cooperatives in name only (Mozolin, 1992). The *kolkhoz* had no real independence in an economic system where the seeds had to be bought from a certain deliverer at a fixed price, and the state officials gave the machinery. All production property was mainly state property. Land and natural resources were exclusively state property.

According to Wiles (1977), the whole economy operated like a huge enterprise. The soviet system was a good example of an extreme hierarchy (e.g., Eggertsson, 1990; Williamson, 1985). The original idea was to rationalize the economy and avoid profits going to capitalists. In principle, such a system could save transaction costs. In reality, the "enterprise" was too big and clumsy. Transaction costs were not taken into consideration. It was only the volume of production that counted. There were also problems with agency relations. In principle, the agency relations could have been controlled by the next upper level but, in practice, the loss of goods was significant at each level. The control on behalf of the state as the principal was inefficient and arbitrary. There were so many levels between the top and the grass root levels that information from the production and consumption level had definitely disappeared on its way upward. The long principal–agent chain effectively blocked all of the important feedback, which would have been needed to correct the plans (e.g., Nove, 1977). Stealing state property was not considered as a dangerous crime, even if the criminal

code sanctioned many economic crimes with the death penalty. On the other hand, enterprises were explained as belonging to the workers.

The economy was based on false assumptions and created an atmosphere of getting what was given from above. It also created a huge shadow economy correcting the defects of the inflexible planned economy. There were underground factories, which could exist by relying on bribery (Hosking, 1985). The falsified economy explains why corruption was so widely spread. It also explains the nature of criminality in the Soviet Union and Russia, her successor. Production of goods or services to gain profit by using the labor force or in the form of a company or an organization was a crime according to the Russian Socialist Federal Soviet Republic (RSFSR) criminal code. Since private economic activity was criminal, those who took part in the activity were criminals according to the Soviet law and therefore had to find "protection" either from the criminal gangs or the corrupted state and party officials or usually a combination of both. The economically important and profitable shadow economy was based on bribery and protection money.

Organized crime did not emerge because of *perestroika* or the collapse of the Soviet Union. The collapse only revealed the mechanism of criminality and made the criminal organizations struggle for their future in the new society. They also successfully took part in the competition for economic resources and political influence. Some members of the criminal sector could transfer their activities into the legal sector. Some preferred to stay illegal. A lot of Russian enterprises still operate on the gray sector of the economy. Private enterprises, which are not privatized former state enterprises, do not always register in order to avoid taxation. Registered enterprises often produce partly unofficially to the gray market using double book keeping. There are no reliable statistics concerning the volume of the shadow economy. It is a well-known fact that those who had capital for business were either members of the old *nomenclatura* or former "criminal" businessmen or even simply criminals. For these reasons, a considerable number of Russian businessmen and politicians are not used to doing business governed by official legal rules. This fact has had profound effects on Russian business culture. Knowing this casts a totally different light on the textbook assumption of rational behavior.

The history of the Soviet shadow economy also explains the difficulties of introducing private entrepreneurship in Russia. Earlier, people were taught that private property and private enterprises were capitalist exploitation. Since economic equality was a socialist moral principle, the sudden enrichment of some people caused a lot of envy and bitterness among the less fortunate fellow-citizens. It is also a commonly known fact that those, who could make profit in the new situation usually, either had a more or less criminal background or could make use of their connections within the Communist *nomenclatura*. Even honest businessmen were labeled dishonest because the common opinion is that business simply cannot be an honest activity. These kinds of sentiments and values of the people are easy to use for political purposes against private ownership and private enterprises.[5] Socialist values are the reason why the idea of private property

[5] Jones and Moskoff's (1991) book about the cooperatives during *perestroika* describes the clash of moral values, mixture of feelings and how they were used in politics.

is so difficult to extend to immovable property and especially to natural resources. The other reason, besides the values, is the fear that Russian natural resources would end up in the hands of a small circle of private persons who already control Russian industry.

2.2 Reforms under Perestroika

Mikhail Gorbachev, who was a younger leader than his predecessors, became the first agent of change. He and many others of his generation of Russian communists realized that something had to be done to modernize the Soviet Union. However, the pressures inside the Soviet Union were so heavy that when the transformation process started it also swept away Mikhail Gorbachev. Soviet society could not face new openness (*glasnost*), which revealed its rotten nature. The corruption and the privileges of the *nomenclatura* were too much, when it was finally possible to discuss it openly. Gorbachev would have preferred to direct the country smoothly towards a market economy in the guidance of the Communist Party. But it was the Party, which was not tolerated any more. Even the party members themselves seemed not to believe what they said. Many adherents of gradual transition still think that Gorbachev's gradual reforms would have led to a better result than the shock therapy, which was chosen after the collapse of the Soviet Union.[6] In principle, they might be right but reality was against Gorbachev. His reforms came too late and the Communist Party no longer enjoyed respect or trust.

Gorbachev's reforms aimed at introducing the private sector and decentralizing the control of state enterprises. A new law on state enterprises was passed in 1987. Before then, state enterprises had been regulated only by administrative regulations of the government. A state enterprise was determined as a juristic person. In practice, they remained part of the state administrative bureaucracy (Mozolin, 1992). As there were no companies in the Soviet Union but there were cooperatives, which started to be used as the first form of economic activity allowing private ownership. The Soviet Law on Cooperatives from 1988 allowed private property to be used beside state property.

Cooperatives became extremely popular in the Soviet Union. Managers of state enterprises channeled economic activity to new cooperatives, which could sell at higher prices than the state enterprises whose prices were centrally controlled. Cooperatives, small businesses and leased assets were also allowed, according to the new laws to undertake economic activities, which were forbidden to state enterprises. The directors established parasitic cooperatives, collectively owned entities, lease agreements and joint ventures, which became profit centers feeding off the assets of large state enterprises. In this way, cooperatives started the spontaneous privatization of state property. Partly because of these activities, cooperatives became targets of those who

[6] Gradual transition could have taken into account the fact that it is almost impossible to manage both economic and political reforms simultaneously (Elster, 1993). It has not been proved that economic growth would need democracy (see, footnote 3). It can therefore be argued that democracy can be developed after economic growth has made the situation easier for changes. Tolonen (1996) pays attention to the danger of chaos because order is absent in the society, where simultaneous changes easily lead. Without legal order changes can not be introduced. The Austrian economy argues that gradual change is possible with the help of creating small businesses (Kregel *et al*., 1992).

resisted changes. They were labeled in the media as exploitation. Some cooperatives even had to face the anger of rioting masses (McFaul and Perlmutter, 1995:43; Jones and Moskoff, 1991).

Gorbachev also tried to persuade foreign investors to enter Soviet markets in cooperation with Soviet enterprises. *Joint venture* became a special form of company regulated by a decree of the Soviet Council of Ministers No. 49 from 1987. Foreign enterprises were allowed to form a joint enterprise together with Soviet organizations. The economy was still strictly state controlled at this stage of development. A new Soviet Law on Enterprises and a Decree of the Council of Ministers on Joint Stock Companies and Limited Liability Companies was introduced in 1990 but, because Russia announced the declaration of independence on 12 June 1990, this new regulation did not enter into force. The Decree of the Russian Federation on Joint Stock Companies of 25 December 1990 was adopted instead.

When the Soviet Union collapsed, reformers or adherents of revolutionary transition (shock therapy) came into power in Russia with President Boris Yeltsin. Yegor Gaidar and many other economists had studied neoclassical economics in the United States in the neo-liberal form (Milton Friedman, James Buchanan and Friedrich Hayek), and were sure that the liberalization of prices and privatization of enterprises would lead to rapid economic growth and spontaneous generation of markets and market institutions. It was a considerable change in the ideology of transition from state controlled gradual transition to liberalization and passive government theory. The main argument for shock therapy was that the bureaucratic state interference blocked reforms (Sachs, 1993; Åslund, 1997:454). The earlier experience of market socialism in Hungary, for instance, gives weight to such arguments. According to Kornai (1990:131), market socialist countries maintained the fundamental attributes of the socialist system. The state-owned sector still dominated the economy and the main coordinator of economic activities was the centralized bureaucracy. Shock therapy and liberalization, however, produced a shock with long lasting and unexpected effects without being able to rapidly turn Russia into a market economy.

3 Privatization of Enterprises

3.1 Mass Privatization without a Proper Legal Framework

3.1.1 Rapid Privatization as the Goal

Privatization of state enterprises was immediately launched after the collapse of the Soviet Union and the victory of the reformers in the new Russian Federation made it impossible to reverse the development. Private property rights were seen as being necessary for a market economy and economic efficiency. This was a clear fact for the reformers who had a lot of experience from an inefficient planned economy and socialist property rights. The common explanation of the inefficiency of the socialist economy was that people did not want to take care of property, when they did not have access to decide on its fruits (cf., Vining and Weimer, 1990; Lott, 1987).

The role of the government was important in Russian privatization, even if the choice was officially a liberalist passive government ideology. Relying on market forces had long-term effects on the Russian economy. The choice was political since it aimed at preventing any attempts to reverse the trail.

Fast privatization should not be an objective in itself. The results are more important. The rapid privatization process in Russia was described both as a success story (Åslund, 1995) and a huge theft of state property (Stiglitz, 1999). Especially in the beginning of the process, the fast enforcement was praised (Frye, 1997; Åslund, 1995). From the official beginning of the program in 1992 until 1 September 1993 one third of the state enterprises were already privatized (Radygin, 1995:5). Between 1991 and 1994, 75% of the state enterprises were privatized. Stiglitz (1999), chief economist of the World Bank, belongs to those who use the notion "*robber baron*" privatization. According to him, the alternatives of privatization for the government in countries of transition were the sale of national assets abroad, voucher privatization or taming "spontaneous" or illegitimate privatization as in Russia's case.

Illegal privatization, which had started with the emergence of new cooperatives during the *perestroika* period, was one reason for a rapid start of the official privatization program (Radygin, 1995).[7] It has also been claimed that the government actually attempted to restore central control over the economy with a legal framework under which enterprises could be subjected to instruments of governmental economic, financial and monetary policy (Clarke and Kabalina, 1995). Especially foreign advisers emphasized the need to break the monopolistic structure of the Russian economy as well as separate management from ownership (Lipton and Sachs, 1990; McFaul and Perlmutter, 1995).

Since communist *nomenclatura* — managers of socialist enterprises and businessmen, who had participated in the shadow economy — were those who had access to capital and the knowledge required in the privatization process, they were those who benefited most from privatization and who started to run the privatized companies. Since the old system was falling apart and a new one had not been created yet, these people acted quite rationally and path-dependently in that situation considering their social capital. Even if the formal structures collapsed, the informal networks remained and increased the opportunities of the *nomenclatura* as an interest group. *Homo sovieticus* can also be described as Simon's (1985) institutional man, whose rationality is tied with the opportunities that the existing environment can provide.

3.1.2 Structure of the Legal Framework of Privatization

The official legal framework is now relatively clear, when most of the state enterprises have already been privatized. The problem was that the legal framework was created while privatization was going on and the methods and the extensiveness of it were largely debated. Several interest groups tried to influence the drafting of the new

[7] As soon as joint stock companies were introduced in Russia, many directors made the workers' collective decide to change the enterprise into a closed joint-stock company with insider ownership. Such privatization occurred both with and without the consent of the state authorities (Krüssmann, 1998).

legislation, and the power struggle between the President and Parliament made the legislative process chaotic. Privatization was started before any constitutional foundation existed.[8] Thus, privatization was carried out almost completely leaning on presidential decrees.

The Supreme Soviet passed a decree on 27 December 1990 concerning the limitations of privatization. In this early decree, the defense industry, railroads and natural resources such as forests, for example, were excluded from the privatization program.[9] The energy sector, however, was included, probably because privatizing the continuously profitable oil and gas industry appeared lucrative to many. Abolishing the monopoly of the state in the energy sector can also be reasoned with competition arguments. At least this argument was emphasized by leading western advisers (Lipton and Sachs, 1990; Åslund, 1995).

The decree on the limitations of privatization, which is not legally relevant any more, shows on the one hand, quite a radical interest in privatization in the Supreme Soviet, which, however, had been elected during the communist period. On the other hand, the limitations of privatization in the decree probably reflected not only the opinions of the deputies of the Supreme Soviet but also the general opinion of the people, the well-established attitudes and values of Russian society.

The Law on Privatization of State and Municipal Enterprises was passed on 3 June 1991 and amended on 5 June 1992 and 24 December 1993. This law was inadequate because it was quite general in character and was actually largely superseded by subsequent presidential decrees. According to the law, the government should present a privatization program that includes the aims, priorities and the limitations of privatization. The program is then accepted by Parliament. In practice, however, presidential decrees played the most important role in the privatization process. Privatization programs were given through presidential decrees and the choice of the methods of privatization was decided upon at the governmental level. The President had a good reason to press forward legal regulations of privatization, since illegal spontaneous privatization[10] was going on while the Supreme Soviet disputed the legal contents of privatization. On the other hand, privatization would have required a lot of preparatory work to find buyers, ensure restructuring of the enterprises, ensure profitability, and arrange proper monitoring of the program. In studies of the failures and successes of privatization in the Americas, it was found that in successful privatization the commitment of institutions is important as well as political stability and adequate preparation (Spiller, 1995). In Russian privatization of state enterprises all these preconditions of successful performance were missing.

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[8] The constitutional basis of private property was laid out in the new constitution of 1993, which acknowledged private, state, municipal and other types of property (article 9).

[9] Enterprises of the defense industry were also privatized with the permission of the State Committee of Privatization. Private railroads also exist. In some subjects of the Federation, natural resources have also been privatized to some extent.

[10] It is difficult to know how common illegal privatization was. There were dozens of cases reported every month in the media. The scandal effect of them, however, diminished because of their abundance and the media lost immediate interest in them (Krüssman, 1998).

Privatization was officially launched with the first privatization program of the government already in the fall of 1991, before the Law on Privatization was passed. The Gaidar government prepared plans for privatization as part of a reform package and issued "The Fundamental Provisions of Privatization" on 27 December 1991. The first privatization program would have given 25% of a company's stocks free of charge to the workers' collectives. These stocks would, however, have lacked the right to vote in the shareholders' meeting. Managers would have received only 5% of the stocks with voting rights. The remaining shares would have been sold at public auction, when the working collective could have bought 10% of the shares with a 30% discount. This was the only method of privatization in the proposal. With this privatization program, President Yeltsin wanted to force the enterprise insiders to accept outside ownership (Radygin, 1995). The program also prohibited closed joint stock companies for the same reason.

