Property Rights in Context: Privatization's Legacy for Corporate Legality in Poland and Russia

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In the first decade after the collapse of Communism, Russia became notorious for conflicts around corporate property and corporate governance. In Poland, such conflicts were far less frequent. This distinction, I argue, reflects the form of privatization in each country. In Poland, negotiation among potential shareholders and current enterprise stakeholders preceded privatization, whereas in Russia privatization procedures pitted these same groups against one another. The legacy of privatization in Russia expressed itself in long-running legal conflicts over the security of property rights. These developments highlight the importance of situational incentives to challenge or respect property rights, undermining various new-institutionalist arguments that link security of property rights primarily to the commitment and capacity of state bodies to enforce them, to the normative legitimacy of the law, or to coordination equilibria in a game-theoretic framework. The argument also enables a clarification of the political trajectory now leading to stronger corporate property rights in Russia.

More than a decade after the collapse of state socialism in the East Bloc, the region displays many striking and intriguing contrasts in national trajectories. This article focuses on one such contrast: the remarkable distinctions between Poland and Russia in the area of corporate governance. In the 1990s, Russia's corporate governance became notoriously conflictual. In any number of privatized firms, management refused to share power and profits with shareholders, sometimes via flouting the law, at other times by simply manipulating it. Legal experts asked "What went wrong?" and sought "corporate governance lessons from Russian enterprise fiascoes" (Black, Kraakman, and Tarassova 2000; Fox and Heller 2000). The state of corporate legality in Poland, by contrast, drew far more flatter-

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ing academic depictions.[1] Practitioners shared academics' impressions: surveys by the European Bank of Reconstruction and Development (EBRD), as well as other systematic cross-country comparisons, generally rated Poland far above Russia in terms of the effectiveness of its commercial and corporate law (Pistor, Raiser, and Gelfer 2000).

The enormous, almost laughable gap in what constituted major corporate governance scandals in each country is a telling indicator of the same divergence. In Poland, one large firm set off a firestorm of investor criticism for failing to disclose that it had given another firm an option to buy shares in an attractive telecom asset at a low price (Piotrowicz 1998). A firm in which this was the most serious governance problem would have been a paragon of good corporate behavior in the Russian market of the 1990s. For many Russian outside shareholders, discussing the quality of disclosure would have been a luxury; they were more concerned with whether or not they would in fact be allowed to attend shareholders' meetings (Black, Kraakman, and Tarassova 2000, 1771; Sprenger 2000).

These contrasts, I argue below, resulted from the way in which privatization structured relations among shareholders and between shareholders and stakeholders in privatized firms (i.e., among and between managers, employees, suppliers, and customers).[2] In Russia, privatization was carried out in a way that strongly discouraged negotiation both among stakeholders in state enterprises and among potential shareholders of the corporations created from them. Division of property thus became a zero-sum game, with large rewards for displacing other claimants. These large rewards led to frequent contestation of the property rights granted by corporate shares. In Poland, by contrast, privatization and the transition to corporate form generally could occur only after potential shareholders and stakeholders had reached a bargained agreement. The allocation of property rights was part and parcel of a larger accommodation about the future of the firm—a positive-sum game, and one in which contesting property rights would risk the gains from cooperation.[3] Thus, the form of privatization in Poland ensured that those in a position to challenge shareholders' property rights were embedded in relationships that encouraged them not to do so.[4] In Russia, the form of privatization made such accommodations impossible, and set the stage for intense and long-running struggles over property rights.[5]

Thus, this article argues, the empirical puzzle of contrasting corporate governance experiences in Poland and Russia finds its answer in how privatization shaped the environment in which property rights would be exercised. The theoretical significance of this argument is the evidence it provides for an "economic sociology of law" (ESOL) approach to the legal grounding of property rights. As Richard Swedberg notes, "From a sociological perspective it is . . . obvious that many factors other than the law determine why people engage in the behavior prescribed by the law. The extent to which it is the law, rather than some other factor that determines the behavior in question, has therefore to be decided in each particular case" (Swedberg 2003: 8). The ESOL approach resonates with several other schools of thought that likewise direct attention to the interests, resources, and options that affect actors' decisions to invoke, obey, or manipulate law. Thus one might also term this an "old institutional economics," "legal realist," or "critical legal studies" approach to law.[6] Scholars in these traditions recognize that law operates on a particular set of legal facts (e.g., who owns what) and in a social context (what other relations, options, and interests owners have) (Commons 1957: 65–7). For instance, the attitude of managers toward shareholders' rights will depend not only on the laws governing these rights, but also on the legal facts of stock ownership and such sociological factors as the firm's intended source of capital and with whom the firm needs to cooperate (Rapaczynski 1996).[7] These points about the importance of context enable a thoroughgoing challenge to various new-institutionalist arguments that link security of property rights primarily to the commitment and capacity of state bodies to enforce them, to the normative legitimacy of the law, or to coordination equilibria in a game-theoretic framework. The ESOL argument also enables a clarification of the politics of corporate property rights that strengthens the case made by historical institutionalists for an understanding of institutions as imperfectly self-contained processes unfolding over time (Thelen 1999: 383–4).

