Mass privatisation – Dictionary entry

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INTRODUCTION

The Washington Consensus – the policy package approved by the international financial institutions to assist developing countries in crisis – faithfully promoted three big policies for transition economies (Williamson 1990) . These were liberalisation, stabilisation and privatisation. This policy package was commonly referred to as Shock Therapy and was based on the experience of liberalisation and stabilisation programs in Latin America and Africa that started with the third world debt crisis starting in 1980. However, unlike in those regions, the post-communist countries were fully industrialized but had no domestic investor class. Furthermore, their economies were dominated by technologically obsolete enterprises that were uncompetitive on globalized markets. In this context, there were no established policy proposals for achieving large-scale privatisation.

Sympathisers of neoliberalism developed a strategy for rapid and large-scale privatisation which they viewed as absolutely vital for both economic and especially political reasons. They were convinced that free markets and rapid privatisation, given a stable monetary environment, would transform the inefficient state-owned enterprises inherited from socialism into dynamic capitalist firms. As the European Bank for Reconstruction and Development (EBRD) would phrase it, "private ownership would ensure profit-oriented corporate governance, while liberalisation of trade and prices would set free the competitive market forces that reward profitable activities. Firms would have therefore both internal and external incentives to restructure" (EBRD 1999: 167).

VARIETIES OF PRIVATISATION

There were nine different ways in which privatisation was accomplished after the collapse of the Soviet empire:

(1) Competitive auctions, which are the most straightforward way of privatisation.
Often competitive auctions occur following a period of active economic restructuring. This type of privatisation often results in some form of foreign ownership, due to foreign investors' extensive experience and better access to markets, capital, and technology. Competitive auctions was the main form of privatisation employed in Hungary and Poland (King and Sznajder 2006) . In case of competitive auctions, governments often pay attention to other criteria rather than just the price paid for the shares: for example, cash transactions and maintaining the existing employment rather than creating new investment are considered important (Berg and Berg 1997).

(2) Non-competitive auctions, which often are associated with “oligarchs”, or entrepreneurs with extensive networks of political connections, who privatise via rigged auctions. Prices paid for shares in the enterprises privatised through this method are remarkably low. Russia’s raw materials sector was mostly privatised through non-competitive auctions, leading to the most crucial assets of Russia’s economy, such as oil and metals firms, being sold to oligarchs for media and political support to the ruling party and Yeltsin’s re-election, in particular (King and Treskow 2006).

(3) Management and employee buyouts (MEBOs) are the most common form of privatisation. In almost all cases MEBOs involve significant discounts to enterprise insiders. Sometimes there would use lease-to-own arrangements, where managers and employees would lease the enterprise from the state until they paid an amount that made them its owners. This type of privatisation is particularly common for small enterprises.

(4) Employee shared ownership schemes (ESOPs). Unlike ordinary management and employee buyouts, in this method of privatization there is a legal device that centralises the ownership and voting of the workers. This is crucial, since it guarantees actual worker control. These were very rare throughout the post-communist world, and were mostly prohibited in practice in Russia.

(5) Foreign Direct Investment (FDI), which is usually the outcome of fair auctions, but can also be accomplished in other ways. Some states express formal or informal preference for FDI (e.g. Estonia, where FDI was sought to counterbalance Russian domination and a way to establish the long desired links with the West). FDI can be attracted via closed tender, where the process is not transparent but negotiated between the government and foreign buyer behind closed doors. Apart from Estonia, FDI is the dominant method of privatisation in Hungary, and other CEE countries. FDI can also take the form of joint ventures, often with state owned enterprises (this is very common in contemporary China).

(6) Cross-ownership, which allows firms to purchase the shares of other firms, which in turn purchase the shares of their new owners. The result is a system of cross-institutional ownership where a group of firms own themselves, which in essence means that the management of these firms control them from outside owners. This type of privatisation was most notably used, for example, in the Czech Republic.

(7) Privatisation via greenfield investment is used to postpone the dismantling of state ownership in order to create conditions conducive to the formation of new enterprises and the exit of inefficient firms. This strategy is used to facilitate the natural growth of the private sector around the existing state sector. This type of privatisation was most notably used in China.

(8) Privatisation through vouchers or coupons, which are distributed to the citizens. Such vouchers, which have much greater value than their cost to the public, are designed to be used for purchasing enterprises during privatisation auctions. They can be used to directly purchase shares in firms, or invested in Investment Funds, which then use them to privatise firms. Russia is the most famous example of voucher privatisation.