3.1.3 Interest Groups of Privatization

Managers, who preferred insider privatization, largely opposed the first model of the government. Industrial managers became the most influential lobby and were led by the Russian Union of Industrialists and Entrepreneurs. They found support both in the Supreme Soviet and in the government. Their position became even better, when Mr. Chernomyrdin[11] became head of the government in December 1992 (Frye, 1997).

The employees were also a lobby group. They had a vast number of votes and they could benefit from the attitudes and ideals of worker ownership, which were inherited from socialism. Because their union was weak and had always been dominated by managers, they decided to ally themselves with the latter to protect their interests against outsiders. Unemployment was the greatest threat to them. Employees were also under tight control of the managers because of Soviet authoritarian management. Soviet enterprises, especially in remote districts, took care of their employees including their social life and entertainment. The employees were actually not independent or ready to resist management taking over the property of the enterprises. The managers also knew how to propagate their own takeover in the name of the "labor collective" (Clarke and Kabalina, 1995; Krüssmann, 1998).

This combined lobby group of managers and employees compromised a second option that allowed enterprise insiders to buy 51% of the shares at a closed auction prior to public sale. 29% of the shares had to be left for voucher privatization and 20% for the government to be sold through cash auction or investment tenders (Frye, 1997; Gurkov, 1998; Radygin, 1995).

The organ responsible for privatization was the State Committee of Property (Gosudarsvennyi komitet RF po urpavleniyu gosudarstvennym imushchestvom — GKI). It could influence greatly on the actual process and in the chosen methods. The GKI was occupied by neo-liberalists who were at least as radical as the Gaidar

[11] Victor Chernomyrdin was the former director of Gazprom, the giant state enterprise producing and selling natural gas. He is said to be a prominent shareholder of the new privatized Gazprom. Russian joint stock companies, however, hold information about stockowners as a business secret.

government, which started privatization. While the GKI governed the privatization process, the practical work for preparing the state enterprises to be privatized was handed to the Foundation of State Property (Rossiiskii fond federal'nogo imushchestvo). Financial responsibility for privatization belonged to the foundation.

There were regional State Committees of Property established in all the subjects of the Federation either by the Federal President, or the President or Governor of the subject of the Federation. The regional GKIs were supposed to form a uniform administration under the federal GKI. In many areas, the regional *nomenclatura*, however, took care of its own interests setting limits of ownership for citizens outside the subject itself. Some regional GKIs worked quite independently from the federal administration. Federal and regional interests were often contradictory (Krüssmann, 1998).

An antimonopoly committee was also established to work together with the GKI. It was supposed to control the markets so that they would not become too monopolistic.

Since circumstances were chaotic and the government had to persuade both the insiders of state enterprises and the public to support the program, firm and steady lobbying had immense effects on shaping legislation and the actual process. Managers had a lot of bargaining power, which they were able to use to secure their positions in a changing environment. There were also other motives such as simple rent-seeking and transferring earlier illegally privatized enterprises within the legally privatized property. Restructuring could also appear among the objectives of the managers, which in the long run was connected with ensuring their own positions.

3.1.4 Corporatizing and Voucher Privatization

The most important legal sources governing privatization activity were the Presidential Decree on Corporatizing State Enterprises (1 July 1992, No. 721) and the Decree on Reforming State Enterprises (23 May 1994, No. 1003). The presidential decree on corporatizing accelerated privatization giving state enterprises only 60 days to corporatize and submit their privatization plan. In practice, corporatizing means that a state enterprise changes into an open joint stock company. Sixty days is an extremely short period taking into consideration that corporatizing requires an evaluation of the property of the enterprise. A short time period increased the opportunities for those who had both access to the information and the required knowledge. In this case, it was the managers who were in the best positions.

74% of the state enterprises chose the so-called second way, which let the insiders buy 51%. Many managers also tried to get the 29% voucher share from the employees or circles around the enterprise (Gurkov, 1998). Only 24.2% of the enterprises chose the original model of the privatization program. 1.6% chose the so-called third option (Radygin, 1995), although the third option was included to satisfy the industrial lobby. According to this option, managers and employees of small and medium-sized enterprises could each buy 40%, if they agreed to restructure (Frye, 1997:90).

Most Russian state enterprises were privatized through vouchers in the mass privatization in 1992–1994. Yeltsin introduced a Decree on Voucher Privatization on 14

August 1992. He accelerated voucher privatization in a situation where the Duma had postponed the Law on Voucher Privatization for 1993 and had left for summer vacation.

Vouchers are a claim against the equity of an enterprise undergoing privatization. Vouchers were distributed free to all citizens and had a nominal value of 10,000 rubles, which was an average monthly salary in November 1992. Like all ruble-denominated assets, vouchers lost much of their value in 1992 and 1993 because of the high rate of inflation.

Vouchers were a substitute for capital markets, which were to create a new class of owners in Russia. Vouchers could be exchanged for shares in an enterprise, traded for cash, or sold to a voucher investment fund. Making vouchers transferable was a decision, which shaped the privatization process considerably in Russia. In Czechoslovakia, where voucher privatization was put into effect before Russia, vouchers were not as freely transferable.[12,13] The Russian voucher program did not make the majority of the people shareholders as was the original official idea, but escalated a market of vouchers (Frye, 1997). However, after the program ended Russia had more shareholders than Germany or the United States (Krüssmann, 1998).

The GKI registered the first voucher fund in 1992 and within a year there were more than 600 voucher funds operating in Russia. The reform oriented GKI allied with the voucher funds and conducted a vast public campaign for mass privatization. The GKI was, in principle, against insider privatization and therefore wanted to promote mass privatization. Conservative state officials occupied ministries, but the bargaining power of earlier powerful ministries had decreased considerably after the collapse of the planning system. Once the GKI had started the process, all attempts to reverse or alter it failed (Frye, 1997).

By the end of voucher privatization in July 1994, the public had invested 139 million of 148 million vouchers in enterprises. A fortunate investment could bring great returns. Shares in the communications giant *Rostelkom* were issued at 80 cents but traded at US $ 6.50 by August 1994. The vast majority of funds experienced severe financial difficulties and were relatively inactive. Promises to pay high dividends attracted many investors but reduced the credibility of the funds. The scope of abuse was also great due to little monitoring and the lack of accounting skills. Several scandals involving organizations that collected vouchers also reduced the credibility of the funds (Frye, 1997; Gurkov, 1998). The worst scandal was the MMM pyramid; the collapse caused one million people to lose their savings in 1994.

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[12] Voucher privatization was officially adopted from Czechoslovakia, because of the idea of making all of the citizens stock owners and acquaint them with a market economy. There was, however, another reason to choose voucher privatization in Czechoslovakia. The managers of state enterprises were not cooperative with the non-communist government. They were drawn by voucher privatization, which enabled insider privatization. In the Czech Republic, most of the vouchers finally ended up in the hands of state-owned banks (Tomass, 1999).

[13] Voucher privatization was presented to the Polish Minister of Privatization in a report by Frydman and Rapacinsky (Tomass, 1999).

Voucher privatization was the first large-scale attempt to introduce principles of a market economy to the citizens, to draw them in and let the market decide. The GKI tried to govern the process to a market-oriented result hoping that the market would do the rest. However, the results largely differed from the original ideas because powerful interest groups managed to turn the trail to a more favorable direction for them.

3.1.5 Insider Privatization as a Result

The insiders were too strong a lobby group with all the knowledge, information and social capital to be able to privatize the enterprises themselves. The government also needed the support of this important interest group, which could have blocked the rapid privatization and thus enabled the communists to prevent the whole process. The result was not Pareto optimal but, however, path-dependent.

According to the Law on Privatization, the methods of privatization were bidding competition, auction, selling shares or other property of the enterprise. The State Committee of Property had the power to choose among these different methods. The GKI leadership favored auctions and tenders to direct bargaining by arguing that competition facilitates fair prices, simplifies the evaluation of enterprises and guarantees the highest prices (Radygin, 1995:11).[14] However, auctions and tenders were often arranged and settled beforehand. Corruption and good relations among the *nomenclatura* people made arrangements not only possible but even easy.

Counting on auctions and tenders as a method and the markets to take care of the optimal competitive result is not realistic in the Russian environment. There is not necessarily a lot of competition when a big amount of unprofitable state enterprises are for sale. The situation cannot be compared to privatizing British enterprises during the Thatcher government. Monitoring and control is easier to arrange in an organized society with well-functioning stock markets like Britain. It can also be claimed that in direct bargaining, issues of restructuring could have been taken more easily on the negotiation agenda. In direct bargaining, foreign investors could have played an important role with their restructuring programs. Restructuring is much more important for the Russian economy in the long run than the amount of money, which privatizing produces for the state. It is quite obvious that the GKI also knew this, but was helpless under the pressure and desperately tried to count on competition, even when it could not find enough buyers for a competition.

The methods of payment are an issue, which the law on privatization allows the seller and the buyer to agree between them. The payment method can also be part of the bidding process or the auction. Payment can be decided to happen at one time or gradually. Also leasing can be a method of payment. Through leasing, both insiders and outsiders could have tried entrepreneurship without any large investments. There was a leasing movement which, however, was crushed by the mass voucher privatization (Gurkov, 1998). There was also a presidential decree on leasing companies from 14 October 1992.

[14] Mr. Radygin was one of the main advisers of the GKI.

The choice was political. Privatization had to advance rapidly. It was not so important that people would have had time to become acquainted with running businesses and obtain the required information and knowledge. Paradoxically, rapid voucher privatization favored the managers of state enterprises, which was quite contrary to the original ideas of the GKI. If the government tried to obtain control or at least regain part of its soviet time control, it did not succeed in that either (Clarke and Kabalina, 1995).

The employees and other insiders were given such privileges that their involvement in privatization was quite well supported. According to the law on privatization, members of the working collective and pensioners of the privatized company could buy at a 30% discount, but had to pay the whole sum within three years from the registration of the company. If there were people in this insider group who either had money or had friends in the newly emerged banking sector, insider privatization could take place easily. The problem for ordinary employees was that it was very difficult to obtain credits in Russia. Ordinary people had lost their savings with the introduction of the shock therapy. It was the managers who had friends in the banking sector. They also had access to dividend policy, since they made it themselves. On the other hand, insiders took care that also many less profitable enterprises could be privatized because they had their own interests to protect in the process.

In most enterprises, managers took over more than 70% of the shares.[15] Besides the 51% of official insider shares, managers managed to make use of the 29% of the shares that were distributed as vouchers. They encouraged the employees to buy shares and use their vouchers with their family members. Later on they offered to buy the shares from the employees (Bim, 1995; Krüssmann, 1998).

3.2 Robber Barons Build up a New Empire

3.2.1 Examples of Misconduct

There was already misconduct in bidding practices and the rules on the maximum amount of insider shares were circumvented with intermediaries. Auctions were often not officially announced and some bidders were even prevented from taking part. Especially foreigners were tried to be excluded from the game. Law, lagging behind the actual privatization process, had only little effect in taming spontaneous privatization. A good example of misconduct was the privatization of *Yukos*, the second largest oil company. The auction was organized by *Menatep* bank, which also won the bidding competition and received 45% of the shares with $ 159 million. In a separate investment competition, *Menatep* managed to obtain an additional 33% of the shares with $ 150 million. Three other banks, which also took part in the competition, immediately requested an investigation which, however, the government was reluctant to initiate.[16]

[15] Exact figures are not available because most enterprises refuse to give information about who are their shareholders (Bim, 1995).

[16] Privatization of the Yukos company is explained in (Sailas, 1996:201). Their description is mainly based on Russian press material. Illegalities and misconduct around Yukos and many other similar cases are public information. Publicity, however, did not seem to reduce the illegalities.

The main theft of the state enterprises, however, took place after voucher privatization was over and the third phase of privatization began.[17] According to the privatization program of 1994, given with a Presidential Decree in June that year, the rest of the shares of the state enterprises were going to be sold in bidding competitions.[18] The decree was an answer to the critics, who demanded that the State should also financially benefit from privatization (Kuorsalo *et al*., 1999; Krüssmann, 1998). At least officially, the decree was a new attempt to find investors outside the companies and broaden their ownership structure. Criticism against the low incomes of privatization is justified when it comes to oil and gas and other similar companies, which are profitable even without considerable restructuring and also because of high world market prices. Selling such "crown jewels" could have given some desperately needed cash to the state for investments in infrastructure, as privatization in the Russian environment could not have given much financial benefit to the state. However, the presidential decree of 1994 was not implemented in practice and the government lost its role in the process completely.

After a short setback due to claims inside the government of reversing privatization and nationalizing the enterprises back to the state,[19] the new elite managed to implement the theft of the century. Vladimir Potanin, director of the Onexim bank,[20] proposed in March 1995 that instead of selling the shares of 29 prominent Russian state enterprises they would be given as a pledge to the banks against credits to the state. The plan was proposed by arguing that there was not enough money in the market and that the market price would therefore drop and the enterprises would fall into foreign ownership (Kuorsalo *et al*., 1999:25–30; Krüssmann, 1998).

The fear of foreign ownership and foreign contribution to restructuring, which includes unemployment, has been effectively used in Russian politics. The managers used it to support their first takeover and continued to fight to prevent outsiders from acquiring shares. The boost effect, which foreign capital could have given to the Russian economy has completely been neglected.[21] Even if Russian politicians do not have to take the opinions of the electors into account very much, foreign takeovers were such a threat in

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[17] Illegal spontaneous privatization can be called the first phase of privatization and voucher privatization the second.

[18] The Duma left for summer vacation without accepting the new privatization program of the government. President Yeltsin, therefore, introduced the privatization program with his decree.

[19] Vladimir Polevanov, during his short-lived period as the Minister of Privatization, proposed the re-nationalization of some strategically important enterprises and gave statements against foreign investors (Kaser, 1995).

[20] The Onexim bank was established by the circles around the old foreign trade monopoly companies. It has good connections abroad including a daughter bank in Switzerland. It has been characterized as "a state bank" because it is the semi-official import-export bank of the government (Kuorsalo *et al*., 1999). A bankruptcy petition was also raised against the Onexim bank after the banking crisis of 1998. The bank was, however, not ordered into bankruptcy because the Central Bank of Russia did not withdraw its license. In such situations, bankruptcy is impossible and the creditors have to sign a plan on reorganizing the bank's debts (17 February 2000, Supreme Arbitration Court's home page: http://www.arbitr.ru/akdi).