However, discussion of implications for politics and other institutionalist approaches will be postponed to the conclusion. The body of the paper first explicates on a general level how the intersection of legal facts, contextual factors, and laws on the books shapes the practical effects of law. I also argue that certain combinations of these factors are unstable even given powerful enforcement commitments, prompting evolution in legal facts or contextual factors. In the second section, I describe the privatization experiences in the two cases, arguing that unlike Poland's privatization, Russia's established an unsustainable combination of stock ownership patterns (legal facts), interests of and relations between shareholders (contextual facts), and corporate laws.

The third section demonstrates that this unsustainable combination promoted enormous dynamism and conflict in Russian corporate governance. The contentious use of "loopholes" designed to force the transfer of property rights and alter the legal facts had a central role in these conflicts. In Poland, by contrast, the persisting legacy of privatization created far less conflict, and corporate property transfers took the more familiar form of voluntary purchase and sale. I conclude by returning to the theoretical implications of these contrasting developments. In particular, I discuss how understanding the context of the legal facts of property changes one's view of the politics surrounding property rights.

Contextualizing Property Rights

Adopt good laws, and enforce them: such, in a nutshell, is the program of what has been termed the "new" law-and-development movement, which promotes the strengthening of legal institutions as a path to growth (Rose 1998).[8] This movement reprises arguments, dating at least to the eighteenth century, which link stability of property rights to investment and thence to growth. More recent support for this position comes from the huge literature in the new institutional economics, corporate governance, and related fields. Characteristic of this approach is an emphasis on enforcement. Enforcement should work to cow the shifty, and thereby embolden the thrifty, who invest and trade; unpunished malfeasance should have the opposite effects.[9] Thus, state capacity to ensure impartial and consistent enforcement of commercial law underpins the predictability that businesses need in order to invest and promote growth.

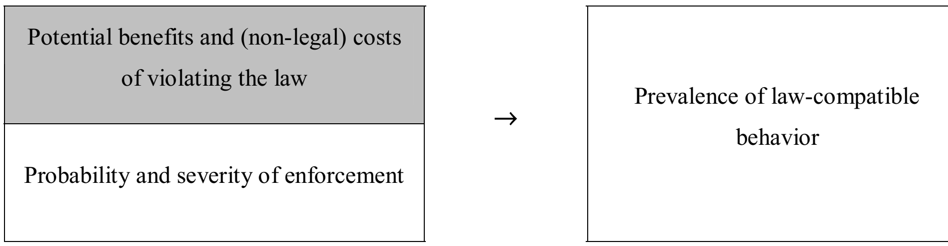
These arguments, I suggest in this section, may be logically impeccable, but they are sociologically naïve. The emphasis on enforcement obscures the crucial question of how hard the state has to work to ensure law-consistent action in the realm of property rights. Do people behave consistently with the laws securing property for reasons of their own, or is the threat of enforcement necessary? In discussions in many areas of legal policy, such as those surrounding drug prohibition, this question is manifestly central, and often posed. Yet it has had little impact on discussions of property rights. I argue that when property laws are flouted or subverted, a "weak state" is not necessarily implied; disregard for property laws may merely imply an effort to strike an unsustainable balance between legal facts, contextual factors, and the laws on the books.

The starting point for moving beyond an exclusive emphasis on enforcement is Wittgenstein's demonstration that any action is consistent with an arbitrarily large number of rules. For example, in stopping at a red light, I might be obeying any of the following rules: (1) always stop at red lights; (2) stop at red lights except when running late; (3) stop at red lights except on 1 January 2010; (4) stop at red lights when it would be dangerous not to; and so on and so forth (Kripke 1982). For social scientists, this argument contains an important lesson about the rules set out in law: actions consistent with a law need not be motivated by that law—by respect for its provisions or fear of those charged with enforcing it. For instance, when I choose to stop at a red light at a busy intersection, the desire to avoid a crash might loom larger in my considerations than the fear of a traffic fine. Just because I am acting consistently with a legal rule does not mean the law's authority and sanctions motivated my actions. Thus, one must distinguish the broad category of law-consistent action, motivated by anything whatsoever, from its subset, the narrower category of law-motivated action, motivated by the law's authority or sanctions.[10] I refer to the multiple possible motivations underlying law-abiding action as the potential embeddedness of law (Woodruff 2000: 442).[11]

The notion of the potential embeddedness of law relativizes the significance of enforcement capacity by emphasizing that fear of legal punishment is only one of the motives that can inspire behavior consistent with law. Many businesspeople refrain from illegal deceit, as a number of scholars have noted, because they desire to reap the rewards of a reputation for fair dealing.[12] More generally, there may be extra-legal costs that deter violations of the law. By the same token, the magnitude of the gains available through violating the law are an obvious motivation to violate it (Swedberg 2003: 8, 11),[13] whereas even a small chance of mild punishment might deter a violation that yields little benefit. This point is clear enough when one compares the prevalence of violation of two different laws in the same jurisdiction. That drivers will exceed the speed limit more readily than they will drive on the wrong side of the road does not primarily reflect the greater severity and probability of legal punishment for the latter. The concept of "state capacity to deter violation of the traffic laws," which superficially seems extremely specific, is actually too general to capture the reasons why people obey or violate particular traffic laws.

To speak of a general state capacity to enforce contracts and defend property, without considering the value and context of the rights the state is protecting, is just as senseless as speaking of a state capacity to deter violations of the traffic laws.