(9) Restitution. Although very rarely used, in some cases the legal title of some enterprises that had been nationalised by the Communist regime was returned to their original family of

ownership. In other instances, vouchers were given by the government as compensation to the owners of property that was nationalised earlier.

All countries combined various privatisation strategies. Mass Privatisation programs were mostly accomplished with a combination of voucher privatisation and MEBOs.

PRIVATISATION DEBATE

There are a number of arguments justifying privatisation. The most prevalent is that private enterprises are significantly more efficient than SOEs as political considerations rather than pure market calculation would lead to suboptimal allocation of resources. Furthermore, as SOEs enjoy continuous bailouts by the state, their performance does not affect the probability of their survival. Finally, it is believed that due to the lack of proper monitoring of SOEs operations, the level of corruption on such enterprises is usually very high, which furthermore affects their performance. While most economists have little doubt about the benefits of privatisation over state ownership, the opinion on how quickly state enterprises have to be privatised varies dramatically. Shock therapists push for rapid privatisation, to gain the benefits of private ownership as quickly as possible.

The gradualist approach to economic change advocates for very slow and incremental restructuring, often finding justifications in institutionalist or statist ideas (Burawoy and Krotov 1992; Murrell 1992). The main assumption of the gradualist stream is that when the institutional environment is underdeveloped, rapid reforms can be devastating for socio-economic development (Hamm, King and Stuckler 2012; Hamm, Stuckler and King 2010). Supporters of gradualism believe that reforms require a well-established institutional environment, including a functioning legal system, regulatory environment, and corresponding norms.

The opponents of gradualism support mass-privatisation, which was designed in the early 1990s by polish academics Janusz Lewandowski and Jan Szomburg, to address the problem of how to accommodate a need to privatise a massive amount of state enterprises in an environment where only a very limited number of investors had enough means and knowledge to privatise assets, while others were not able to borrow the necessary funds in underdeveloped capital markets (Estrin and Stone 1997). About 8,600 enterprises needed to be privatised in Poland, a staggering 215,000 enterprises were to be sold to private investors in Russia, while the whole post-communist space at that time almost completely lacked experienced investors, strong public institutions and a political mentality in which distribution of previously publically owned property would be encouraged (Lewandowski 1997). Complicating matters, most of these enterprises would be uncompetitive and incapable of independent functioning in the free markets if they were not significantly restructured (Lieberman et al. 1995b).

The Western economists and International Financial Institutions that advised transition governments prioritized speed. They felt there was not enough foreign direct investment to accomplish privatisation in a short time frame, and they mistrusted ESOPs because they believed workers would prioritize their jobs over enterprise restructuring. Thus, they advocated “mass privatisation”. As defined by World Bank:

> Mass privatisation is a process in which a substantial portion of an economy's public assets is quickly transferred to a large, diverse group of private buyers. It involves bundling or grouping firms to be privatised, as opposed to the "classical" or case-by-case approach taken in the OECD countries and widely emulated in many developing countries in Latin America and Asia and in Hungary. Mass privatisation usually involves the distribution of shares of state enterprises to the public, either for free or for a minimal charge, generally through a voucher allocation scheme. (Lieberman et al. 1995a: 3)

Mass-privatisation usually entails a combination of different methods of privatisation (such as sales of assets; capital dilution; management and employee buy-outs; management contracts or service contracts) with a free distribution of shares to the general population (Berg & Berg, 1997). In practice mass-privatisation programs heavily relied on voucher-based privatisation combined mostly with MEBOs.

The economic justifications for mass-privatisation were based on the superiority of private property to state ownership. (King 2003a) . Behind the general efficiency enhancement arguments generally put forward in favour of privatisation there were some arguments particularly pertaining to rapid mass privatisation. The most important task involved in transition was to abandon state ownership and to curtail the influence of firm managers on the budgetary process. This was not only seen as necessary because it led to efficient market-based firms but also because it allowed monetary stabilisation. State owned firms were seen as carriers of hidden unemployment and inefficient production financed through state subsidies, leading to budgetary deficit and to inflation – firms thus had to be "depoliticised" (Boycko et al. 1993) . Advocates of shock therapy via mass privatisation were aware that property rights, regulations and a functioning state is necessary for a successful market economy, and knew that privatisation in itself did not lead to the creation of such institutions, but believed that the newly emerging private owners of mass privatised companies will represent a political opposition against anti-reform coalitions and would successfully lobby for the creation of the necessary institutions *after* privatisation (Shleifer and Vishny 1998) . While mass privatisation advocates recognized that the owners of vouchers would have no capital to add to the firm, this wasn't seen as a fatal flaw, since "[u]sing the resources at hand more effectively has historically been far more important quantitatively than capital formation" (Blanchard et al. 1993: 81) . The liberalisation of the economy would provide the market forces to reallocate this capital more efficiently: "the rapid emergence of markets for goods, labour and capital [would create] an appropriate environment for the massive reallocation necessary for a fundamental transformation of the economy" (Lipton and Sachs 1990: 111).