[21] A typical example was the Lada Togliatti factory, for which General Motors (GM) offered to pay considerably more than the insiders, who got the factory. GM offered to restructure the factory as well as develop the product to a world market level. The workers' collective started a strike against GM fearing the loss of their jobs and managed to turn GM down.

the public opinion, which made the politicians reluctant to make decisions that could have cost them their jobs. Thus, short-term effects of restructuring would not have been favorable for the politicians' careers either. Foreigners are mostly seen as intruders, who should not have any decision power in the Russian economy.

The problem with Russian privatization was indeed the lack of capital. Because of the lack of domestic capital, privatization did not increase the revenue side of the state budget, but made it difficult for the state to cope with new social costs with less income. The state and municipal authorities were given a lot of social costs, which the enterprises had earlier taken care of. In this respect, privatization in countries in transition cannot be compared to privatization in established market economies, where the state has been able to gain money for budget expenditure. The loss of state property without any income led to a confiscating tax policy, since the taxation of private companies should have contributed to cover the expenditure of the social sector, the direct financing of which the enterprises got rid of. Therefore, enterprises that previously lacked capital ended up in an even more difficult situation, which was unfavorable for restructuring.

On 31 August 1995 President Yeltsin approved the plan for giving the shares of the 29 enterprises as a pledge to the banks. It was promised to be arranged through free auctions that were also open to foreigners for offers of credit. In practice, foreigners and other outsiders were not given anything as the winners of the auctions had been arranged beforehand. The crucial term of the contract between the government and the banks was that the banks were able to sell the shares, which were given for pledge, if the credit was not repaid in August 1996 (within less than one year). In practice, the deal meant that the "crown jewels" of Russia were donated to the banks (Kuorsalo *et al*., 1999:25–30; Krüssmann, 1998).

3.2.2 Oligarchs Take over Governmental Power

The donation of the 29 enterprises to the banks was neither a favorable result to the state, nor did it fit together with the liberalization ideals of the original transition program. Creating conglomerates of banks and enterprises capable of financing and managing business is an argument for favoring the banks in privatization.[22] The result was, however, a shift of power from the government in the economy to a new narrow and powerful circle of so-called *oligarchs*. This transfer of power may appear favorable from the standpoint of weak government theories. On the other hand, privatization and transition generally is a profound process, which would require not only a strong government but also one that is responsible to the people.

A narrow leading economic class may be dangerous not only to democratic development but also to the economy. Monopolistic markets with tight connections to the governmental sector effectively block any market impact. Successful entry into such markets is impossible without good connections to the governmental sector and protection of one of the monopolies. The Antimonopoly Committee proved to be too weak during both the second and the third wave of privatization. Directors of the

[22] For instance, Stiglitz (1993) has emphasized the need to create financial markets.

committee have openly admitted that their agency has been toothless (Krüssmann, 1998). Other interests of powerful interest groups have overridden the official antimonopoly policy.

Conglomerates, which are called Financial-Industrial Groups (FIGs) in Russia, are holding companies led by large banks with stakes in large industrial enterprises. Establishing holding companies was made possible with the Presidential decree on Holding Companies of 16 November 1992, No. 1731. The elite banks and their holding companies are the key financial players — the Big Seven — controlling half of Russia's economy. These authorized banks have good political connections, industrial and media holdings and, of course, financial capital. Authorized banks are entitled to handle the funds of central and local governments. They may, for example, collect and transfer customs payments and tax revenues to the state budget. They have made huge profits in delaying budget transfers and allowing managers to use the money to invest in the government securities market. The status of a favored authorized bank cannot be obtained without good connections of the bank's management with the governmental level.[23]

In the presidential elections in the summer of 1996 the new elite — the *oligarchs* — financed President Yeltsin's campaign because they were afraid of the rising popularity of the communists. The *oligarchs* had reason to fear that the communists would either have reversed privatization or at least started investigations on the illegalities of the process. The common interest led to a pact between the governmental power and the *oligarchs* lasting until the end of the economic collapse of August 1998. Former ministers became millionaires and the *oligarchs* obtained a free entry to governmental

[23] The Big Seven FIGs are: (1) *Alfa-group of Mikhail Fridman* and *Pyotr Aven*. It started as a trading company founded by graduates of the Moscow Steel and Alloys Institute in 1987. Alfa extended its activities to foreign trade and created connections to the Ministry of Foreign Economic Relations. The Alfa bank made profit on government treasury bills. It also handles funds of the State Customs Committee. One of Alfa's key holdings is Tyumen Oil. Its holdings are spread widely on different branches of industry and commerce. (2) *Inkombank* is led by *Vladimir Vinogradov*, who started his career in business developing commercial activities of the Komsomol. The bank handles accounts for the State Customs Committee and is the authorized bank for the city of Moscow. It has a lot of regional branches and regional governments as well as city councils as its customers. (3*) LogoVAZ* was founded by *Boris Berezovski*, who started his business career in 1989 as the general director of the first private car dealership in Russia. It handles funds for Aeroflot and holds Obedinionny Bank, Oil Finance Company and Sibneft Oil. The group holds 38% of ORT Television, etc. (4) *Rosprom* or *Menatep* group was founded by a former Komsomol deputy secretary, *Mikhail Khordovsky*, who became engaged with Komsomol commercial activities. The bank was created in 1988 and is the authorized bank for the federal government. It has supported a lot of federal programs. It has a lot of holdings in the oil industry (Yukos, see p. 15), the paper and pulp industry, metal trade and, of course, holdings in the media (38% of ORT, Literaturnaya gazeta, Moscow Times, etc.). (5) *Most* group is lead by *Vladimir Gusinsky*, a former theater director, who started cooperatives and sold office supplies. The Most bank was established in 1989 to finance Gusinsky's office building renovation business. Several regional governments in Central European Russia are its customers. The Most group is especially active in media holdings (NTV). (6) *Oneximbank* was created by *Vladimir Potanin*, who originally came from the Soviet Foreign Trade Ministry. It is considered to be the most powerful bank in Russia (cf. footnote 20). (7) *SBS-Agro* is led by *Aleksandr Smolensky*, an Austrian citizen, who came into business with the help of his ties to the Communist Party and government financial sources during *perestroika*. Acquiring the failing Agroprombank it obtained a lot of influence in the agricultural sector. This bank also steers industrial holdings and the media (RFE, 1998; Kuorsalo *et al*., 1999).

power. During this period the conception "*robber baron capitalism*" became widely known.[24] Deputy Prime Minister Nemtsev's and President Yeltsin's warnings to the robber barons no longer had any effect (Kuorsalo *et al*., 1999). The robber barons managed to tame the *Kremlin* and not *vice versa*.

However, the Primakov government, which was appointed in the autumn 1998, acted differently from its predecessors. It started to defend state property and took before the court the sale of the shares of *Pugneftegas*, which the bank *Mapo* had received as a pledge against a short-term credit that was not repaid.[25] The Primakov government started an attack against the *robber barons* including a warrant for the arrest of Boris Berezovski and three other *oligarchs*. This was too much for the powerful businessmen and the *robber barons* started to hit back. As a result, Primakov fell from power and Berezovski returned to politics boasting that he had managed to dismiss the government. After that, the theft was covered up with the constant change of governments (Kuorsalo *et al*., 1999).

If the government had planned to regain its lost power over the economy with a pact with the financial and industrial circles, it succeeded partly. However, the negative effect of this pact was that the government became a hostage of the *oligarchs*. The pact was not an easy one. There were power struggles between the government and the *oligarchs* as well as between the different *oligarchs*. There were murders of bankers and mysterious raids to the premises of some companies.

After the banking crisis of August 1998, when most banks found themselves in financial difficulties, the government could decide, which bank was to be saved. If the Central Bank withdraws the license of a bank, that bank can be made bankrupt. Otherwise it is saved and can continue with a reorganization plan. Inkombank (27 May 1999) and SBS-Agro (7 October 1999) were made bankrupt, but the Central Bank did not withdraw the license of Oneximbank.[26]

3.2.3 The Government Tries to Save Faces

The attack of the Putin Government on Chechnya also served as a good cover for economic misuses of the *oligarchs* and the bribery scandal connected with President Yeltsin's family members. Prime Minister Putin was able to use the underlying Great Russian sentiments and encouraged hatred towards the Caucasians to draw attention away from the fact that it was actually a small group of influential Russians of different ethnic origins, not Caucasians, who robbed Russia and are responsible for her economic misery. In this respect, it is the distribution theory that best describes Russian privatization. But, since the interests of the state were not looked after, bargaining

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[24] Deputy Prime Minister Nemtsev started to use the concept "robber capitalism" and made it widely known in Russian politics.

[25] The Arbitration Court of the City of Moscow held the contract void (9 December 1998). Also Procurator General Yurij Skuratov gave a report to the arbitration courts on October 1998 demanding them to pay attention to illegal bidding processes and possibilities to reverse illegal privatization (www.arbitr.ru/akdi).

[26] The fate of Menatep bank is still open (see, Supreme Arbitration Court: http://www.arbitr.ru/akdi).

became more a total victory of the strongest in "jungle" circumstances. Formal rules were circumvented, neglected and ignored. The result was far from being Pareto optimal.

The change in President seemed to give new hope to the Russians, even though Mr. Putin came to the Presidency without any economic program, only promising to put the economy in order. Just like the Weimar Republic before World War II, people wanted first and foremost order after chaos in the economy and politics and voted for somebody who promised to bring order. In chaotic circumstances, even war is an acceptable method "to bring order" and the frustration of the people is easy to project on an ethnic group. Restoring order, which Carl Schmitt predicted in the Weimar Republic, was given to Hitler to put into effect. The Russians trusted a former KGB officer to bring order. Tolonen (1996), who leans on Carl Schmitt in his point of view, considers that also in Russia order has to be restored before anything can be developed.

President Putin's restoring of order has been quite arbitrary. One of Mr. Putin's first decrees, which he gave on the first day of his Acting Presidency, was the decree (No. 1763, 31 December 1999) giving immunity to Yeltsin as the former President. The scandal around President Yeltsin's family and near assistants had decreased the credibility of the political system and his alliance with the *robber barons* does not increase trust on the origin of private property rights. President Putin may pick on some corrupted state officials as an example in order to tame the noise around the scandals and in that way try to increase the credibility of the political system. He may also increase centralism by attacking corruption on the regional level, because regional and local corruption nearer to the citizens seems to arouse more disapproval from the public than even worse corruption on the central government level. This fight is also a struggle on the state control of the economy between the central and the regional levels. In this struggle the central government is on the same side as the *oligarchs*, who prefer a monopoly in the Russian common market. It is quite obvious that the regional level will lose this struggle.

The majority of the citizens seem to hope that illegal privatization would be reversed. It is, however, not presumable that anything like that could happen. It could be an escalating process, which many of those who are in power have reason to fear. Reversing privatization may even be a stronger stroke on the credibility of the government than the *robber baron* privatization. It could break the economic structures again, since the old structures are already broken.

The *robber baron* privatization does not support the emergence of trust in the legal system either. When courts protect property rights, they can also be labeled as those, who protect the rich and the powerful. Only a small number of the illegalities in the privatization process were brought before the courts. Arresting, investigating or raiding premises seemed to be a game connected with the power struggle between the *oligarchs* as well as the *oligarchs* and governmental structures.

The *robber baron* privatization may still constitute a ticking time bomb in Russia. It should be born in mind that economic inequality severely contradicts communist morals, which have been taught to Russian people during the seventy years of communism. When inequality is implemented illegally without the legal system being

able to interfere, law appears toothless to ordinary citizens. On the other hand, toothless and arbitrary law in Russia seems to be an ordinary situation. For the development of the rule of law *robber baron* privatization as well as covering for it with operations such as the Chechen War have been serious drawbacks.

It is also fatal to Russia that injustices of the past have never been investigated and studied. Opening the files of the secret police, which took place in Eastern Germany or even the truth-commissions in South Africa, has not even been considered in Russia. There was no shift of power to new democratic circles in Russia. Most of those who are in power also have a long and established communist past often in the KGB. Investigating the past would therefore be dangerous. It is also a typical tradition in Russia that power cannot be challenged and that those who hold it are not responsible for the people. It is a question of mentality as well as political culture, which have developed in the absence of control from below. Therefore politics, which does not recognize the value of human life, can continue. It is quite sure that the Chechen war would not have happened, had the Russians really known and understood their history and past injustices towards the Chechens.

3.3 Theoretical Implications of the Results of the Privatization of Enterprises and Shock Therapy

3.3.1 A Virtual Economy and Gray Markets

Privatized enterprises form the core of the Russian economy. Many of them have a monopolistic position in the market. The author of this report shares the idea with the so-called Austrian economists, according to whom it is small-scale business and entrepreneurship that is most important for a market economy to develop (cf., Kregel *et al*., 1992). In Russia, there are also new small businesses especially in the service sector that do not have socialist inheritance in their business culture. They are, however, forced to function in the markets that are dominated by big privatized enterprises, which carry on bureaucratic management of the socialist type. The big companies can dictate the rules.

Small-scale business also has a lot of problems with criminal organizations and tax officials. Without good friends in the tax collecting sector, banking sector, illegal or legal private self-help, the business is likely to die before any legal protection from the court system can be used. The police do not give any protection either. The state should support small-scale industry and commerce both financially and in contributing to a better business climate. The heavy tax burden and complicated state bureaucracy increase the transaction costs of legal transactions. There are also a lot of small-scale enterprises, which have not registered and therefore function in the shadow economy. They live only to make short-term profit. Many companies have extended or moved their business to offshore sites.

There certainly have been considerable structural changes in the Russian economy. However, the changes have been different than what the reformers expected. Private ownership did not lead to improved efficiency, but to a situation which Gaddy and Ickes (1998) started to call a *virtual economy*. It is a mixture of pretended market economy

and Soviet institutions in a new form. A virtual economy functions through the extensive use of barter, allowing fictitious prices of goods and services separated from their market values. A virtual economy effectively breaks the market-based price signals.

This system works well between firms and also with the taxing system. The government is also in great need of money. The firms are allowed to pay their taxes in barter. Building a new metro station can be a means of paying taxes, which the building company cannot otherwise afford. Problems arise only with respect to households. Households need cash to buy the necessary food and other products that are needed. The prices in ordinary shops are extremely high for ordinary citizens, yet the employees have to accept the continuous delay of their salaries being paid (Gaddy and Ickes, 1998). They have to rely on their networks of relatives, friends and their small garden plots.