FIGURE 1



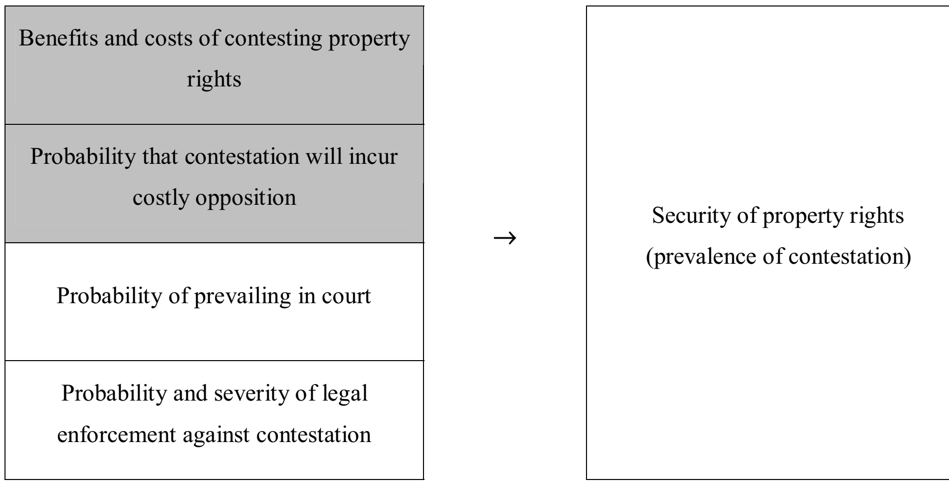
The argument about how situational incentives (potential costs and benefits of violating the law in some specific instance) contribute to law-compatible action is shown in the shaded cell of Figure 1. The unshaded cell shows the effect of enforcement considerations.

Traffic laws, however, are an imperfect metaphor for the laws securing property rights. Property rights are rights to invoke the state's backing to compel people to behave in certain ways (e.g., to pay debts, allow shareholders to participate in the governance of a corporation, etc.). It is possible to violate a traffic law while alone on a deserted road, but property rights are claims that people assert against one another. Thus, the relevant decision is whether to contest property rights claimed by someone else, either via litigation or simply by taking actions that negate these claimed rights. The chance of succeeding in such a contestation, through prevailing in court or simply by the opposing side conceding the rights in question, must be weighed against costs and benefits (see Figure 2).

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

Establishing that the security of claimed property rights (i.e., how broadly they are accepted) is a product of situational considerations still leaves open the question of how best to describe these situational considerations. As suggested earlier, these considerations are usefully divided into three parts: laws on the books, legal facts, and contextual factors. The latter two categories require some explication. By legal facts, I mean the set of facts that are relevant to the implementation of laws. For instance, while the law might state that contracts will be enforced, that any two particular parties had signed a contract with particular provisions would be a legal

FIGURE 2



fact. Contextual factors are those that shape the costs and benefits of accepting a given set of legal facts and their law-driven consequences in a particular context. These costs and benefits will have multiple sources. Some are purely sociological: what relationships will be hurt or helped by accepting or challenging particular claims of property rights (Granovetter 1985)? Some are transparently material: what are the costs of contesting claimed property rights, and what are the potential payoffs?[14] Others are determined by situational bargaining power: are there alternatives to remaining exposed to the power of others' property rights, and how attractive are these alternatives (Commons 1957: 65; Hale 1952; Kennedy 1993: 87)?[15]

A single legal provision can intersect with any number of configurations of legal facts and contextual factors. The law says debts must be repaid, but one creditor might take a harsh line with deadbeat debtors due to pressing obligations, whereas another will forbear in expectation of an economic upturn. To present an example more relevant to the concerns of this article, many analysts have argued that managers who themselves hold stock will be more respectful of shareholder property rights. In short, the observation that property rights are rarely challenged is not necessarily testimony to the authority of the law and the impartiality and power of its enforcers; it could also reflect a configuration of legal facts and contextual factors that make challenging property rights unattractive. By the same token, prevalent challenges to property rights do not necessarily reflect corrupt and ineffectual authorities defending illegitimate laws: *a priori*, there is no reason not to seek the explanation in a lack of property-supporting embedded relationships or in high payoffs to successfully contesting property rights. Indeed, as I will argue below, just these factors explained the conflicts surrounding Russian corporate governance over the last decade, as well as their dynamism.

An Implication: Paths of Change and Loci of Conflict

Before turning to the case material, it will be helpful to explore the implications of the argument that law-consistent action derives from a configuration of legal and situational factors for institutional change. When a table wobbles, one can stabilize it by making one leg longer or the other three shorter. Likewise, if a configuration of elements renders property rights unstable, there should be multiple paths to stability. Change in the laws and their enforcement is only one possible path—and for actors pursuing their advantage in local contexts, it is sometimes a rather distant one. This is especially so in a civil-law system like Russia's, in which courts have limited authority to extend or modify laws through precedents, making rules harder to change. By contrast, changes in legal facts or contextual factors do not require moving the massive machinery of the nation-state.[16]