"Gradualists" cautioned against Mass Privatisation. Gradual privatisation makes it easier to experiment with economic policies "on the go" and makes it more likely that potential failures are corrected duly and comprehensively (Roland 1994). Mass privatisation in contrast might make it very costly to correct failures or to restructure policies ones a significant proportion of the economy has been privatised. A gradual privatisation of state owned enterprises also allows restructuring before sales and thus makes enterprise success more likely and also leads to more revenue for the government. A slower privatisation process with less enterprise failure makes it also less likely that voters will revolt against privatisation and will raise and maintain the legitimacy of transition (Dewatripont and Roland 1992). Even some neoliberals were worried about the type of owners that would be created by Mass Privatisation. Obviously, voucher holders and firm-insiders possessed no capital to invest in companies and no new skills to help restructure the companies. As the remainder of the chapter will show, János Kornai, a vocal advocate of gradualism, seems to be justified to argue ten years after *The Road to a Free Economy* (Kornai 1990) that he was right in suggesting a more careful ownership reform. Kornai compares Hungary and Poland with the Czech Republic and Russia and highlights that gradual sales of state owned enterprises is the best way to privatise existing assets, mass privatisation is less effective and can even be harmful (Kornai 2000).

While the economic arguments in favour of mass privatisation were always invoked, the most important justification was political. It was believed that the early years of transition constituted an "exceptional period" when the population would be willing to make sacrifices in order to transform the economy. If this window of opportunity was not seized, it could be expected that immediate short-term interest would reassert itself, and those that stood to lose from privatisation, specifically managers and employees who enjoyed guaranteed employment in state owned enterprises, would form a political coalition to block reform. So, while neoliberals generally acknowledged that Mass Privatisation was not the best way to privatise from an economic standpoint, they believed it was absolutely essential for political reasons. Failure to implement Mass Privatisation, in this view, meant that large-scale privatisation would not be accomplished, resulting in "market socialism" that was bound to fail due to an inadequate incentive structure. They argued that not only was mass privatisation the best way to privatise very quickly, but by distributing shares to the population, it would give everyone a tangible and short-term objective interest in wide-scale privatisation (King 2007; Lieberman et al. 1995a).

MASS PRIVATISATISERS

Significant mass privatisation programs were implemented in approximately half of the transition countries (see Table 1). In Poland mass privatisation was proposed but only implemented in 1996 and concerned a limited number of medium sized enterprises (Berg and Berg 1997) . The designers of the Polish mass privatisation program were afraid of the possible negative governance repercussions of dispersed ownership and have thus relied on investment funds to act as mutual funds owning much of the shares in privatised companies. These investment funds were managed by private fund managers, often with the involvement of foreign advisers. Similar to the Russian mass privatisation program, each Polish citizen was allowed to purchase a voucher for a nominal fee. However, this voucher represented a share in the investment funds not direct ownership in the companies themselves.

Table 1: Extent of Mass Privatization by Country

Country	Mass privatisation scheme
Albania	Never implemented
Armenia	75% medium and large enterprises
Azerbaijan	Less than 10% of firms by assets
Belarus	Never implemented

Bulgaria	Never implemented
Croatia	Small program (225,000 people) in residual state holdings, 15% of enterprises
Czech Republic	33% of assets of all firms
Estonia	Never implemented
Georgia	50% of medium and large enterprises
Hungary	Never implemented
Kazakhstan	60% of large enterprises
Kyrgyz Rep	50% of medium and large enterprises
Latvia	About 40% of large or medium enterprises
Lithuania About	45% of all enterprise assets
Macedonia	Never implemented
Moldova	40-50% of assets
Poland	About 10% of assets, restricted to small and medium enterprises
Romania	About 38% of medium and large enterprises
Russia	More than 80% of the industrial workforce
Slovakia	About 10-15% (all while part of Czechoslovakia)
Slovenia	Never implemented
Tajikistan	Never implemented
Turkmenistan	Never implemented
Ukraine	About 44% of medium and large enterprises
Uzbekistan	Never implemented

Source: Hamm, King and Stuckler (2012), Table C1, online supplement. Estimations based on all years of EBRD Transition Report. Mass privatisation = privatisation by vouchers alone or in combination with management and employee buyouts.