This non-payment system is inherited from the socialist economy when money had no value and the industry was subsidized by under-priced raw materials and insufficient changes of capital. The manufacturing sector pretended to produce value but, in fact, destroyed it. The system was masked by arbitrary pricing. Gaddy and Ickes (1998) see the roots of a virtual economy as lying in the maintenance of the socialist pretense. The big privatized companies have not been able to restructure for a cash payment system and a market economy. In mutual acceptance, the system can continue. Discontinuing the system is not needed by those who take part in it. On the contrary, discontinuing the system would ruin the whole economy. A virtual economy is actually the way the Russian economy has adapted to the changes.

Boiko (1997), a Russian economist who has paid attention to the same non-payment phenomenon, believes that the main reasons for this nonpayment system are the monopolistic character of the economy and the weakness of political power. According to Boiko, the other typical feature of the Russian economy besides the nonpayment system is the gray market, which Boiko himself calls the black market. In the Soviet Union, the shadow economy had an important role in correcting the errors of the planned system. Nowadays, the gray market is one way to earn cash, which both individuals and firms need. This cash should not, however, be officially shown anywhere in order to avoid paying tax. High prices in the market actually encourage gray market business.

The official statistics showed a drastic drop of production in Russian industry in 1994–1998. Depending on the source, the drop has been either from 20–25% or even 40–50%. As an example Boiko (1997) takes of one firm, which produced ten times less in 1996 than in 1995. The amount of used raw material dropped 2.5 times. The exchange of products dropped four times. Boiko suspects that the management of the company in this case either could not or forgot to hide the higher use of raw material compared to production. He also shows with statistics that in 1995 there were 61.5% more TV-sets, 22% more refrigerators, and 49% more automobiles sold in the market than officially produced or imported. This means that either smuggling of these products is immense or that the companies produce mostly hidden products for the gray market. He suggests, referring to the statistics and according to what he has heard from managers, that most of the exchange occur unlawfully on gray markets. It is, of course, impossible to

estimate precisely how large the gray market sector actually is. According to the journal "Den'ki", 97% of the exchange of a typical Muscovite shop is on an illegal basis and only 3% flows through the official legal market.

3.3.2 Impacts of Insider and Robber Baron Privatization on the Industrial Structure

The Russian industrial sector is in great need of restructuring. The machinery is old and the premises in a bad condition and as a result pollution is a great problem. This situation was largely blamed on socialist ownership and irresponsibility connected to it (e.g., Nove, 1977). Turning socialist enterprises into private companies has, however, not made any difference. Companies have not restructured production. There are both good and bad consequences. In the short run, it is good that jobs have not been lost but in the long run, continuous pollution is dangerous to the environment. This situation is due to the virtual economy, which anyhow manages to give some social security to the population. The low salaries are sometimes paid and production continues. Bankruptcy would not be in anyone's interest. The creditor would not receive anything and would only be in trouble himself in the chain of a virtual economy. In the long run, however, the virtual economy is going to destroy the Russian economy completely (Gaddy and Ickes, 1998).

It seems, however, that the situation has developed in a better direction paradoxically after the 1998 bank crises. Prices of foreign products suddenly became too high for Russian citizens. The fall of domestic prices together with favorable oil market prices created devaluation, which has given a temporary boost to the Russian economy. This effect has also increased tax revenues and enabled companies to pay salaries. Salaries are, however, still as low as before and restructuring has not started. The gray market is not as favorable as before because the prices have come down. Transaction costs of formal production have diminished compared to informal production.

On the other hand, Russia experiences a wave of bankruptcies. Banks are especially in financial difficulties and the foundations of the monopolistic economy are shaking. Bankruptcy was made easier with the new bankruptcy law of 1 March 1998. In 1998, there were 10,000 bankruptcy cases in the Russian arbitration courts, which is twice as many as in 1997 (http://www.arbitr.ru/akdi). The banking system was created on an unsound basis. The collapse of the banks, however, does not shake the basis of the Russian virtual economy, since enterprises can operate with barter. Banks did not yet manage to gain any significant financial role in ordinary business transactions.[27]

It can also be claimed that the virtual economy helped to keep the Russian economy alive during the difficult transition period. If the government and the companies use the temporary boom caused by devaluation in investing in the infrastructure and restructuring, the Russian economy would have a better chance in the future. Owner

[27] According to a series of case studies carried out by IIASA on the Russian forest sector, only a few enterprises used bank accounts for their payments (see, Carlsson and Olsson, 1998a; Carlsson and Olsson, 1998b; Carlsson *et al*., 1999a; Carlsson *et al*., 1999b; Efremov *et al*., 1999; Kleinhof *et al*., 1999; Piipponen, 1999; Sokolova, 2000; Ivanova and Nygaard, 1999; Blam *et al*., 2000).

managers might be among those who have an interest in restructuring. This, however, is highly unexpected, even if there are exceptions. There is no investment wave yet to be seen even if Russia's second largest trading partner, according to the latest statistics, is Cyprus, which is the most important offshore site of Russian enterprises. The active role of offshore Russian firms only shows that laundered money has not completely abandoned Russian markets. If investing in infrastructure is not profitable in Russia, laundered money is not going to be reinvested. Such investors are only interested in quick profits. An amnesty that has been suggested for those who repatriate laundered money is a short cut, which would have a new negative effect on legality.

For foreign investors, the Russian virtual economy is an obstacle to overcome to gain access to the market. Foreign firms have to pay taxes since they receive cash from abroad. They are also inspected more and the corrupted state officials would gladly receive bribes from them. Bribery, however, makes a foreign firm vulnerable. It can be thrown out from the market at any time, using illegal operations as the reason. Due to high barriers, foreign companies are not going to invest in restructuring the Russian industry either as they cannot be sure that they will ny profit in the long run. Unstable political and economic institutions favor only short-term quick profits. Without trust in business partners and political decision-makers, the desperately needed investments in restructuring are not going to emerge.

3.3.3 Laissez Faire, Opportunism and Positive Law

Shock therapy did not prove to work out in Russia. *Laissez faire* has not worked out anywhere. Emphasizing the abolition of state interference by Adam Smith and other early liberalists was historically connected with fighting against mercantilist state policy. The background of Russian shock therapy, the need to abolish the state governed economy, is actually quite similar to the situation that Adam Smith criticized. However, in European established market economies, transformation was gradual and the role of the state never became one of a Smithian night watcher. Poznanski (1992:91) describes post-communist liberalism as the "perverse" interpretation of liberal philosophy. It is largely deprived of its traditional concern for universal well-being and, instead, praises the "jungle" struggle for survival or "private warfare". It is no wonder that claims for restoring order have grown in Russia. These claims have also led to an increase in centralization and state bureaucracy, which were the evils that were supposed to have been crushed by privatization and liberalization. The power of the former ministries was broken but bureaucracy has now concentrated in the Presidential Administration (Nysten-Haarala, 2000).

Russian privatization shows that the role of the government is important in the transition process. A weak government that cannot or does not bother to control the process, only provides the chances of opportunistic behavior. Markets do not guide the process towards Pareto optimality because a functioning market does not exist yet. When the legal framework is vague, informal rules become more important. Legal rules were largely ignored and social networks counted more. Russian privatization did not lead to an efficient result. Insider groups were able to secure their positions and financial conglomerates, led by a few *oligarchs*, took over the earlier state monopoly in the economy. Privatization strengthened the role of informal institutions at the cost of

formal legal rules. Privatization made it clear that informal social networks among the new elite are powerful, while the formal rules are weak and not respected. It was also a process that rather weakened than strengthened the development towards the rule of law. It proved that the political and economic elite does not show respect to the developing legal system as long as good relations among the elite can supersede the law.

Kelsen (1991) was right when he claimed that any political system must be based on positive law. The problem, however, is that creating positive law is not enough in a state where the legal and especially the political culture has not developed to respect it. Legality is especially important in connection with privatization because a lot of temptations exist for personal economic benefit. It is vitally important to control and limit opportunism, which is typical for human beings everywhere (Williamson, 1985). In the Russian privatization of enterprises, opportunism took over due to the lack of control and the strength of informal social networks among the *nomenclatura* and criminal organizations. There was a mutual understanding of opportunism in those circles because the window for personal opportunities was open to them.

Even if privatization (*privatizaciya)* became petty stealing (*prihvatizaciya*) in common language, no one had to take the political responsibility. President Yeltsin's resignation and apologies a few months before ending his presidency, was only a show covering the plan to give power to a reliable crown prince. And indeed, the people elected the crown prince, who is a good friend of many *oligarchs*. State power was lost to the *oligarchs* and instead of free markets economic oligarchy was created. Public choice does not play a significant role in Russia because people feel that there are no choices. The propaganda campaign of the new elite, masking their takeover with securing jobs and preventing foreign takeovers, was effective.

3.3.4 The Role of Legislation and the Rule of Law

Property law is still in the formation process. In Russia, the system of property rights is still developing and especially everything connected with private ownership is still unfamiliar. It is not clear what rights and duties an owner has and what duties and rights those have who can govern the private assets of other people. Control of private ownership in a country where private ownership is newly gained is a difficult question. Also, changing the public administration of state property into a modern system of state control does not happen easily. The omnipotence of the state is strongly vested in Russian mentality,[28] as is also the belief that bribery is the only effective way to affect it.[29] State officials act with this mentality and the government wants to regain its lost

[28] The Russian attitude to state power has been explained in her history. When European development led towards different power centers of the church and the state and growing opportunities to challenge power, Russian development led to one absolute power center, which came from God and could therefore not be challenged (e.g., Berman, 1983).

[29] In a survey comparing attitudes in Russia, the Czech Republic and Korea, 62% of the Russian respondents were likely to bribe when there was a delay in obtaining a government permit. While almost half of the Czech and Korean respondents would have written a letter to the head of the office, Russian respondents thought that would make no difference (Mishler and Rose, 1995).

power. Since laws are not largely respected, regulations of the use of property may not be effective enough. Strong property rights require the rule of law and respect of formal legal rules. Economic growth cannot be sustainable before property rights are established and legally well protected.

The role of law in a transition process is twofold. Law should be obeyed but it is also an important practical tool in forming a new society. Privatization is especially an extremely delicate question, which has to be handled in legal ways. It is a change that people have to accept. Privatization has to also correspond with other informal rules of society, otherwise law will lose its strength and will not be followed and the political and economic system will also lose the trust of the people. On the other hand, informal appropriation is inevitably going to become formal in the course of time. In established market economies, law usually changes from factual law to normative, positive law. However, in countries in transition the mechanism works the other way around. In Russia, the development of law is understood to occur in such a way that specialists draft laws, which the citizens then are supposed to obey. The rule of law is identified with "dictatorship of law" given from above. Business practices do not simply complement legal rules in Russia. Factual law in countries in transition usually contradicts legal rules because the rules of business have to adapt to the inadequate legal environment. The result is double standards, where the state tries to enforce formal legal rules with the short cut of the "dictatorship of law".

There is also a difference between changing positive law and fundamental legal principles. Drastic changes of positive law make it difficult for the citizens to adapt. But principles, whether they are metanorms as Eckhoff (1987) suggests or of independent character as Dworkin (1986) sees them, are much more difficult to change than ordinary norms of positive law. This is due to the fact that principles are institutional values, which are connected with the weight value and authority of the legal machinery (Tolonen, 1997). Therefore, principles that are not accepted by the citizens are not worth anything. Principles have to reflect the values and social norms of the people and the legal machinery should be able to apply them.

Transition changes almost all of the principles in the economic and political fields. Since the values in Russia are unclear, because they are transforming, there are still institutional and cultural hindrances on the way to strong property rights. Courts have an important role in applying new legal rules in compliance with social values and principles. Their newly gained independence from the political system has given them more power, which judges themselves seem to have realized. Their role should, however, not be exaggerated. If legal rules do not correspond with real circumstances, courts are regarded as bodies applying strange impractical rules, which are made for lawyers but not for businessmen or ordinary citizens. It is important that ordinary citizens understand and agree with the contents of legal rules. It is called a democratic rule of law.

4 Privatization of Apartments

During the socialist period apartments were also state property, which were given to the possession of the citizens. A new apartment had to be applied and queued for. The reforms made it possible for every citizen to privatize their apartments. A law containing the basic principles for privatizing state, municipal and enterprise housing was already passed on 4 July 1991. According to a Government Decree on Approval of the Tentative Regulations on Free Privatization of Housing in the Russian Federation (25 October 1993), a citizen could privatize the apartment where he lived without any charge. Privatization of an apartment is possible only once. It is not possible to sell the apartment and get another from the state and privatize it, too. At the same time, the rents of state apartments were increased as well as the payments for communal services in social housing (Decree of the Council of Ministers, September 1993). Apartments that belonged to privatized companies remained state property and could be privatized within the apartment privatization program.

Many citizens took advantage of the possibility to become private owners of the apartments in which they lived. Some were not so enthusiastic because an old apartment in bad condition or with dilapidated plumbing or electric wiring could become costly to the owner. Houseowners' associations or cooperatives where such costs can be shared, are still rare and do not function yet because it used to be the state that had to look after the housing system in a socialist society. A Law on Houseowners' Companies (*tovarishchestvo sobstvennikov zhil'ya*) came into force in June 1996. Since 1993, there was already a provisional regulation, approved by a presidential decree, on housing condominiums. During the transitional period, the state housing office continued to be in charge of the maintenance and housing services until the citizens could start their own association or hire a private firm.

Due to the lack of apartments in big cities, prices have risen quite high. The prospects of buying a bigger or better apartment are, however, not good for poor people or even for the new middle class. There is already a law on Mortgages of July 1998, but a mortgage is not yet common in Russia. The banks do not give credits for buying an apartment. Neither do they provide credits to repair apartments. Those who have money have been able to invest in apartments and rent them for quite high rents because of the lack of housing and the pressure of migration to big cities. In such a situation, governmental price control does not work and the markets turn to the gray sector. According to the rent control regulation, invalids, pensioners and large groups of low-income people are not allowed to be charged more rent than half of one minimum salary per month.[30] This kind of regulation means that those groups of people have difficulties in finding new and better apartments because they are not popular tenants.