Highlighting struggles over the definition of legal facts as a route to institutional change is one of the ways that an economic sociology of law improves on an enforcement-centered view of property rights. When actors pursue their interests through struggle over the definition of the legal facts, legal rules can become a factor of uncertainty rather than certainty because actors will canvass the massive body of the law, seeking rules that give the substantive changes in the legal facts they need, whatever the implicit or explicit reasoning behind the rule. A brief exposition of this argument, adapted from Karl Llewellyn (a central figure in legal realism), illustrates the kinds of frictions likely to arise when actors find powerful material or contextual reasons to challenge legal facts.[17]

Llewellyn argues that statutes implicitly or explicitly depict "situation-types" involving a specification of relevant actors and their motives.[18] In considering whether a given situation ought to be brought under a legal provision, judges weigh how adequately the provision depicts the motivations of the actors involved. When the motivations implied in legislation fail to match those in practice, judges often determine that applying the provision would be unjust. In Weberian terms, formal rationality gives an unwelcome substantive result; Llewellyn describes this as a violation of the "fireside equities," i.e., of the judge's intuition for what a fair decision would be (Llewellyn 1960: 274).

Llewellyn provides an example in his discussion of the abuse of legal remedies for failure of a shipment of goods to conform to specifications. In the situation-type (recall that this refers to relevant actors and their motivations for invoking a law), a buyer and a seller have agreed to a transaction in which the seller undertakes to deliver goods of a specified quality and the buyer agrees to pay a set price. The law makes provision for refusal of delivery so that buyers may be confident they will get what they pay for. However, courts have seen a number of cases in which buyers claimed that the delivered goods did not conform to specifications for a very different reason: the price of the goods in question had gone down. Thus, actors reacted to a change in contextual factors (the price of goods) by contesting legal facts (the quality of the goods).

Because the law offered no straightforward way to disallow non-acceptance of goods on such motivations, judges sought other, technical grounds to disallow them (in Llewellyn's phrasing, judges were "trump[ing] the sharper's ace" by invoking a legal rule irrelevant to their real concerns, just as the buyers were) (Llewellyn 1960:

123). Fireside equities were driving decisions; as one appeals-court judge noted, "it would seem at least possible that [the decisions in lower courts on such a case] were influenced not a little by their natural desire to prevent purchasers on a rapidly falling market from escaping from a bad bargain, by taking advantage of a variation from the terms for which they in fact cared nothing" (Llewellyn 1960: 123 n. 58).

This example illustrates nicely how, when applying a legal rule to a situation, one is also offering a depiction of the motivations of the parties that may or may not be accurate. When a rule is invoked for reasons other than the motivations implicitly or explicitly embodied in it, we may term the rule a "loophole" or "technicality." In the type of cases discussed above, buyers exploited non-conformance to the agreed terms as a loophole to avoid their agreed-upon obligations. Judges sought other loopholes to force buyers to uphold these obligations.[19] The search for loopholes undermines the predictability of laws. Because this search may conceivably involve a huge body of rules, it becomes difficult to predict which rules will be considered relevant.

Legal development does not necessarily get mired in an endless hunt for rules that adventitiously justify particular substantive outcomes in particular cases. When situations repeat, it is sometimes possible to find—or create—a single rule that consistently gives the desired substantive outcome in a situation-type, rather than in a single case. Llewellyn even asserts that situation-types generally imply some "immanent law" or "singing rule" with these features, a rule which talented judges can uncover (Llewellyn 1960: 122).[20] Such loophole-closing increases legal certainty by fitting rules to the circumstances in which they are invoked and producing substantive results that accord with most judges' sense of the fireside equities. As Stinchcombe's reading suggests, an indicator that legal certainty (or "reasonable regularity," the phrase Llewellyn prefers) has been achieved is that "hard cases" stop reaching the stage of appeals, because appeals are generated by precisely those cases in which the desire of judges for a substantive outcome must be supported by vulnerable legal reasoning (Stinchcombe 2001: 80, 95).

In the example considered above, Llewellyn does not say how (or whether) judges conceived of a rule that made it clear that buyers could not use nonconforming goods as an excuse to return to the market for a better price, but devising such a rule would have been the final stage in his process. Stinchcombe terms the process of forging rules that give substantively desirable results in classes of cases a "trajectory of improvement." The intellectual possibility for such a trajectory—leaving aside all practical matters—depends on the recognition that particular loopholes are being invoked on similar motivations in similar situations. Thus, stability in the workings of a legal rule depends on regularity in the sort of situation in which it is applied, including regularity in the motivations of the parties. *By itself*, a rule defining the basis upon which a buyer may reject a seller's shipment as unacceptable does not create predictability for the seller if the market situation determines how intensively the buyer will look for grounds for rejection or the kinds of remedies the buyer will seek. How much certainty the rule gives depends on how stable the market situation is and how well the law is able to recognize and sanction efforts to exploit a technicality for commercial advantage. In some circumstances, such as purchases of unique goods not available elsewhere, the rule's predictability might well be completely adequate.