The Czech approach to mass privatisation also rested on the idea of distributing property widely with the use of vouchers at nominal prices (see Shafik 1995). In 1992 all adult citizens were allowed to buy a voucher booklet for a very low price and purchase shares in up to 10 companies with these vouchers. The Czech approach represented a mixture of the Russian and Polish strategy. Citizens could either buy a share in the newly established 429 investment funds or could directly acquire ownership in state companies. The investment funds were owned by banks and insurance companies. In terms of the speed of the process it was less quick than expected though still fairly rapid. The entire cycle of mass privatisation involving project preparation, public information, and bidding for almost 1,500 enterprises lasted for 14 months. As a result, 70 per cent of the shares of privatised enterprises went to the investment funds and thus resulted in corporate structure the resembled German and Japan system of capitalism with a strong position of banks. However, banks were also slow in restructuring firms (Brada 1996) , and the ensuing Czech financial crisis gave the Czech transition a new direction mainly relying on FDI.

The most known example of mass privatisation is that of Russia (for a full description see for example Boycko et al. 1993) . The Russian mass privatisation program started in 1993 and ended in July 1994, involving 100,000 medium and large companies. As a first step firms were divided into those that could be sold for cash by local governments and those that would go into the mass privatisation scheme. Small shops and smaller enterprises were allocated to the local governments and represented a major source of revenue for them. As a second step, larger firms were divided into further subcategories: a) subject to mandatory privatisation, b) subject to privatisation with the permission of the privatisation ministry, c) those requiring government approval for privatisation, and d) privatisation prohibited. Firms in the natural resources sector and the defence industry could only be privatised with government approval. Additionally, all medium and large companies were corporatised, or registered as joint stock companies with shares owned by the government.

The Russian privatisation program entailed elements to favour managers, but the majority of shares were sold through vouchers. Every Russian citizen born before 2 September 1992 was offered a voucher denominated at the value of 10,000 Rubles. These vouchers could be traded and were the only means allowed to be used in auctions for shares in the companies. As vouchers were tradable investors could acquire blocks of vouchers and bid for a larger chunk of shares. Managers were allowed to buy additional shares cheaply in voucher auctions or in the aftermarket from employees. Because major shareholders were not imposed on the privatisation process managers initially gained de facto control over enterprises.

Though no official statistical data are available on the degree of participation of managers in the privatisation process, some sources demonstrate that about 75 per cent of enterprises were factually owned by their general directors and the top managers (Appel 1997). Workers were largely passive, lacked the understanding of their rights and hence were almost not represented in companies' boards. Various studies in Russia show that about 30 per cent of voucher recipients have sold their vouchers and another 30 per cent have exchanged their vouchers for shares in voucher funds, while only 10 per cent of privatised enterprises allowed open access to shares (Berg & Berg, 1997). All in all the Russian mass-privatisation program managed to privatise nearly 16,000 state-owned enterprises, employing about half the industrial labour force, in less than two years (Brada 1996). However, the emerging new ownership structure with dispersed owners and strong control of insiders has had several detrimental consequences for the economy as will be discussed in the next section.

SYNTHESIS OF EXISTING RESEARCH

The preponderance of research indicates that mass privatisation was a disaster. The resulting increase in unemployment was not associated with greater efficiency but rather with firm failure, again leading to elevated levels of stress among former and current employees, as well as those indirectly dependent on the firms. Even worse consequences, in terms of alcohol consumption and stress-related mortality, flow from these more chaotic changes. Even if mass privatisation had worked as intended by those advocating it, the programme would have led to increased unemployment and consequences for health. The fact that it failed simply exacerbated these consequences (Stuckler, King and McKee 2012b). The existing research notably concentrates on the economic, political and social outcomes of privatisation. The following section is going to provide a summary of the existing qualitative and quantitative research in the area.

The economy

The majority of empirical findings conclude that mass privatisation had dramatic negative effects on the economy of countries in transition. Mass privatisation has directly impacted corporate governance and had several indirect effects on state capacity and macroeconomic performance.