[30] Nowadays, the minimum wage is 83.49 rubles per month (less than $ 3), according to the Law on Minimum Wage of 1 January 1997. A new law on the minimum wage, which was passed in June 2000 (No. 82, F3), raised the minimum salary that the employers have to pay to 132 rubles from 1 July 2000, to 200 from 1 January 2001, and 300 rubles from 1 July 2001. The change, however, did not extend to using the minimum wage as a unit for calculating rents or company capital. It only affected the minimum salary that employers have to pay to their employees.

5 Property Rights and Immovable Property

5.1 Development of the Regulation of Land Property

5.1.1 Background of the Land Law Concept

The branch of law regulating property rights on land is called land law in Russia. The land law concept was introduced during the Soviet period and it developed to be the administrative regulations concerning land property. Nowadays, it is regarded as being partly public law (administrative) and partly civil (private) law regulation (Ikonitskaya, 1999b).

Russian civil (private) law was significantly influenced by the German law from the second half of the 19th century. The German civil code (the BGB) was the model for the first Soviet civil code in 1922. However, the socialist economic system transformed the original model into a new form. The division between private and public law, which is a significant feature of continental law, was not important in the Soviet economic system because the sphere of private law was so insignificant. Questions concerning immovable property as well as contracts in the planned economy changed to the sphere of administrative (public) law.

The most important feature of German property law was the distinction between the law of obligations and property law (the law of things).[31] The law of obligations regulates an "obligational" relationship consisting of both rights and duties, which exist between contracting parties and them alone, while the law of property (things) regulates absolute rights and duties, which are vested in a single person protected against any other person questioning his title. Within the law of obligations, rights depend on the relationship, which is a bond of obligation between the parties. Obligational rights are relative, while rights concerning immovable property are absolute (Larenz, 1989:13). This distinction between the law of things and the law of obligations is inherited from Roman law and exists in every Germanic legal system including Nordic legal systems.[32] Immovable property was the basis of wealth of the ruling class both in ancient Rome and in pre-industrial Germany. It was therefore important to control and register changes of ownership and the most important use of land. Alienation of immovable property was not as important as the security of its ownership. Rules facilitating transactions of goods developed in the law of obligations in the sphere of contract law, where transactions were considered as functioning between contracting parties.

In the Soviet Union, the distinction between the law of property and the law of obligations worked in its own way. Exchange was derived from the static property rights of socialist ownership. Property rights could not be exchangeable objects apart from the socialist rights vested in the means of production. Subjective rights were not

[31] In civil law countries, property law is a wider concept than in common law countries containing the law of obligations (contracts and torts), the law of things (property law) and commercial law as well as the property relations of family and inheritance law.

[32] In Nordic legal systems, the operative meaning of subjective rights as well as other legal concepts was reduced to a minimum due to the impact of Scandinavian realism (Helin, 1988:306).

rejected. Only the role of the relations in the sphere of the law of obligations was different. The relations between individuals were not as important as the "obligational" (contractual) relations between the subjects of the socialist economic system (Tolonen, 1976:88).

The concepts of subjects and objects of law are important in Russian law even today. Textbooks as well as the Civil Code are structured with these concepts. What these subjects and objects are seems to be treated as a question of definition by the legal system. It is not only returning to the roots but also path-dependency of legal history that some scholars (e.g., Efimova, 1998) have now started to emphasize the importance of the distinction between the law of obligations and the law of things in Russia.[33] The starting point of the distinction that static rights are more important and dynamic relations of exchange contribute to the static rights of ownership is quite understandable. Ownership used to be static in socialism and problems connected with dynamic rights are new.[34] Protection of new owners' rights is also important in Russia, since the concept of ownership has changed significantly after the emergence of a market economy.

In Russia, the role of property law changed and diminished after the October Revolution. In 1917, the Bolsheviks already passed a Decree on Land, abolishing private ownership of land. Before that, there were several forms of private ownership in Russia. There were fiefs, state and governmental land, land belonging to the church or to the monasteries, peasant land, and common property belonging to villages or municipalities (Korostelev, 1998:17). The Bolsheviks withdrew land from commercial exchange and its redistribution and use was regulated with administrative methods. Therefore, the land law concept was introduced to cover the relations to land as state property (Ikonitskaya, 1999b). The purpose of the land law was administering different types of land, which were all state property. The only exceptions were cooperative farms that were, in practice, also treated as state property. Administration of some types of land developed into their own branches of law. Forest law regulates the use of forests. Forests form the so-called forest fund of the country. Also waters form a water fund, which is divided into different types of waters with its own specific regulations (Ikonitskaya, 1999a).[35]

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[33] The theory of subjective rights regarding relative rights contributory to absolute rights was also developed in the Soviet Union towards the socialist direction (Ioffe, 1949).

[34] In Nordic countries, however, scholars of property law see that the increase of exchange in society has made the collisions of rights more important than the static right of the ownership of the owner to use his property freely. In dynamic relations the distinction does not work at all. Therefore, the old distinction is considered to be of hardly any significance. Both fields of law are concerned with the collisions in exchange situations. The law of property is developing into a general doctrine for explaining the protection of third parties in transactions (Kivimäki and Ylöstalo, 1981).

[35] In current legislation, land is categorized into (1) land for agricultural use, (2) land of municipal areas, (3) land for industrial use, transport, energy, (4) land for nature protection, recreation or cultural historical significance, (5) forest fund, water fund, and (6) reserve land. The purpose of land use cannot be changed (Ikonitskaya, 1999a:182).

The first land code was passed in 1922 during the New Economic Policy (NEP) period[36] and only the general starting points of land use and land building were introduced by it. The new code of 15 December 1928 introduced socialist forms of land use, such as collective farms (*kolkhoz*) and socialist farms (*sovkhoz*). During the socialist period a more administrative point of view developed. Property became an administrative question, and the different roles of the state as the *imperium* and the *dominium* were mixed (Tolonen, 1976). Property was either local or state property, cooperative (*kolkhoz*) and forests, for example, were treated as a special type of state property with special administrative regulations. Therefore the idea, which is more or less clear in western property law that the owner of the property has the same property rights irrespective of who he is, is not familiar in Russia. Since the state has the *imperium* on land, even its *dominium* is treated differently as different kinds of ownership are mixed up with the *imperium*. The absence of a market changed the nature of the law and new basic principles of legal theory developed.

Collectivization of land was a great human tragedy in Russia, where land was actually one of the reasons that gave rise to the Revolution (Ikonitskaya, 1999b:16). The Bolsheviks who started to industrialize the country, however, saw the countryside as backward and its function was only to provide food for the industry. Forced collectivization, the terror against the *kulacks* — "the richer" peasants — who had owned one or two cows, led to disaster and hunger. According to Soviet statistics, which used to falsify production numbers, the Soviet countryside recovered in production only in the 1950s from the disaster of collectivization (Hosking, 1985). Psychologically, the disaster seems to have been even worse since it destroyed initiative in the countryside.

The state farms (*sovkhoz*) and collective farms (*kolkhoz*) were factories led by a manager. Their workers were allowed to cultivate small plots for their own consumption and later also for the *kolkhoz* markets of the towns and cities. Those markets were important in supplementing fresh vegetables and other groceries with better quality and higher prices than in state shops. Since the productivity of these plots was much higher than in the land of collective or state farms, this fact could have been interpreted as proof of the superior efficiency of private farms. It should, however, not be forgotten that cultivating private plots had no risk, since the employees of the state and cooperative farms could use the equipment and working time of the farm for their own purposes. They did not have to invest anything in their plots. Successful cultivators of small plots of the socialist Soviet Union did not turn out to be successful private farmers of the new Russia. The reasons for this development are many, legislation being only one reason.

5.1.2 Agrarian Land Reform of the Russian Federation

Russian land reform started mainly as an agrarian reform. The first law to change the situation was the law "On the Land Reform" which was passed on 23 November 1990.

[36] NEP was launched by the Bolsheviks to save the Soviet economy from a total crush. Private entrepreneurship was allowed during the NEP period (1921–27). When Stalin managed to take the power into his hands, the NEP was changed into a command economy (see, Hosking, 1985; Nove, 1977).

Land was going to be distributed to new enterprises, individual farmers and agricultural cooperatives. The law aimed at creating favorable conditions for the development of alternative forms of agricultural business on an equal basis (Ikonitskaya, 1999b).

The reform introduced private ownership and payment for land property. The Soviet principle of no price for land was broken to create markets for land with the "Law on Public Fee for Land" of 11 October 1991. According to Ikonitskaya the right to possess agricultural land under private ownership was already introduced to Russian legislation as an amendment to the RSFSR Constitution in Article 12. The Law on Property of 24 October 1990 recognized the right of private ownership of land in the RSFSR as well as the new Land Code of the Russian Federation from 25 April 1991. According to the Land Code, land "can be transferred with a contract". Private ownership was in a way smuggled into the code. The word "private ownership" was not mentioned nor was the land "freely" transferable. The code, however, established private ownership and transferability and made them legal (Ikonitskaya, 2000a; Krüssmann, 1998).

Politically allotting land for private ownership in agriculture has been a bitterly disputed issue (see, e.g., Kruglii, 1993:8; 1998:5). Private ownership has been received in different ways in the regions. Managers of the state farms have often opposed the distribution of land to the employees. They have a lot of power in the countryside and the employees of the farms are dependent on their directors. The Agrarian Party has lobbied for the interests of the farm managers, who have closely allied with the Communists.

The Agrarian reform, however, aimed at redistribution of land. If the applicant for land was a worker of a state or collective farm, he was entitled to an allotment of land from his former farm. If he was a newcomer, land could be allotted from a specific stock of land, which was taken from the existing enterprises. According to the Federal Land Code, collective and state farms were to be distributed among the employees and pensioners of the farms. The farms were either distributed or a right for a share of the farm was established. This is common ownership with a right to have an allotment. The share of the farm could also be given as an investment to the reorganized privatized farm. Often the shares were not measured or the borders of the allotments made clear. Pensioners, who were too old to cultivate themselves often gave the land to be used in the collective farm against the right to obtain agricultural products from the farm. Many other people, who preferred to move out of the farm to find a job somewhere else did the same thing (Ikonitskaya, 2000a).

The governance structure of common property determines how clearly it allocates rights to members of the collective. Ostrom (1990) identifies a number of factors that contribute to long-enduring common property resources:

- clearly defined borders,
- congruence between rules and local conditions,
- representative collective choice arrangements,
- agents with an incentive to monitor use,
- the gradual application of sanctions,
- the availability of conflict-resolution mechanisms, and
- the recognition of the collective by government authorities.

However, Ostrom points out that long endurance does not imply that the common property is being used efficiently.

Ostrom's list also includes factors, which are important in introducing private property rights. Clearly defined borders, congruence between rules and local conditions as well as the recognition of private property by government authorities is of significant importance in the Russian transition of property rights.

Unclear allotment was definitely a problem in Russian agrarian reform, but it seems that the lack of understanding of the reform among the employees of collective farms was even a worse problem. People were not prepared for the reform. The Soviet system, which had taught people to wait for everything to be given from the state, had destroyed initiative. Typically new farmers were newcomers from cities and not employees of the state or collective farms. The Moscow based specialists, who planned the reform, probably had no clear understanding either of the problems of the countryside or the values and thinking habits of the local people. Thus, local authorities neither understood nor opposed the reforms. The managers of the farms, who were in key positions to monitor and apply the reform, were usually against it. The result was that the *kolkhoz* and the *sovkhoz* in practice prevailed. They were turned into joint-stock companies led by the former managers. The reform failed to respond to any of the factors that, according to Ostrom, contribute to long-endurance of common ownership.

New farms faced the same kind of problems in the Soviet Union at the same time as the cooperatives in industry and trade. A successful farmer was envied and even sabotage from neighbors was not rare. Most of the problems are, however, connected with unprofitability. New farms have difficulties obtaining seed or equipment or to sell the products, especially when the farm is remote. When the distribution channels are built for big state farms, it is difficult to buy or sell in smaller amounts. The prices paid by governmental agencies are kept low and they do not cover the expenses of the private farmers. When the farmers try to produce directly to town markets, the mafia is a nuisance. Credits for buying machinery are difficult to obtain in the absence of securities (Kaser, 1995; Krüssmann, 1998).

Development from this stage to private plots is a slow process. Most people have chosen to continue in the former collective farm as shareholders or simply to reject the land and move to the city. People are not motivated to start as private farmers because often neither the local authorities nor the local population support them in their business. In 1994, there were only 285,600 private farmers in Russia, owning an agricultural area of 11,8 million ha. Family farms would need support both from the government sector and mutual cooperation. The state has, however, been more eager to support joint stock companies that were former state or collective farms (Kaser, 1995).

5.1.3 Land Reform and the Regulation of Land Markets

The Land Code of 1991 is, in principle, the most important law regulating land law. It deals with the right to ownership and other rights for land and allotment of the plot. The Land Code also deals with the rights and duties of use and protection of land, payment for the use, the general principles of carrying out the state land cadastre and state control for the use and protection of land as well as liability for infringement. The specific part

of the Land Code deals with different types of land such as land for agricultural use, land of municipalities, land for industrial use, transport, etc. (see, footnote 27). These are all considered as different types of land, which need different kinds of regulation.

After the Land Code of 1991 was adopted, considerable changes took place in Russia. The struggle between the President and the Supreme Soviet lead to the events of October 1993 at the White House and to the new Constitution of 1993 with the ensuing extension of presidential powers. The President started to amend gaps of parliamentary legislation in the economic sphere with his decrees (*ukaz*). In this way, President Yeltsin started to push economic reforms forward even without the consent of the parliament. In such crucial questions as property rights, a political balance should be found. Reforms, which are not commonly accepted, are usually diluted. Along with the privatization of enterprises the president also wanted to trigger land markets, since it was evident that a need existed for land markets (Ikonitskaya, 1999b). Actually, there was a need to change informal land markets into formal legal ones.

The following new decrees were issued in the land law sphere:

- The Decree "On Sale of Land Plots to Citizens and to Juristic Persons under the Privatization of the State and Municipal Enterprises (25 March 1992),
- The Decree "On Approval of the Procedure of the Sale of Land Plots under Privatization of the State and Municipal Enterprises, under Enlargement and Additional Construction of these Enterprises as well as of the Land Plots at the Disposal of the Citizens or of their Organizations for Entrepreneurial Activities (14 June 1992),
- The Decree "On the Regulation of the Land Market and on the Development of the Agrarian Reform in Russia (27 October 1993),
- The Decree "On Bringing the Land Legislation of the Russian Federation to Conformity with the Constitution of the Russian Federation (24 December 1993),
- Decree "On Implementation of the Constitutional Rights of the Citizens on Land (7 March 1996).