Thus, this argument describing a trajectory of improvement reflects the ESOL approach by recognizing the interplay between legal facts and contextual factors in determining the significance and effectiveness of legal rules. The need for a trajectory of improvement stems from the fact that enforcement of rules uncovered in a search for loopholes and technicalities may decrease the predictability of law, and thereby the security of property rights. This apparently paradoxical conclusion illustrates how radically the ESOL approach differs from an enforcement-centered, state-capacity view. One cannot focus solely on the resources for law enforcement when actors are actively seeking to turn the law against itself. In other words, law cannot only be violated, it can also be made vague.[21] The Llewellyn-Stinchcombe argument thus provides a useful indicator for distinguishing between corporate governance conflict traceable primarily to weak enforcement and that stemming primarily from an unsustainable configuration of legal and contextual factors. In the latter case, much of the conflict should center around the use of loopholes, and development should take the form of not improvement in enforcement, but of modifications in rules. Below, I demonstrate that corporate governance practice in Russia possessed these features. First, however, I turn to the privatization policies that gave rise to them.

Privatization in Poland and Russia

If we accept the overwhelmingly shared impression that legal certainty of shareholder rights in Poland has been far greater than that in Russia, the forgoing arguments suggests that we look for an explanation in the different contexts in which shareholder property rights were exercised.[22] The privatization programs in Russia and Poland "embedded" the corporate law governing privatized enterprises differently, an outcome that reflects distinctions in how these programs reacted to the existing relational context of state-owned enterprises. The programs had different ways of addressing the interests of stakeholders—those in existing, ongoing relationships with the enterprises subject to privatization, for whom these relationships constituted a form of property or investment that they wished to preserve. In Poland, the dominant forms of privatization allowed stakeholders to achieve negotiated, locally appropriate recognition of their stakes as part of the privatization process. Importantly, these negotiations involved structuring the relational context in which the post-privatization property rights would operate.[23] Russia's privatization employed the shortcut of converting stakeholders to stockholders according to standardized procedures. The allocation of property rights to stakeholders thus was detached from discussion of the substantive character of their relations, and indeed promoted fragmentation of these relations.[24] At the same time, Russia's privatization offered outsiders a share of ownership in privatized enterprises, without providing for (indeed, discouraging) pre-privatization negotiation between outsiders and insiders. The upshot was an allocation of property rights carried out without a simultaneous restructuring of relational context. This disjuncture created, for reasons explained below, massive incentives to contest the legal events authorized by possession of corporate stock.

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

On the eve of privatization, it would have been difficult to predict that privatized enterprises would have such distinct relationships to the law in the two countries. In both Poland and Russia, crucial choices regarding the form of privatization were made in an extraordinarily difficult economic atmosphere in which the state appeared to have little real control over the enterprises it nominally owned. Reforms in the 1980s had destroyed what coherence the planned economy had attained, leading to a loss of both macroeconomic and microeconomic control mechanisms. The macroeconomic context involved roaring inflation, fed in part by a disorganized banking system in unsteady transition from its status as an organ of accounting and planning under the command economy. On the microeconomic level, in both countries, industrial enterprise insiders (workers and managers) had gained substantial autonomy from higher-level planning and management agencies. This autonomy was regularly used for what has been termed *nomenklatura,* or "spontaneous," privatization, in which state managers transferred assets and cash-flows to new legal entities. An effective summary of the situation is that the state "did not really own the assets it needed to privatize," and "various 'stakeholders,' including the managers, the employees, and the local governments, exercised substantial control over the allegedly public assets and could stop privatization if they wanted to" (Boycko, Shleifer, and Vishny 1995: 13).[25]

What differentiates the two cases is the reaction to these circumstances of macroeconomic and microeconomic disarray by the liberals in charge of economic policy at the transition's outset. Roughly speaking, Polish reformers focused more on the macroeconomy, and found themselves in a long political stalemate over privatization to restore microeconomic control. Privatization proceeded slowly, effectively on a case-by-case basis, with stakeholders granted a de facto veto over how privatization occurred. Veto rights were not property rights, however; reformers were not willing to "support preferential privatization to . . . inside groups associated with the Communist regime" (Orenstein 2001).

Russian reformers, quite aware of the Polish impasse on privatization, made the opposite choice.[26] When plans to privatize without insider preferences met political opposition, reformers created a program that would neutralize the resistance of stakeholders by turning them into stockholders. Even with outsiders excluded, they argued, stockholders would have an interest in maximizing the value of their property, which would manifest itself in firm restructuring and political support for capitalism. Fast privatization would also help render the end of the planned economy irreversible.

Privatization in Russia

Russian politicians, with the aid of outside advisors sophisticated in economics, designed the country's rapid and comprehensive initial wave of privatization (1992–1994) with several aims in mind. First, they felt that managers of enterprises were engaged in destructive asset-stripping, and wanted to forestall the destructive effects by giving managers some de jure control to create an incentive to enterprise adjustment. Second, they wanted to offer incentives to stakeholders within the enterprise to support (or at least not oppose) privatization, by giving them privileged access to shares. Third, reformers hoped that despite the imperfections of economic legislation and the weakness of its enforcement, the new group of private property owners would become a constituency for property rights, pushing the state to strengthen them (Boycko, Shleifer, and Vishny 1995).

Russian reformers did all they could to make privatization a rapid process. Once the privatization law was passed in the summer of 1992, presidential orders soon followed, implementing the distribution of vouchers for use at auctions of property, and mandating legal transformation of enterprises into corporations. Over 22,000 enterprises were registered as corporations by June 1994; of these, nearly 15,800 had been privatized (Boycko, Shleifer, and Vishny 1995: 98, 106).