Perhaps the most notable exception to the generally negative findings about mass privatisation is a quantitative study by Bennett et al. (2004). Using dynamic panel data techniques to analyse the impact of differences in privatisation methods on economic growth in transition economies and to examine the effects of the private sector, capital markets and the methods of privatisation, Bennett et al. (2004) use observations for 23 countries in transition over a period of 10 years (1990-2001). They find that mass privatisation was the only privatisation method to have had a significant positive effect on growth. The authors hypothesize that mass privatisation had beneficial effects on demand, as the recipients of shares might have felt richer, and that mass privatisation also might have boosted the development of capital markets. Bennett et al. conclude that full privatisation (selling a company for outsiders for a positive price) was less beneficial for growth in the transition countries suggesting that “mass privatisation may be the appropriate choice” for countries that have still to undertake large-scale privatisation.

However, Bennett et al. point out that the positive effect of mass privatisation is particularly robust for the CIS countries after 1995, acknowledging that it might be correlated with the generally improving demand in those countries between 1996 and 2001. They try to control for the demand effect by including the price of oil and exchange rate but they do not control for period effects (either with a dummy variable for each year, or a time-trend), which would have fully captured this effect. The authors find that the price of oil and the exchange rate had a significant positive effect on growth with the effect of mass privatisation remaining positive as well, but these variables do not cover the improving economic situation throughout the region as the great recession that accompanied the transition ended in most countries. Another problem with the study is that they failed to consistently take into account the size of Mass Privatization programs, thereby distorting their results. They coded the worse than average performing Latvia, Kazahkstan, and Romania as non-mass privatisers, in spite of that fact that about 40% of large or medium enterprises were subject to a mass privatisation programme in these countries. Similarly, they coded the above average performer and oil rich Azerbaijan as a Mass Privatizer, despite their program only covering less than 10% of state assets. It is thus likely that due to miscoding of cases and failing to include the generally improving demand from Russia and other countries after 1995 skewed their results in favour of mass privatisation.

The majority of empirical studies find that mass privatisation turns out to be significantly less effective than gradual privatisation (Estrin et al. 2009). Qualitative studies in general emphasize that the experience of voucher privatisation in most countries has been poor (Megginson and Netter 2001: 345). Mass privatisation programs, by design, led to greatly dispersed firm ownership (Ellerman 2001) which in turn was fundamentally mismatched with the existing civil law system (Coffee 1999). The new owners had only limited incentive to monitor firms, and more importantly, lacked the capacity to exercise control over managers and employees. Therefore, the initial result of Mass Privatisation was insider control by mangers. However, the shares of workers were quickly centralized by firm insiders and politically connected outsiders.

In a qualitative study, McDermott (2002) researches political and economic networks and their transformation in the Czech Republic. He pays special attention to “political embeddedness” - a process of intertwined political and economic changes, which plays a pivotal role in economic transitions. The state, argues McDermott, is crucial in the process of restructuring as an agent who is responsible for mediation and communication among privatisers. Thus, the role of the state has to be transformed to facilitate better negotiations among the privatising agents. Empirically, McDermott demonstrates that in the case of Czech privatisation, new owners had only limited incentive to monitor their firms, and more importantly, lacked the capacity to exercise control over managers and employees. This greatly complicated corporate governance, causing assets to go unutilized because of the ambiguous ownership situation. This discouraged foreigners from investing.

In another qualitative study, Kogut and Spicer (2002) conduct a comparative analysis of market formation in Russia and the Czech Republic. They demonstrate that mass privatisation led to a situation in which shareholders were so poorly informed about the basics of private property relations that they were incapable of navigating in the economic environment,, which did not facilitate effective sales of the shares. As a result, this stimulated the development of a black market for sales of shares, which was devastating for the newly created financial markets. Moreover, as democratic and transparent institutions were absent from the newly independent countries, markets, instead of facilitating economic restructuring,, became battlefields of economic and political games. Just like McDermott, Kogut and Spicer find out that a mere withdrawal of the state from the economy does not guarantee the creation of successful market institutions. Moreover, the authors emphasize the failure of the state to engage the broader population in privatisation processes.

What Kogut and Spicer find is not surprising because the institutions that protect shareholder rights and contribute to creation of markets in advanced capitalist systems (e.g. regulators and regulatory agencies, an independent business press, credit rating agencies) were not yet established in the post-socialist states (Hall and Soskice 2001). Mass privatisation creates its own corporate governance problems and thus can exaggerate the problem of rent seeking (Stephen and Backhaus 2003). Due to the impact mass privatisation has on corporate governance and ownership structure, companies with residual state ownership were outperforming fully mass privatised companies, because the government had both the incentives and the resources to restructure firms that it owned partially, while insider owners and dispersed outsiders were either not focused on efficiency or lacked the ability to influence the enterprises (Anderson, Lee and Murrell 2000).