These presidential decrees created a general legal land market, because they extended the rights of private ownership of the land to all sectors of the economy. The earlier agrarian reform was limited to the agricultural sector. The new Constitution of 1993 abolished all of the restrictions for private ownership of the land in the Land Code. Therefore, the Decree of the President on "Bringing the Land Legislation in Conformity with the Constitution" made a considerable number of articles in the Land Code, as well as certain articles of the Law "On the Land Reform" invalid. Presidential decrees abolished the articles on the types of rights on the land plots, on the conditions to transfer the land plots in the ownership of the legal and natural persons and on the procedure of the allotment of the land plots to the citizens (Ikonitskaya, 2000b).

The right of foreigners to own land in Russia is not clear at all. According to presidential decrees on privatization (14 June 1992) foreigners (only juristic persons) can become the owners of land, which they acquire in connection with privatized enterprises. The current land code is, however, silent about foreigners' rights to own or

use land in Russia. In practice, however, the rule is applied that a foreigner (a juristic person with foreign ownership) can acquire land for long term lease (Ikonitskaya, 2000b). In practice, leasing is mostly used also in domestic business (Hüper, 1998).

5.1.4 The System of Russian Land Law in Transition

According to Russian legal scholars, the new decrees and the new constitution created a legal vacuum in the land law (Ikonitskaya, 1999b). It was evident that a new Land Code was needed. The land law was amended and developed further by presidential decrees, which actually should have been based on a federal law. It took four years to draft a new code, not only because a new land code requires a lot of work with all the technical details, but also because private ownership was such a debated issue (Ikonitskaya, 2000a). However in 1997, the Land Code was approved by both the Duma and the Federal Council, but in a diluted form. Therefore, the President decided to use his power to veto the law. After the Duma elections of 2000, a new draft was introduced in the Duma on the initiative of a few deputies. This draft has started to advance in the Duma and it may become the new land code. It could, however, become an unclear and obscure law if preparation has been inadequate.

The Civil Code, which came into force in 1995, also contains rules on land issues. The connection between the Civil Code and the Land Code is also an important question. The Civil Code does not regulate the transfer of the rights on land. The Code, however, mentions that land may be in the ownership of the state, a municipality or a juristic person and that the rights of the land plots can be of various categories. The Code does not mention private persons as owners. Chapter 17 of the Civil Code on the ownership of land and other rights on land was decided in the Duma to come into force only after the adoption of a new land code. The reason for the decision was again the disputed right of private ownership of land (Ikonitskaya, 1999a).

Even with these contradictions, Russian land law would be complicated enough. The system becomes more blurred because, according to the constitution, the land law belongs to the joint powers of the federation and its subjects. According to the Constitution (article 36), the federal law should regulate the conditions and the order of the use of the land. However, the constitution does not define “the conditions” and “the order” (principles of regulation) of the use of the land.

One of the most distinguished specialists of the land law, Ikonitskaya, basing her analysis on the current Land Code of 1991 and the draft, which did not come into force, considers that “the conditions” include the categories of the rights on land, payments for the allotment and the use of the land, accessory duties for the user of land in case the law specifies them, and the conditions for the deprivation of the rights for the use of the land. “The order” of the use of the land includes the more detailed rights and duties on the use of the land for specific purposes, the procedure of the state bodies’ control of implementing the law, and the issues on the management of the land by state bodies. State management includes, for example, setting out the plan for the use of the land fund, carrying out the state land cadastre, and the issues on the organization of the use of the land.

According to Ikonitskaya's analysis, regional codes can supplement federal land law in details, but the principles of both the rights for ownership and use should be the same in every region as well as the principles of state control and registration of land property. In practice, however, there is quite different legislation in different parts of the country because land resources belong to the joint jurisdiction of the federation and its subjects. Malyi (1999), a constitutional lawyer representing the regions, sees that as long as there is no federal land code, the regions can pass their own laws. As soon as the federal code is introduced, the regional laws should, however, not contradict the federal law. The regulations of the Civil Code belong to the exclusive competence of the federation. Therefore, the rules of the Civil Code cannot be supplemented let alone changed with regional legislation. So, there is not much left for the subjects of the federation to regulate.

Even if the new overwhelming federal land law is still missing, new federal codes concerning the use and ownership of other natural resources have been passed. The Forest Code regulating ownership and the use of forests as well as forest management, protection and registration was passed in 1997. A new Water Code came into force on 23 November 1995. The land covered with water, swamps or ice is also regulated as belonging to the water fund. The Code on Below Ground Natural Resources[37] from March 1995 regulates the alienation of minerals, oil and gas.

5.2 Types of Legal Property Rights of Immovable Property

5.2.1 Rights of Ownership

5.2.1.1 Ownership of Agricultural Land

One of the most debated issues after the collapse of socialism in the Soviet Union has been allowing private ownership of land. Land is still mostly state owned property. Those, who supported economic reforms, clearly saw that the agricultural sector, which is based on collective and state farms, is ineffective and hinders initiative. They saw that private ownership should be able to initiate changes and make agriculture more effective (Ikonitskaya, 1999b). Others, however, saw that especially small farms are nowadays ineffective in market economy countries and that therefore big farms should not be divided into smaller allotments.[38]

Article 9 of the Federal Constitution acknowledges private ownership stating that land may be in private, state, municipal or other forms of ownership. This article has later been criticized by many of those, who see that land should stay in state ownership (a roundtable discussion reported by Bakunina, 1998b). Those, who demand new forms of ownership, can always refer to the Constitution. At the federal law level, however, private ownership is quite narrow. It was introduced in 1990 with the law "On the land

[37] The Russian name of this code is "o nedrah", which means that below ground natural resources (economic useful material.

[38] Roundtable discussions in the legal journal *Gosudarstvo i pravo* (Bakunina, 1998a,b) show how legal specialists situated far from state farms derive their opinions from theories and scientific concepts, which do not have much to do with life in the countryside.

reform" in the agricultural sector. Private persons were able to become owners of the land plots for the subsidiary small-holdings, gardening and buildings of the dwelling-houses. Furthermore, the lands of the reorganized state and collective farms were transferred into common ownership (with the right of alienating the allotment) of their employees and of the people who were engaged in all kinds of auxiliary services in the living areas where the farms were located.

In 1992, the circle of the persons who were allowed to own land plots was widened. Also those who had summer cottages (*dachas*), which they did not use for agricultural purposes, became owners of the land on which the cottage was located. Earlier use of the land for agrarian purposes was required for privatization. Furthermore, private persons engaged in private business in the non-agricultural sector were allowed to own land on which the enterprise was situated. Also juristic persons acquired the right to own land. Privatized firms were given the land on which the company was situated with the company itself. However, the question whether the right of natural (private) and juristic persons to own land can be extended to other land plots than those, which were in the use of privatized enterprises, remained unanswered. Therefore, it is not certain that buying new land for extending business is legal. From the standpoint of foreign investors the situation is a considerable risk (Krüssmann, 1998).

Ikonitskaya (2000b) represents an opinion according to which both natural and juristic persons have the right to own land in all sectors of the economy, irrespective of the origins of the ownership on land, except when the land according to the legislation may only be in the state or municipal ownership. This opinion is based on the list of the categories of persons and activities allowed to own land given in article 7 of the Land Code as well as on the Decree of the President "On bringing the land legislation of the RF in conformity with the Constitution" and articles 212 and 214 of the Civil Code (Ikonitskaya, 2000b). The typical opinion in Russian jurisprudence is that if something is not especially allowed it is prohibited. The absence of a clear regulation allowing companies to buy land for business purposes therefore does not give enough security in transactions of land property. It gives local bureaucracy too much power and increases transaction costs.

There are, however, differences between the subjects of the federation. Regional laws are not consistent with federal legislation. For example, in Bashkortostan and in Saha-Yakutia land is considered to be the common national property of the population. In Mari El', citizens may possess land for subsidiary small-holdings, gardening and building dwelling-houses. Private ownership of farm land is, however, not allowed. On the other hand, there are regions such as Moscow, St. Petersburg and Karelia, where private ownership is allowed (Ikonitskaya, 1999b).

It can also be claimed that not allowing private ownership is unconstitutional since the constitution allows all forms of ownership (Ikonitskaya, 1999b). The constitution also stipulates that the forms and rules of the use of the land are fixed by federal legislation (article 36.3). On the other hand, federal legislation although allowing private ownership is obscure. In the absence of an up-to-date federal land code, the subjects of the federation interpret that they have a right to regulate on the forms of ownership. In some subjects of the federation, private ownership goes further than in federal legislation. For example, Karelia allowed private ownership without the inheritance

right of forest land. The federal presidential administration has actively strived for the unification of legislation. The federal constitutional court has supported the tendency for unification leaning on the interpretation of the federal constitution. The subjects of the federation, however, would like to keep their newly gained right for their own legislation, which does not have to be unified under principles given from the federal level (cf. Nysten-Haarala, 2000).

There is also land in *municipal ownership*. According to article 215 of the Civil Code, municipal land property is the property of the rural and urban communities as well as other types of municipal units. It is, however, unclear what kind of land can be in municipal ownership (Ikonitskaya, 1999a; Brinchuk, 1999:188). It is also not clear, whether it is the subject of the federation that can decide what property is municipal and what belongs to the subject of the federation. This issue is not regulated in legislation. In practice, the subjects of the federation have decided whether or not to give land to municipal ownership (Ikonitskaya, 1999a).

According to the Decree of the President on Regulation of the Land Market, every owner of a land plot was given a certificate of ownership and those rights were also to be registered. This certificate was the proof of the right of ownership and the basic document for every transaction with the land plots. The certificate had to be used to register the right. Creating a new registration system and a land cadastre is, however, taking a long time. On the basis of a government decree (266 of 25 August 1992) and a presidential decree of 11 December 1993, the GKI and the State Committee of Land Resources and Land Management drafted a registration system. There was already a "Land Book", which was used in many localities (Butler and O'Leary, 1996). This intention was superseded by the Civil Code of 1995, which created a national registry of immovable property.

After several attempts, a governmental registry on the rights on immovable property and transactions was created on 21 July 1997. Ownership, lease and other uses of land are registered as well as the different categories of land, the technical data and the economic value of land. The law regulates that a registration number should be given to every land plot. In the future, the register is intended to cover all of the property in the area of the whole federation. Nowadays, it is kept on regional levels.

Legislation and implementation of the regulation concerning the cadastre is still in transition. Nowadays, it is the State Committee on the Land Resources and Land Management that takes care of the state land cadastre. Its activities are financed from the regional budget under a unified scheme. Regional or local committees on land resources and land management carry out the main work, the actual registering of data. The registration procedure is stipulated in the regulation on the procedure of the state land cadastre, which was approved by the Resolution of the Government of the Russian Federation on 25 February 1992. There is a new law from 21 January 2000 aiming at creating a complete land cadastre covering the whole area of the federation. The law stipulates that the country should be divided into cadastre units and a new administration arranged. This process has not yet started. Nowadays the cadastre contains only buildings. The process of including real estates is still going on.

Nowadays, the state registration is the only evidence of the existence of a registered right. A registered right can only be challenged in court. However, registering privatized apartments or buildings is not required as long as the property is not transferred. If the property is sold, it has to be previously registered in the name of the owner. If all the documents proving the owner's right are in order, registration is only a technical question. People, who are not planning to sell their property, have not bothered to register their right in order to avoid the costs and the trouble of registration.[39]

Before the Land Code and the Resolutions of the Government on Registration were adopted, there was a moratorium on the transactions on land and the registration of the transactions had been suspended. Nowadays, transactions are again permitted (Ikonitskaya, 1999b). Moratorium is quite logical from the point of view of clarity and the necessity to develop a reliable formal system. However, in spite of the moratorium, there were a lot of unclear or obscure transactions. When creating a new system of registration and cadastre is going on, the system cannot be completely reliable. If certificates were lost while registration was not yet possible, it is difficult to prove ownership and have it registered. In the former state and collective farms, where land is in common ownership but where every one has the right to alienate his own plot, the borders of the plots are not always drawn. Since unclear rules allows informal rules to supersede formal rules, corruption is likely to occur around registration and applying the rules for the right to alienate land property.

Another problem for creating a land market is that the regulation of the mortgage of the land plots was under formation for a long time. Already the Civil Code (article 334) of 1995 mentioned the possibility of mortgage referring to a specific law which, however, only came into force on 16 July 1998. However, mortgages were temporarily regulated by a presidential decree "On the additional measures on the development of mortgage credits" from 28 February 1996. Already the decree contained a mandatory form of the contract of a mortgage and defined the content of the contract, rights and duties of the parties. Mortgage is, however, not yet much used in Russia. It is also difficult to obtain credits from the banks, which limits the possibilities of former collective farm workers or anybody without money or property to buy agricultural land or run an agricultural enterprise. Agricultural land is not valuable and is often badly transferable, except near big cities.

According to current legislation, a land owner has a duty to use the land effectively and according to specific purposes, to increase the fertility of the land and refrain from deteriorating the land, protect the land and follow the requirement for building. State bodies are not allowed to intervene in the activities of the owner, except when land legislation is infringed. The Presidential Decree on the regulation of land market grants the owners of land plots the right to sell, to leave the land by inheritance, to mortgage, to lease and to invest land plots as shares in companies (Ikonitskaya, 1999a).

[39] This information was given by Maria Kotova, senior lawyer of the Solombala Paper and Pulp Company in Arkhangelsk on 21 August 2000.

5.2.1.2 Ownership of Forests, Waters and Below Ground Resources

With the exception land for agriculture and land for entrepreneural use, which covers at least the land plot on which the enterprise building is situated, land is very rarely privately owned in Russia. The owner of natural resources is usually the state. According to the Civil Code article 214, the state ownership of land is divided between federal property and the property of the subjects of the federation. How the division is drawn is still a largely disputed issue. The first attempt to draw the line was a presidential decree of 16 December 1993 on the federal natural resources, the following property was regulated to be in federal ownership:

- plots for military defense and security of the country,
- land plots for the border guard, and plots of the federal energy, transport and space facilities,
- for the operation of nuclear power plants,
- for telecommunications and meteorological services, and
- objects of cultural and historical heritage, natural reserves as well as other objects in federal ownership.