Russia's privatization law offered three options for privatization, each of which gave insiders what have been called "colossal" benefits, but no detailed influence over the shape of the process (Radygin 1995: 43). The most popular option, chosen in 73 percent of cases, was "Option 2," which allowed workers and managers to purchase 51 percent of the shares at 1.7 times their largely meaningless "book value," determined mechanically by reference to Soviet-era nominal values. In another 25 percent of cases, "Option 1" was chosen; this option gave 25 percent of the stock as nonvoting shares to the workers, with another 10 percent available at approximately one-third less than the book value (Boycko, Shleifer, and Vishny 1995: 75, 78; Radygin 1995: 39). Internal distributions of shares were also conducted as voucher auctions. Thus, the distribution of shares among stakeholders reflected not the substantive character of their stakes, but the number of vouchers they could mobilize. Because insider stakeholders in these auctions were competing with one another for a fixed number of shares, explicit negotiations that would link shareholding to the nature of stakes were practically out of the question. Naturally enough, managers' control over firm cash flows gave managers an advantage in these internal auctions.

Having chosen to give controlling blocks of stock to insiders whom they considered extremely unlikely to do a good job of restructuring, the privatizers focused on ensuring that shares could be traded after privatization, and opening the road to at least some outsiders. Polish insiders who had privatized their firms through leasing-style arrangements regularly formed "closed" joint-stock companies, with existing shareholders eligible to buy further shares, but this corporate form was practically eliminated as an option for privatizing Russian firms.[27]

The fate of the shares not distributed to insiders varied. In general, the official intent was to have 29 percent sold at public voucher auctions, with the remaining 20 percent (under Option 2), held for future sale by the state (Radygin 1995: 64; Boycko, Shleifer, and Vishny 1995: 75, 78). Voucher auctions were a major way for outsiders to acquire stock; the notorious efforts of insiders to rig auctions to their own benefit and block outside purchasers were not always successful (Radygin 1995: 67). Remaining state shares were gradually parceled out in a variety of ways, including via "investment tenders" that linked their purchase to a commitment of additional investment in the firm (Radygin 1997).

No form of privatization pursued in Russia involved discussion of the allocation of property rights between suppliers and customers, or of how to maximize the value of enterprises as "going concerns." Indeed, the procedures for privatization promoted isolation of stakeholders from one another and conflict between them. Internal auctions transformed stakeholders into competitors, and because of the extremely cheap distribution of control in each privatized entity, privatization's design had a fragmenting effect: more valuable subunits of "going concerns" had every reason to secede. Even existing integrated enterprises experienced intense conflicts over whether subdivisions would be privatized jointly or separately, as some subdivisions had the legal right to do. Participants in longer supply chains had even fewer opportunities to reach a negotiated decision about the degree of their legal integration. Efforts at joint privatization of technologically linked enterprises, forwarded by descendants of Soviet sectoral ministries and production associations, were resisted by privatization authorities, who could usually count on the backing of individual enterprises that preferred to be privatized alone (Boycko, Shleifer, and Vishny 1995).

Not all large firms underwent voucher privatization. Most notoriously, some of the most valuable energy—and metals-producing firms were sold for a pittance to Moscow-based bankers in an effort to build a coalition that would back Yeltsin's reelection as president in 1996.[28] As in voucher privatization, allocation of property rights occurred without negotiation between stakeholders. The situation was destined for conflict between outsiders who had no stake in the firm beyond their stockholdings, and insiders whose de facto control was threatened. In most cases the outsiders were indeed able to consolidate the control they had won through the loans-for-shares plan, but it was in no case a trivial task.

Privatization in Poland

Privatization in Poland did not set the stage for long-running insider-outsider conflict centered around stock ownership. Polish Communists had retreated from their claim to domination in the face of economic pressure and popular mobilization by the Solidarity workers' movement. Although intellectuals close to the Solidarity movement launched the economic reforms, they rejected the movement's longstanding advocacy of worker control (Orenstein 2001), leading to sharp conflicts in the Sejm, Poland's parliament. The result was a compromise privatization law, created in 1990, which provided for three forms of privatization. (Although no provisions were made for implementing one of these, mass privatization for free vouchers ensured distribution to citizens) (Orenstein 2001). Some privatization was also carried out using socialist-era bankruptcy provisions (Blaszczyk et al. 1999: 3–5). Not until 1993 was legislation implementing mass privatization enacted, at a time when the original reformers had already been voted out of office. Implementation did not begin until 1995 (Blaszczyk et al. 1999: 3–5).

The hallmark of the most widespread privatization methods in Poland was a simultaneous transformation of legal form and social substance.[29] In other words, changes in legal status were directly connected to negotiated reorganizations of the social environment in which law would be implemented.[30] Particularly important was the circumstance that in the vast majority of cases, commodification of stock was permitted only on terms acceptable to insiders. Furthermore, when outsiders did receive an opportunity to buy into privatized firms, the purchase was effected either on terms decided by insiders or in a way that gave insiders an overwhelming dominance in shareholding. Because privatization occurred in so many ways, length considerations prevent a full review. However, a couple of examples give the flavor.