In another qualitative study, King (2003b) conducts case studies in 25 Russian firms from various industrial sectors. The overwhelming impact of mass privatisation in these cases meant that state resources were withdrawn, while the new “owners” provided no new capital or expertise. Similarly to the qualitative study by Kogut and Spicer, King finds that the rapid shift to private property is not enough for successful transitions as the new owners of private firms lack resources and knowledge for successful restructuring of their companies. Cut off from state resources, but without any capital to carry out desperately needed restructuring, and without the injection of new managerial talent, many firms found themselves in untenable positions. Owners, managers, and workers, unable to work cooperatively to better their common cause, pursued short-term, self-serving strategies to accumulate wealth and survive the transition. Most firms were only able to survive by lowering their technological level of production and retreating from the capitalist economy into nonmarket activity like barter and debt swaps. King finds that only enterprises in the raw-materials sector and enterprises that produce simple goods with “natural protection” were able to restructure successfully. King argues that mass privatisation did not lead to an emergence of a lively private sector, which would be able to benefit from the resources of the newly privatised enterprises. This, in turn, meant that because of the general economic collapse, combined with the deterioration of infrastructure, the lack of credit, and the inability of the state to provide a crime-free environment, the Russian economy could not attract much FDI or create conditions for the emergence of an adequate amount of new small and medium-sized enterprises that could lead to further economic development in the country.

Quantitative studies of mass-privatisation, in turn, corroborate the findings of qualitative investigations. Researching the growth effect of mass privatisation Hamm, King and Stuckler (2012) use a multilevel methodological approach and combine both country- and enterprise-level data. On the country-level, they use time-series and cross-sectional models with data on the social, economic and political development in 25 transforming states over the period of 10 years. On the enterprise-level, they use the World Bank/EBRD Business Environment and Enterprise Performance Survey, which covers 4,106 enterprises in 26 post-socialist states. In their time series models Hamm et al. demonstrate that countries that implemented a mass privatisation program, on average, experienced about 16 per cent less growth in GDP per capita (PPP) during the period from 1990 to 2000. In their cross-sectional models, in countries that adopted mass privatisation programs, *ceteris paribus*, the percentage of firms reporting insecure property rights and contract enforcement was about 27 per cent higher than in countries, which did not implement such programs. Firms in these countries were also substantially more likely to report government inefficiency and pervasive unofficial payments. Countries that implemented a mass privatisation program were thus more likely to experience a significant decline in government effectiveness. Comparing domestic firms privatised in countries with significant Mass Privatization programs with domestic firms privatised in countries with other privatisation strategies, they find that firms in the former group were far more likely than the other firms to engage in barter, have tax arrears, decrease employment, decrease sales, decrease investment, not develop new products and fail to upgrade the production process.

In a quantitative study, Godoy and Stiglitz (2006) try to understand whether the speed of privatisation, initial structural and economic conditions or the presence of certain institutions can predict successful transitions and the consequent economic growth in the post-socialist countries. The authors analyze the growth rate in 23 countries for a period of 10 years. They find that the speed of privatisation has a negative effect on growth, while institutional capacity has a significant positive effect on the outcomes of transitions. The form on privatisation, as a result, almost always affects the outcome of economic transitions.

The state

There are several studies linking mass privatisation to economic outcomes, with a general consensus emerging about the vital role of sound institutions in creating a positive linkage between privatisation and development. However, the impact of privatisation on institutions and state capacity is much less analysed, though the relationship seems to be important and manifold (Hamm, King and Stuckler 2012).

While it is widely recognized that the Communist state propped up many poorly performing enterprises, it is often forgotten that it funded itself from the profits of those enterprises that performed well. Privatization severed this funding mechanism before a corporate or income tax system was up and running. To the extent that Mass Privatization programs made possible the extremely rapid privatization of the economy, this mechanism for extracting resources was quickly severed. Since Mass Privatisation lead to enterprise failure, retreat to non-monetary transactions and tax arrears, and technological down-grading there was much less surplus to tax anyway. This leads to a failing state, that is unable to provide necessary support for the enterprises sector. King (2003b) reports that Russian firms suffered from the collapse of state training of skilled employees and support for research and development. This led to a vicious circle of declining state capacity and enterprise failure. In the time-series analysis conducted by Hamm et al (2012), government spending in countries that had large Mass Privatization programs was more than 20% lower than in other countries.