The territories of national protection parks, national natural parks and other similar parks enjoying the protection of the state form a separate group of the federal property. Russian protection of nature is criticized by up-down legislation of aspirations, which was also typical for Soviet legislation (Greenspan-Bell, 2000). Also, the debate between the federation and its subjects hinders development of questions, which belong to the joint powers of the federation and the subjects. However, the principles of administering and monitoring nature protection have not changed. This means that the former institutional framework has not collapsed.

The debate between federal and regional state ownership has concentrated on the ownership of natural resources. In the Federation Treaties of 1992 all natural resources were given to the subjects of the federation. The Constitution of 1993 regulated natural resources as belonging to the joint ownership of the federation and its subjects.[40] Most subjects of the federation have concluded a treaty on the division of rights and duties between the federation and the subject and some have gained ownership of their natural resources in this way. There is, however, a tendency of centralization going into the new federal legislation. The Forest Code of 1997 stipulated the ownership of forest resources to the federation. It seems that treaties between the federation and the subjects are superseded by new federal legislation and the ownership of natural resources is brought to the federal level. However, the income of the property is divided between the subject and the federation even when ownership belongs to the federation.

The Republic of Karelia and the Territory of Habarovsk challenged the Federal Forest Code of 1997 in the Constitutional Court. Karelia referred to the fact that the Federal

[40] The relationship between the Federal Treaty of 1992 and the Constitution is a debated issue in constitutional law (cf., Nysten-Haarala, 2000). An environmental lawyer, Brinchuk (1999) sees the debate in a simple way claiming that the Constitution substituted and avoided the Federal Treaty.

Treaty and the Treaty on the division of powers between the federation and Karelia gives the right of ownership of forests to Karelia. In its decision from 9 January 1998, the Constitutional Court did not pay attention to federal treaties but interpreted only the Constitution. According to the court, the forests are still within joint jurisdiction since the Federal Forest Code gives rights and duties to both the federation and the subjects. The court also saw that Karelia among others has participated in the legislative process and could have affected on passing the law. Furthermore, the court saw that not all of the forests belong to the federation, but only the forest fund. However, almost all of the productive forests, which are harvested, belong to the forest fund (cf. Forest Code Article 8). Only parks and forests around municipalities do not belong to the forest fund. These forests, however, are supposed to be the property of the municipalities (cf., Ikonitskaya, 1999a; Brinchuk, 1999). The Federal Forest Code also stipulates that the transfer of ownership is also possible according to the rules of a federal law. Such a federal law, however, does not yet exist.

Article 46 of the Forest Code stipulates that the possession, use and right to decide on the forest fund belong to the federation. Unified investment policy, the means of payment for using the forest fund and the rules of using forest resources, are decided on the federal level. According to article 47, the subjects of the federation implement federal forest policy. They also participate in possession and the use of forests as well as decide on renting or leasing plots of forest for harvesting purposes. In practice, it is the subjects of the federation that control harvesting and give the permissions. Forests should, however, be used according to federal policy. The income is divided so that the federation receives 40% and the subject 60% of the lease or other rent of the forests (article 102). The division can be agreed in a different way in an agreement between the federation and the subject. Some subjects of the federation (26 of them) that do not have a lot of forests do not have to divide the income with the federation. This means that paradoxically only the owner holds the title without getting any income for the property.

There are also two kinds of tax payments, which the user of the forest has to pay (article 103) One payment goes to the federal budget and the other to the subject of the federation. The federal payment is 5% of the value of the wood and is based on a presidential decree from 23 December 1993, No. 2271. There is also a special payment for exported wood (article 106).

The forest code divides forest land into three different categories, which were developed during the socialist system. The forests of the first group (article 56) can be of many different kinds, but usually they are areas that need special protection or are important for social purposes. Areas that are protected and where entrance is forbidden belong to the first group. Also forests that are evaluated as being the most valuable belong to the first category. Furthermore, forests that border on waters belong to the first group.

The second category of forests (article 57) contains areas that are situated near populated areas and transport routes. These forests are most often used for harvesting. Forests of the third category (article 58) are situated in areas of dense forest zones. These forests are mainly reserve forests and the ecological questions should be paid a lot of attention in using them. For the use of forests of the second and third categories, the subjects of the federation have more power than in the first category

(Kommentarii…, 1997). The federal organs decide about the borders between different categories.

The categorization of forests has been criticized. There are demands in the subjects of the federation with vast forests that forests should be divided between the federation and the subjects. There have also been suggestions that forests situated near villages could be given to the common ownership of the people living there. In this way the local people could start to get used to private ownership.[41] If this form of ownership is introduced, monitoring and maintaining the borders becomes important and the arrangement should be in compliance with local values (Ostrom, 1990). Suggestions of common ownership may be overridden by the demands of municipalities. It is exactly the forests around settlements that have been extracted from the federal forest fund to the ownership of municipalities.

The idea of common ownership, both in the above-mentioned suggestion and in the agrarian reform, is that it might gradually lead to private ownership. Privatizing forests to private farmers would support private agriculture, since forests could give significant additional income to private farmers. Especially in northern areas, e.g., Finland, the income from forests is vitally important for farmers since agriculture there is otherwise unprofitable. In Russia, the institutional setup and especially the mentality hinders the introduction of private ownership. Privatizing forests might be dangerous in Russia, if it were arranged in a similar way as privatizing state enterprises. Forests would soon be the property of a handful of *oligarch*s. Privatization of forests should, therefore, be well planned and targeted to support agriculture.

State forest management and the use of forests has not changed radically. The system did not collapse but continued to function in spite of transition. The only significant change in the forest sector has been the privatization of forestry companies. The new private owners are, however, usually the managers of those companies. Their policy to preserve the existing system is path-dependent. The centralization tendency nowadays prevents innovations. The whole system is run in a rather bureaucratic way on both federal and regional levels. At least in the forest sector, it is in nobody's interest to introduce private ownership. Harvesting with tickets functions in practice and owning forest property might only be a burden for the company. In the present situation powerful forest enterprises can control the harvesting system.

According to the Law on Below Ground Resources of 1995, minerals, oil, gas and all economically useful resources of the earth´s crust (e.g., ground water) belong to the state. This is a joint ownership between the federation and its subjects. The use of these resources is governed together with the federation and the subject (articles 3 and 4). The policy to use these resources should be planned together with the federation and the subjects. According to the law the subjects of the federation should in practice have more power to decide on excavating activities, because licenses are decided on the regional level (article 30) or on the federal level with the consent of the executive power of the subject of the federation (article 11). Only licenses to use the continental shelf,

[41] These suggestions were presented in IIASA's policy exercise "Institutional Problems of Development of the Tomsk Forest Sector" in Tomsk held on 13–16 June 2000 (Carlsson and Olsson, 2001).

which belongs to the ownership of the federation, are decided on the federal level without the consent of the subject of the federation.[42] The federation, however, govern the policy with federal programs, which the regional programs should follow.

There is no such concentrated federal administration for the whole so-called fund of below ground resources, which does exist for forestry. But there are plans and suggestions to take minerals, oil, gas and other below ground natural resources more into federal control and to establish one federal service for all of them. Now, areas already exist where underground resources are defined to be of great federal importance (Pevsner, 1997). A lot of issues concerning the policy for the use of oil, gas and minerals are decided by the president and the government of the federation.

The longest period for a license for using below ground resources is 25 years. The Federal Law on Below Ground Natural Resources ("*o nedrah*") regulates on the division of incomes from payments for use. The state collects incomes from those who participate in the auctions for licenses. The licensees also pay rent, income and excise tax. Incomes are divided between the federal, subject and local levels (article 42). From hydrocarbon raw material (e.g., oil and gas) the local level receives 30% and for others such as minerals 50%. Of hydrocarbon raw material the federation receives 40% and the subject 30% and for other than hydrocarbon resources the federation and the subject both receive 25%. In such autonomous areas, which are situated in the territory of a region or territory, the territory or the region receives half of the federal share.[43] Incomes from excavations on the territorial sea bottom are divided 60% to the subject and 40% to the federal budget.

The ownership of waters is divided between the federation, subjects of the federation and municipalities. Inland waters that do not border foreign countries and do not belong to natural parks of federal protection are in the ownership and control of the subject of the federation, where the water is situated. Waters that are needed for military purposes, energy production or transportation may also belong to the federation. Also inner and territorial seas belong to the federation. Small waters inside municipalities belong to the municipality.[44]

An important issue among the other changes in Russia is the rights of indigenous peoples. Russian legislation has paid a lot of formal attention to the rights of "small peoples" (*malochislennye narody*) and indigenous peoples (*korennye narody*). There is a new federal law of 30 April 1999 on the guarantees of the rights of indigenous small peoples in the Russian Federation listing all possible rights. Unfortunately, the "guarantees" only exist on paper. The law did not establish any mechanism for indigenous peoples to influence on the use of natural resources or on the protection of nature in their living areas. The new federal law is a typical example of the uselessness

[42] In the legislation of some subjects of the federation, e.g., Saha-Yakutia, also the continental shelf belongs to the ownership of the subject.

[43] This arrangement guarantees that such regions as the Tyumen region containing one oil producing and one gas producing autonomous area receive a share from the profits (cf., Nysten-Haarala, 2000:45, footnote 37).

[44] Regional legislation does not, however, always comply with the Federal Water Code or Mineral Code.

of formal rules when they cannot be effectuated. Such legislation only shows the good intentions of the legislators, but ignores practical and economic obstacles. Such a law is not credible. Indigenous people's rights of using land are also guaranteed, for example, in the Land Code permitting the traditional use of land to indigenous peoples in their traditional areas. It is also allowed in natural parks of one type (*zemli prirodno-zapovednogo zona*). The Law on Below Ground Resources generally states that a part of the regional budget revenue from below ground natural resources, which originates from the living areas of indigenous peoples should be used to develop social and economic circumstances of these people. There is, however, no effective monitoring by indigenous people for the proper implementation of the rights, which are given to them in Russian legislation. Indigenous people have not yet organized themselves in such a way as in the Nordic countries and North America, where they already claim for restoring the ownership of the land.

5.2.2 Other Rights on Land

Other forms of the right on the land, besides the right of ownership, are regulated in the Civil Code. These are:

- the inheritable right of possession (article 214),
- the right of permanent use without a fixed term (article 216),
- the easement (article 216),
- the lease (article 607), and
- the gratuitous right of use (article 689).

The inheritable right of possession and the right of permanent use without a fixed period were created by the Civil Code and are stipulated in articles 266–270 of chapter 17. This chapter is, however, not yet current legislation, since it is going to enter into force only with the new Land Code. The Civil Code refers to land legislation. Current legislation mentions the inheritable right of possession only in connection with the land property for the subsidiary small-holdings, gardening and the building of dwelling houses. The law from 23 December 1992 regulates that land plots in possession that do not exceed certain standard limits can be inherited. The possessor can possess and use the land plot. He also has the right to build on the land and become the owner of immovable property on the building. Sale, mortgage or any other transactions, except lease of free use for a fixed time, are prohibited.

The right of permanent use without a fixed term is more limited than the inheritable right of possession. The holder of the land plot can agree upon building and using the land or a lease for a fixed period only with the approval of the owner.

Leasing land is regulated in chapter 34 of part two of the Civil Code, which provides the possibility for legislating special rules for leasing land plots. On the federal level there are, however, no such rules yet. In some subjects of the federation, rules of sale of the leasehold on the land plots exist. The Civil Code also stipulates that the maximum periods for the lease of certain categories of property can be limited in legislation. In the Land Code there was a limit of 50 years for leasing state owned lands and 5 years for leasing land owned by private persons. These articles are, however, not in force now

because the Decrees of the President abrogated them. In business practice, the most popular period for long-term lease is 49 years (Ikonitskaya, 2000b).

Easement is also an unregulated type of use of land. It is regulated in the Civil Code in chapter 17, which has not yet entered into force. The Forest and Water Codes introduced easement in current Russian legislation.

Since forests are the property of the federation, plots of forest are leased for harvesting. Subjects of the federation decide over leasing the plots according to federal programs. Some subjects of the federation have also sold forests for private ownership, but after the Federal Forest Code of 1997 this is prohibited in federal legislation. Article 22 of the Forest Code stipulates that the forms of use of forests are:

- lease (rent),
- use without compensation,
- license, and
- short-term use.

Leasing contracts are offered in auctions or they may be concluded with the administration of the subject of the federation without auction procedure. The representation of the federal organ on the subject level has to agree with the contract. Also, the decisions for use without compensation, which in practice means hunting, are done in the same way (Kommentarii…, 1997). The price depends on whether functioning markets exist or not. In Russian monopolistic markets powerful companies can in practice influencing the price.

Short-term use up to one year can be decided through auctions or simply by selling a ticket to harvest the forest on the plot, which is the most commonly used form of the use of forests. The decisions are made on the level of the subject of the federation. License agreements are made for both harvesting purposes and taking care of the plot. Such contracts are made on the federal level with the consent of the subject of the federation. Licenses are sold through auctions or competitive bidding. The term of the license can be from 1 to 49 years (Ikonitskaya, 1999a:237).

Natural (private) persons can also establish an easement on forest land (article 21). An easement is usually established for access to private property through forest land or for distribution of electricity (Kommentarii…, 1997, article 22).

The rights to use waters by those who do not own them are long-term use, short-term use and easement (Ikonitskaya, 1999a:241). Both long and short-term use is given through license agreements. Exploitation of peat is regulated in article 99 of the Water Code. An easement for both waters and forests can be founded by a contract or in court procedure. It can be established for using a road, taking water, etc.

There is also traditional common use of waters permitted in Russia. Swimming, fishing and taking household water is permitted in other than nature protection areas (Ikonitskaya, 1999a:240).

There are no regulations concerning the other rights on land by foreigners. In practice, foreigners can acquire land for long-term lease (Ikonitskaya, 2000b; Hüper, 1998).

Most of the other rights of land that are regulated in the Civil Code are new property rights, which have been included in Russian legislation with the Civil Code. Excluding lease, they are not yet widely used. The main reason for not using other forms of the right on the land is, of course, that chapter 17 of the Civil Code is not in force yet. Use rights are mostly rights to use state property, which is understood as a different kind of a property right than private property. The attitudes to state property still have a socialist flavor. Land was not understood to be property at all as it had no price and could not be sold or bought. Therefore, creating land markets was a decisive change. Land law, which derived from socialist principles, has been changed and amended, but seems to have preserved its original flavor of administrative law. This is especially typical in forest law, which is still based on the system established earlier. The regulation of land law, which has tried to be changed with new principles is, however, still unclear and has not been accepted in practice.