Direct privatization. This method of privatization encompassed roughly a third of all privatized enterprises. Although it consisted of three subtypes, approximately two-thirds of these privatizations took the form of installment purchases (usually termed leases) of the assets of the former SOEs. The SOE was legally dissolved, and its assets transferred to a new company formed by the SOE's employees, who had to commit to buy at least 20 percent of the assets. After all the payments had been made, the assets became the property of the new company (Kozarzewski, Krajewski, and Majak 2000: 38).[31] The procedure was voluntary and could only happen after a vote of the employee council (Kozarzewski, Krajewski, and Majak 2000: 38).[32] The valuation placed on SOE assets was regularly so great that it was beyond the means of the company's employees, requiring the involvement of outsiders. However, the newly organizing firm both located buyers and determined "which of these buyers to let into the process. . . . [Outsiders were] usually drawn from the network of the firm's suppliers and buyers" (Levitas 1994: 108–9; McDermott 2001). The approving authorities included the SOE's "founding body," often an arm of local government, which brought another stakeholder into pre-privatization negotiations.

Survey research suggests that the nearly 90 percent of new enterprises formed in this way employed corporate charter provisions restricting the sale of shares to outsiders. These restrictions did not block them, however, from issuing new shares to allow additional outsiders to buy into the company—presumably, when this was a legal form that suited both bodies (Kozarzewski and Woodward 2001: 22).

Mass privatization. Poland's version of mass privatization involved a complex two-tier procedure in which Poles were given certificates for shares in 15 newly created investment funds, which in turn were allocated shares in the 512 state enterprises (about 11 percent of all privatized enterprises) participating in this program. For the purposes of this article, the important point is that participation in the program was subject to veto by either management or the council of employees. Although this did not preclude subsequent conflict between insiders and outsiders, the procedure left high-visibility, government-backed outsiders with a dominant share of the outstanding stock (Rapacki 2000; Blaszczyk and Woodward 2001).

Privatization's Legacy for Corporate Legality

State socialism built an economy of idiosyncracies (Woodruff 2000). As the system approached its demise, each enterprise operated according to an accretion of particularistic bargains with planners and ministerial supervisors over such things as norms for material use and allocation of capital to different purposes. This diversity of local situation, of production and its organization, of course persisted after privatization. Nevertheless, the distinct forms of privatization in Poland and Russia did produce characteristic patterns in the relationship between corporate stock as a legal form and the social substance underlying it—the day-to-day routines and interactions that make a firm a "going concern."

In Poland, all evidence suggests that insiders' veto on privatization generally meant that outsiders could acquire firms only when such an acquisition was deemed beneficial to insiders. There was regularly an option to privatize as a closed corporation with non-fungible shares, which many employee-manager buyouts adopted. True, some firms' poor financial situation left them faced with an unpleasant choice between outright liquidation and a bank-led reconciliation plan that might involve a reassignment of property rights through debt-for-equity swaps. But even in such cases, the deals were negotiated on the basis of mutual gains for creditors and debtors, not as a zero-sum division of property (McDermott 2001). In short, property rights were transferred to outsiders when insiders were willing to accept the legal consequences.

In Russia, by contrast, outsiders received shares only through tenacious efforts by central government officials over the objections of enterprise managers (Boycko, Shleifer, and Vishny 1995; Radygin 1995; Frye 1997). Outside shareholders represented a threat to the nearly total control managers held over enterprise finances (Boycko, Shleifer, and Vishny 1995: 117). Stakeholder-shareholders (i.e., workers) could be kept in line through their other dependencies (Clarke and Kabalina 1995), but outsiders were simply new claimants for the firm's earnings, who could conceivably be backed by the courts or bring other resources to bear. Given the extremely cheap valuations the privatization process put on Russian firms (Boycko, Shleifer, and Vishny 1995: 117–120), managers had every reason to purchase as many shares as they could to secure their control over their enterprises. Surveys in the immediate aftermath of privatization suggested that insiders in the median firm controlled 52 percent of the stock, and that general directors, on average, aspired to have 69 percent of the stock controlled by insiders (Blasi, Kroumova, and Kruse 1997: 193–194). They also took other measures to prevent outsiders from acquiring stock or exercising the legal rights it was supposed to afford. Thus, unlike the situation in Poland, allocation of stock resulted not from acquiescence of the firm's de facto owners when such allocation was to their advantage, but over the objections of these owners.

These contrasting histories explain why Russian privatization created regular, systematic frictions between legal facts and contextual factors. On the side of legal facts, the distribution of stock shares set up insiders as majority owners and outsiders as minority owners. Contextually, these outsiders did not share any network relations with the insiders. Another important element of context was material interest: corporate stock's market value was extremely low. For insiders, this meant that selling stock would be senseless because sales brought little reward and might threaten effective control (Wintrobe 1998). For outsiders, finding a way to force management to share profits would greatly increase the value of stock holdings. The stage was set for conflict.

Polish privatization did not create these legal and contextual features. Insiders were minority shareholders, not majority ones. Outsiders were often drawn from existing networks and in any event had to negotiate with the insiders, who could veto their participation. Finally, the extremely low valuations stemming from the voucher process were avoided in a situation in which firms were sold rather than distributed.