The fiscal crisis also resulted in the state not being able to pay appropriate wages to public sector employees, who because of the economic hardships became particularly susceptible to corruption. Rather than being bureaucratic, the state became riddled with clientilistic relationship between state office holders and businessmen, which created even more formidable obstacles for entrepreneurs with no social capital (Reddaway and Glinski 2001). In other words, bureaucratic structures were dominated by “patrimonial capitalism” (King and Szelényi 2005). Success in the new economic system was determined not by performance, but rather, by the intensity of political connections and the ability to exercise lobbying power. T he state in the newly independent Russia was no longer in control over violence, which resulted in the level of crime doubling over the course of a couple of years, making Russia one of the most criminal countries in the world (Popov 2004).

Demographics

Mass privatisation, resulting in profound effects on the economy and the state capacity, also imposed severe human costs by damaging the health and longevity of the population affected by the consequences of market transitions. The impact of mass privatisation on health was the most devastating in Russia. Mismanaged capitalist transitions aggravated by a plethora of problems that a country as big and as diverse as Russia inherited from its

Communist past resulted in poverty, insecurity, anxiety and despair, which, in turn led to an unprecedented mortality crisis (Anderson and Silver 1989; Chen, Wittgenstein and McKeon 1996; Dutton 1979; Okolski 1993) . Between 1990 and 1995, an estimated 7 million premature deaths was registered in the post-Soviet space, while in Russia alone, the increase in mortality in the 1990s accounted for 4 million extra deaths (Men, Brennan and Boffetta 2003). Whereas the most dramatic fall in life expectancy was observed especially in the beginning of the transitions, the trend continued rising throughout the first half of the 1990s, with the majority of deaths accounting for cardiovascular and external causes (Cornia and Paniccia 2004) . The mortality crisis disproportionately hit Russia's working age male population.

The main reason for the sharp increase in male mortality was rising alcohol consumption (Anderson and Silver 1989; Bobak et al. 2003; Dutton 1979; Okolski 1993) . The loss of socio-economic status following unemployment produced severe distress, associated with increased drinking (Chen, Wittgenstein and McKeon 1996) . Thus, by 2004, 70 per cent of men and 47 per cent of women in Russia were drinkers (Atun 2005); while 30 per cent of the overall male population drunk heavily (Parfitt 2006) . Besides, its direct negative health effects, excessive drinking exacerbates many other unrelated health concerns which used to be controlled by the public healthcare system prior to the transitions (Coker 2001).

Research strongly suggests that unemployment, job insecurity and the associated stress through alcohol abuse link mass privatisation and mortality (Perlman and Bobak 2009; Stuckler, King and McKee 2009a); In an article using cross-national time-series data published in *The Lancet* Stuckler et al. 2009 find a strong link between mass privatisation and adult working age mortality. However, they found that that unemployment was not the only factor leading to mortality. Indeed, there are many potential mechanisms linking Mass Privatization and mortality, as illustrated in Table 2.

Table 2: Possible Mechanisms Linking Mass Privatization and Mortality

Mass Privatization → Unemployment → Stress → Mortality

Mass Privatization → Loss of firm provided medical care → Mortality

Mass Privatization → Loss of firm provided social consumption → Stress → Mortality

Mass Privatization → Firm failure → Economic decline → Stress → Mortality

Mass Privatization → Fiscal crisis/state failure → Less health spending → Stress → Mortality

Mass Privatization → Fiscal crisis/state failure → Increased violence → Mortality

Mass Privatization → Inequality → Status loss → Mortality

State owned enterprises under Communism provided all sorts of social consumption goods, like health care, homes, education opportunities, vacations, and childcare. Newly privatized companies discontinued these services, which in theory would be transferred to local governments. However, most local states faced severe budgetary crises, and could not provide these goods. As a result, Mass Privatization lead to a curtailment of the provision of social consumption, greatly increasing stress and reducing access to medical care. To the extent that Mass Privatization contributed to firm failure and state failure, it also could impact on mortality. Finally, mass privatisation stimulated the increase in absolute and relative inequality, which in turn, through status loss and the stress of not feeling in control of one's life, led to deteriorating health and increasing mortality (Marmot 2004).

King et al. (2009b) use cross-national panel regression to test the mechanisms underlying the observed relationship between mass privatization and mortality. They find that Mass Privatistaion was associated with significant declines in life expectancy, as well as greater alcohol-related deaths, heard disease, and suicide rates. They also found that Mass Privatization was associated with declining health resources, but did not find robust evidence linking these declining resources with decreased life expectancy. Therefore, they conclude that the most important pathway linking Mass Privatization to mortality involve elevated psycho-social stress, caused by both unemployment as well as other mechanisms.