5.3 State Protection and Administration of Land Property

Russian land legislation guarantees the protection of the rights of all persons who use land plots. Any interference from state bodies is forbidden except in cases of violating land legislation. According to current legislation, state bodies that have unjustifiably intervened into the activities of the use of the land have to compensate the loss to the land holder. Such regulations limit the rights of the state also as a land owner. Protection of private ownership of the land is guaranteed in article 36 of the Constitution. All transactions should be registered and the land registry is kept by state officials.

One of the main principles before the economic reforms was the principle of the free use of land. The reformers, however, saw that free use of land leads to irrational use and encourages enterprises to hold more land than they are able to use.[45] Therefore, the payment for the use of the land was introduced in 1990 already during the Soviet period. At present the payment is regulated in the Land Code and by the law "On rent payment for land" of 11 October 1991.

Russian land legislation stipulates that payments for the use of land are land tax, the rent payment (of lease or license) and the regulated price of the land. The land tax on agricultural lands is calculated according to the quality, size and the location of the land. The average amount of land tax per hectare is enacted in a specific annex to the Law on payment for land. The tax for land in urban areas and land for other purposes is calculated according to different rules. There is also a long list of exemptions from the payment of land tax including areas for scientific institutions, public health services, nature preservation areas and veterans of wars, invalids of certain categories, people who suffered from radiation, etc.

Rent payment is determined in the lease contract. However, renting state or municipal lands is regulated and the authorities decide on the basic rates of the rent depending on the categories of the land plots and the categories of the leaseholders.

[45] A survey made by Hendley *et al*. (1997) proves this opinion.

The land market price is also regulated because the land market is only being formed and because the state is afraid of speculation on land and of high prices. There is a so-called fixed price of land. This price is set by executive authorities of the subjects of the federation for the lands of different categories depending, for example, on the location of the land. The Resolution of the Government from 15 March 1997 does not clearly define which categories of natural and juristic persons have the right to buy state and municipal lands for a fixed price and who and what land has to be bought on the free market price (Ikonitskaya, 1999a, 104). People entitled to a fixed price are at the mercy of civil servants, who apply the law. In practice, land is sold more eagerly to those who can pay.

One of the most important functions of the state administration of the use of the land is the territorial planning of the use of the land. It is however, not yet regulated by law. During the last few years, the planning of the use of the land has intensified and there are schemes for the use of the land on regional and local levels (Ikonitskaya, 2000b). The need for such planning has been realized on the local and regional levels. In the absence of a proper federal land code, the regions have taken more initiative and started to regulate land use themselves. Using the data of the land cadastre, which is still under formation, is mandatory in planning the use and protection of land. Planning the use of the land obviously suffers from the absence of a proper legal framework.

The state administration of land also includes the control over possible infringements of the land legislation. The State Committee on the Land Resources and Land Management[46] and other organizations of the executive power are responsible for controlling infringements. The executive officers of these institutions have powers to suspend any kind of building activity infringing land legislation, to give mandatory orders for the elimination of infringements and to impose fines. The land management also has the right to control procedures of the contests and actions on land and initiate court procedures for invalidating transactions contradicting current legislation. When property rights are unclear, the state authorities have a lot of power to interfere. Corruption is also likely to occur when monitoring is not based on clear regulation.

Besides the State Committee on the Land Resources and Land Management also bodies of natural protection, Ministry of Agriculture, planning and architecture offices, offices on the use of mineral resources and geological institutions as well as some other ministries and departments carry out monitoring of the land. Administration, management and environmental protection of other natural resources is carried out with even more different governmental bodies. The distribution of powers, especially with those governmental bodies engaged in environmental protection, management of natural resources and supervision of the use of natural resources, is unclear. Such an obscure situation causes a lot of trouble for enterprises, which have to cope with several different and usually contradictory standards of different state agencies (Kotova, 2001).

There is a tendency of trying to simplify the administration of natural resources especially with merging the tasks of different agencies under a new federal administrative or supervising unit. The Administration of Forests is currently being

[46] The State Committee of Land Resources and Land Management was founded in 1991.

restructured. The State Committee of Environmental Questions and the Federal Forest Service were liquidated and their tasks transferred to the Ministry of Natural Resources by a presidential decree No. 867 from 17 May 2000.[47] All the questions concerning the management of the forest fund is going to be concentrated there.

The state administration of land property and natural resources is experiencing a decisive change. The administrative command economy is changing towards land markets. State property, which was regarded as only administrative units, now has a price value and should provide profit. Such a change requires skills of modern planning and management. Old state officials may not be able to change their attitudes and change may, therefore, take time. In the present economic situation, when the state does not have enough money to support its huge bureaucracy any more, monitoring suffers and confiscatory rent-seeking policy is likely to appear in the administration to cover up the cost. Constant changes and continuous uncertainty also have similar side effects.

5.4 From Administrative to Court Control

Since land was not regarded as property and it all belonged to the overwhelming state, the disputes of land were between different state departments. Such disputes were administrative by nature and also handled as administrative disputes. With the changes it became clear that land disputes require court procedure. For some time both court and administrative procedures were in use, before a presidential decree of 24 December 1993 abolished the administrative procedure.

Land disputes can either go to ordinary courts or arbitration courts, which are Russian commercial courts. Disputes between enterprises (juristic persons) or enterprises and governmental bodies belong to the arbitration courts. However, if one of the parties of the dispute is a natural (private) person (not a juristic person) it is the ordinary court that has to decide over the dispute.

A suit can be raised against local or regional administration as well as against another juristic or natural person. Disputes in the forest sector are between companies and they are therefore settled in the arbitration courts. Leasing contracts have been disputed even to the level of the Supreme Arbitration court, which decided 21,524 leasing cases in 1998 and 24,734 cases in 1999 (Sudebno-arbitrazhnaya…, 2000).[48]

There have also been disputes concerning the payment for services of different governmental bodies. Such services as rendering harvesting tickets, allotting harvesting areas, services connected with the state cadastre are liable to be charged. State bodies offering these services can themselves decide on the payment. Such a system has led to high prices of services, which enterprises have started to challenge in the courts. The courts have considered such services, which are not based on law, as hidden taxation and declared them invalid (Kotova, 2001). The number of cases decided by the Supreme

[47] The development of forest management structure from Soviet times to the 1990s is described in Carlsson *et al*. (1999a) and Piipponen (1999).

[48] These figures include leasing of all kinds of property.

Arbitration Court concerning demanding too high payments on the use of the land back from state or municipal authorities was 2,325 in 1998 and 2,507 in 1999. The Supreme Arbitration Court has also decided cases concerning the authorities' refusals to register property rights or contracts.

6 Summary

Transition makes property rights insecure, especially when the forms of property rights are debated. In Russia enterprises were quickly privatized. The decision was political. Preparations were forgotten, when the main goal was privatization itself. There was already illegal and informal privatization going on without any legislative basis, a fact that also accelerated the start of the official program. From the legal point of view, the privatization of enterprises was not a success story. Legislation was superseded and ignored. Decrees became more important than the laws enacted by parliament since there was no political consensus on privatization and therefore no political commitment either. The final result of privatization was a complete theft of former state property. At that stage even presidential decrees did not count any more. The new Russian elite arranged a donation of the most valuable state enterprises to banks. A few big banks with holding companies led by *oligarchs* now have monopolistic power in the Russian economy. The government is their hostage but still controls who is admitted to the circle of the elite. Admittance to the circles occurs with state authorization. In financial difficulties the state can again decide, which bank is worth saving and which can be made bankrupt. The new elite also controls the media.

Incompetence and corruption are mostly considered as the reasons for the bad success in transforming Russia into a market economy (Åslund, 1999). Poor control leads to illegalities and opportunistic behavior. Many western advisers support this reasoning which, however, is too simple an explanation. The Russian economy and society are largely misunderstood, because of ignoring the past. "Social capital" and trust cannot be created through legislation and control. Social capital in Russian business was created in the shadow economy. Such businessmen had to know how to avoid the law and rely on the corruptness of state officials. State enterprises were run in a bureaucratic way. Managers were chosen according to their political merits or connections. Social networks and good personal relations were used in allocating the fruits of the socialist economy both legally and illegally.

Doubtful and partly illegal privatization may be a ticking time bomb in Russian society. At least it explains why people are unsatisfied and why trust does not exist in the political and economic system. The main problem of privatization was the lack of control, which gave opportunism a chance. It was, however, a path-dependent development managed by the network system of good relations between the *nomenclatura* circles. Who could have controlled the privatization process, when the controllers themselves belonged to the same circles and also wanted to get their piece of the cake?

Privatization did not bring economic efficiency. Transaction costs for producing formal profits are too high. Profits stay in the gray sector of economy because of the fear of

having to pay taxes or protection money to criminals or being taken over by foreign investors. The official economy keeps running as a pretense, virtual economy with barter trade and artificial prices. Restructuring has not started because the new elite still seems to be interested only in short term gains. Such behavior is rational in the Russian environment. The most successful enterprises in the oil business give profit without restructuring anyway. Even less profitable enterprises are now owned by former managers, who only wanted to guarantee that everything is going to continue as before. The most dangerous phenomenon for the economy is, however, the illegal flow of assets abroad. However, it may be that managers, who secured their positions, are now likely to be motivated to restructure in the long run to be able to keep the company going. Self-interested owner managers should, in principle, be more likely to restructure than private investors, who seek quicker profits.

The bank crisis of August 1998 also introduced bankruptcies in Russian business. It is, however, not certain that the wave of bankruptcies will abolish the most unhealthy enterprises from the market. Uncertainty continues and the enterprises try to secure their future with monopolizing aspirations and good contacts with the authorities and government circles. For small enterprises the environment is difficult for long-term business. The state does not pay enough attention in developing flourishing small and medium sized business.

Land property has not experienced the same radical reform as the privatization of companies. Agrarian reform aimed at introducing new forms of ownership and giving the possibility to the workers of state and collective farms to start the own private businesses. The reform was also necessary for new enterprises to be able to obtain land. Private property rights were, however, not clear enough. The aim of the reform was to offer choices by introducing a new form of common ownership, which could also have been used for allotting a plot for a family farm. In practice, redistribution of land proved to be unclear. The tragedy of the agrarian reform was that it was needed but too debated. It was introduced from above but in a diluted form. Managers of state farms and local officials opposed the reform and did not encourage people to take the initiative and start their own business. Private farms were not in the interest of the most important interest group of the countryside, that is the managers of state and collective farms. Private property of agricultural land has faced a lot of resistance also because of the fear of speculation on land. Such fear is not urgent in the deep countryside. But estates in Moscow and other big cities and their surroundings have become extremely expensive. State control of prices and rents has not been able to prevent the prices from rising.

Weak property rights in land property prevent the countryside from developing. Property rights cannot be made stronger by only developing the formal legal system. The hindrances for strong and effective property rights are institutional. The destruction of the countryside was so total in the socialist system that it is difficult to find incentives to make people develop those areas. The problems are both psychological and depend on the badly developed infrastructure. It is difficult to start a farming business when there are no distribution systems, electricity or equipment. The idealistic plans of legal and economic specialists for the positive results of re-introducing private ownership failed. The lack of initiative and risk-taking are results of rationality, which developed in the Soviet environment. This environment has not changed considerably in the countryside.

Russian agricultural reform has experienced almost all of the problems, which make property rights unclear and weak. Borderlines have not been drawn carefully. Alienation is still on an insecure basis. It is not clear who is entitled to buy and sell land property, and the registry is not yet reliable. Often local and regional administration has not been interested in the reform which, on the other hand, has given them power in the field of informal and weak property rights. Strong interest groups resist changes in fear of losing their power and influence. The lack of trust in the politicians and the persistence of changes is a significant hindrance for reforms.

Besides the agrarian reform, there have been no other programs for introducing private ownership on land property. Forests have not been privatized, as there seems to be a large consensus in the society that forests should remain state property. This is one way to prevent "the robber barons" taking this national property and destroying it. The privatization of forests to private farmers should, however, be considered. The income of forests would significantly support private agriculture. However, the destruction of forests is also possible when only the use of forests is permitted and when it is connected with bad control. The system of using forests has not changed considerably, even if forest enterprises were privatized to their managers. New payments have been introduced and there has been a dispute about dividing the profit between the central and the regional level. Even if the federation is the owner, the regional level receives more of the income from the use of forests. There is an administrative change taking place in the forest sector but it seems that the change is only organizational, not institutional. There is a tendency towards centralized administration to clear and simplify the rules.

Clarity of allocation is not yet on an acceptable level. The state registration and the cadastre are still unreliable. The costs of alienation may be too high due to corruption. Security against trespass is not good since the state administration has not yet adapted to the terms of a market economy. Violations of property rights are not protected enough in the administrative and executive levels. Disorder still gives criminal organizations too much power. The persistence of property rights is not protected and law changes all the time. For five years, it has been attempted to draft a new federal land code. In the meantime, the differences between the regions of Russia grow and a balance has not yet been found. When property rights remain unclear, the government loses its credibility. Foreign investments, especially, are not going to be made in such insecure circumstances.

There are still a lot of institutional remnants from the socialist period. Such remnants can be found in the peculiar concept of land law, which regards law as an administrative means. Also the whole concept of property is old-fashioned and has not yet adapted into dynamic relations in property rights. Introducing private property to an administrative system does not yet make a big difference. State property continues to be governed in an old administrative way. Introducing new payments easily leads to attempts of state agencies to charge too high fees to cover their administration costs. The role of the state as an owner has not changed. The state is still a privileged owner compared to others. The reforms brought land disputes from administrative tribunals to the courts that, in turn, have the important task of bringing equality among the different owners and stopping irresponsible management and corruption. It is, however, doubtful whether the

courts have enough competence to solve all the new disputes that have not previously existed. The courts are now busy with bankruptcies and cases of frauds in privatization.

The most dangerous features of the socialist economy are the persistence of the gray market, stealing state property, and corruption. The persistence of these features does not create trust in the legal and political system. Rationality in an environment, where informal property rights dominate, is different from rationality connected with strong and efficient property rights. The absence of trust and the incapability of the political institutions to commit themselves to develop the property rights system are blocking the Russian economy from sustainable growth. If the politicians would commit themselves to firmly developing a strong property rights system, economic change should start to occur. The Russian experience also shows how political the property rights system is. A consensus is urgently needed as well as a commitment to make changes. However, Russian uncertainty prevents such commitments and the absence of credibility of any political commitment maintains uncertainty.

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