The study by Stuckler et al. published in *The Lancet* attracted a high level of academic and policy attention (see for example, Earl and Gelsbach 2010; Gerry, Mickiewicz and Nikoloski 2010; Sachs 2009) . The critics of the Stuckler et al. study argued that an ecological fallacy might be the case and suggested that alternative econometric specifications would lead to different findings. This provoked a debate on methods which we do not have space to outline here (see for example, Stuckler, King and McKee 2012a; Stuckler, King and McKee 2009b; Stuckler, King and McKee 2012c).

Earl and Gelsbach (2010), on the basis of analysis using other non-publicly available enterprise-level data, that they were not able to prove the link between privatisation and mortality. Furthermore, they claimed that there was no link between privatization and unemployment. Some other notable exceptions in the literature argue that privatisation is found to have beneficial effects on health (e.g. Egan et al. 2007; Galiani, Gertler and Schargrodsky 2005) . Yet, these studies have excluded the former socialist countries from their analysis and have not considered how the transfer of enterprise ownership to the private sector takes place, whether via cash/voucher schemes, auctions, or give-aways to firm insiders. Indeed, the consequences of mass privatisation for public health appear to be massive and are yet remarkable under-researched.

Clearly, the discussion of health outcomes of privatisation is crucial for academics and policy-makers across the world, yet it cannot progress with only the data currently available for analysis. In particular, meso- and micro-level data would be crucial for further investigation of both direct and indirect effects of privatisation and the structural changes caused by it on the health of the population.

ALTERNATIVES TO MASS PRIVATISATION

If mass privatisation turned out to be a socio-economic disaster, what other types of economic restructuring could have been used in Eastern Europe as an alternative? While the absence of a sufficient class of domestic played the lead role in the political decision to implement mass privatisation, several economists participating in the early design of privatisation policies (Bolton and Roland 1992; Ellerman 2001) , point out that rapid privatisation could have been implemented by relying on ESOPs, where the new owners would lease the enterprises with the aim of ownership. Thus the government would privatise by selling assets in exchange for debt claims thus transforming the government into a creditor. This option would have left the state with a planned stream of revenues. Compared to mass privatisation, ESOP had major governance advantages that stem from the fact that they fully internalise principle-agent externalities. That is, workers and managers would be able to police opportunistic behaviour, since one tends not to steal from oneself. This should also lead to health benefits because increased control should decrease stress. One can also expect a bias against firing workers, and thus decreasing unemployment, which will decrease population level stress and thus stress-related diseases. This strategy, while capable of privatising enterprises as quickly as mass privatisation programs, was actively discouraged by International Financial Institutions and neoliberal governments (Ellerman 2003: 21-22).

Moreover, the historical record indicates that the need for rapid privatisation to safeguard the transition was misplaced. Countries that privatised slowly, like Poland and Slovenia, did not revert to central planning, and did not become stuck in “market socialism.” The political analysis on which mass privatisation was based has been falsified. This means that there were many alternatives to mass privatisation, including following the Chinese path of “growing out of the plan” – creating the conditions for the emergence of new enterprises and a domestic capitalist class, and privatising via competitive auctions after firm restructuring.

CONCLUSION

The challenge of transition to capitalism was mistakenly perceived by radical reformers as a simple task of freeing market forces and privatising enterprises. Though it quickly turned out that initial conditions and path dependence matter much more than expected by economics text book recipes (Smyth 1998), the idea of a quick designer capitalism leading to a singular endpoint through the whole post-socialist world was pervasive during the early years of transition. Within the shock therapy reform package rapid property restructuring was central.

Mass privatisation not only had a profound effect on the economy, but also on institutions and state capacity, creating a vicious circle of market failure and state collapse (King 2003). As (Popov 2004) argues, the three crucial monopolies of the state (legitimate use of violence, the provision of revenues by collecting taxes and on the control of monetary emission) were undermined during the 1990s to such an extent that the very existence of the state was put into question. The collapse of the state contributed to the emergence of a patrimonial capitalism widely differing from the type of capitalism envisioned by the designers of shock therapy. The failure of the state and the collapse of the economic system both in turn led to a demographic disaster. Thus, in short, Mass Privatisation was quite possibly the worst possible type of privatisation - with the only competition being the infamous "loans-for-shares" program in Russia, which was limited to raw materials.

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