In sum, Russian privatization created an unsustainable combination of legal facts, contextual factors, and laws; Polish privatization did not. One could try to provide evidence for this proposition in a number of ways, such as by describing the incredible prevalence and intensity of corporate conflicts in Russia. Others, however, have done this already (Black, Kraakman, and Tarassova 2000; Fox and Heller 2000).[33] Instead, I will focus on an indicator directly related to my argument on the impact of tensions between contextual and legal factors: actors' use of legal "loopholes" to change legal facts in the context of zero-sum legal battles.[34] Although it is more difficult to prove the absence of a phenomenon than its presence, I also offer brief contrasts to the case in Poland that suggest the absence of parallel developments there.

Russia: Exploiting the Legal Definition of Value as a Loophole

This section details how the configuration of legal and contextual factors created by Russian privatization—a fissure between insider and outsider shareholders, with the former unwilling to share net revenues or sell their stakes in the firm at low prevalent prices—prompted a search for loopholes. These loopholes had the effect of resolving conflicts by forcing one side to surrender stock in return for legally determined, but inadequate, compensation. The elimination of competitors' ownership claims left both de jure and de facto control in one set of hands. The first example presented here is a case history that illustrates in some detail the use of such a loophole to resolve contestation over property rights. The second example chronicles the emergence of an industry devoted to debt-for-equity takeovers, which used bankruptcy law to contest the property rights of manager-shareholders who were unwilling to sell.[35]

Case: The Conflict at the Volgograd Factory of Drilling Machinery.[36]

This conflict, which centered around a factory controlling approximately 30 percent of the Russian market for oil-drilling machinery, pitted minority shareholders with 43 percent of the outstanding stock against majority shareholders with 51 percent. The majority shareholders, who controlled the factory's management, were members of a Volgograd-based banking group called NOKSS. The outside shareholder, initially, was the United Machinery Group (known by its Russian acronym as OMZ), a holding company that controlled much of the rest of the oil-drill market. OMZ, having acquired its shares apparently through door-to-door purchases from workers who had received them in privatization, spent more than a year trying to reach an arrangement with management and the majority shareholders regarding representation on the firm's board and division of its profits. Eventually, OMZ turned over 40 percent of its shares to MINFIN, a firm specializing in aggressive efforts to enforce legal claims. MINFIN, for unclear reasons, split these shares among two smaller partnerships.

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

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

The second action proved to be of more enduring significance. According to the law on joint-stock companies, a company's board of directors was allowed to take decisions on stock splits or on stock consolidations. The majority shareholders used this provision to carry out a consolidation of the company's nearly 190,000 outstanding shares into four shares. Because the two MINFIN partnerships held less than 25 percent of the shares each, they were not entitled to one of the four new shares in the company. Instead, the law specified compensation based on the board's determination of reasonable value for the outstanding shares.[37] The board paid the minority shareholders around $400,000. By contrast, MINFIN had some time earlier publicly offered $7 million for an additional 25 percent of shares in the company (whose annual sales were around $30 million). The two shares actually issued in the consolidation went to the existing majority shareholders, who then started proceedings to convert the firm into a private partnership. MINFIN then pursued suits and regulatory appeals contesting the consolidation, losing in the local courts, winning once in at a higher-level court in Moscow, and finally losing on a second appeal. MINFIN continued to claim (to no apparent avail) that the board taking the consolidation decision was not legitimately elected. The majority shareholders were left with full control over their property.

Worth noting is that this provision of the law had been on the books since early 1997, but seems to have been first exploited in this way in 2001. The argument that it was a poorly drafted law is thus too simple; if the pattern of motivations had been different, this provision of the law might have been entirely inoffensive. Rather, the particular circumstances of Russian privatization—the struggle over control and division of firm profits—led to the search for this loophole.

Debt-for-equity takeovers. The minority shareholders in the case just described announced their willingness to purchase the firm in question, but they were unable to reach an agreement on the price. This situation was very typical of the time; firms intent on industrial acquisitions—especially the largest Russian business groups—found pursuing them through stock purchase very difficult. This led to a search for loopholes that would force insider shareholders to part with their shares.

Acquisition specialists found a solution in exploiting the secondary debt market to as a mechanism to achieve debt-for-equity hostile takeovers.[38] Would-be acquirers bought up the outstanding loans of a target firm from its creditors; because they were not entrenched insiders, creditors were willing to sell. Acquirers then used the court system to try to enforce these debts in a way that would give them control over the assets of the target—ideally, by compensating debts with "undervalued" stock, though the mechanisms were many. Thus, these acquisitions were debt-for-equity hostile takeovers.

Because assets were the target, creditors often sought ways to prevent targeted debtors from paying off their outstanding obligations, since doing so would leave the creditor with only money instead of the more valuable assets. Legal provisions designed to protect minority shareholders by giving them the right to challenge certain company decisions offered one way for hostile acquirers to prevent loan repayment. Another was to push the target firm into bankruptcy proceedings, during which the firm would be run by a court-appointed administrator who could often be convinced to interfere with the repayment of the debts that had led to the bankruptcy in the first place.

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

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

The Polish contrast. Proving the absence of contested shareholder property rights in the Poland case is a more difficult task than is documenting their prevalence in Russia. However, the available record of firm acquisitions displays no parallel conflicts. Consider the history of the Elektrim conglomerate, which until 2001 was one of the country's most prominent and successful business empires. Elektrim began as a state trading firm coordinating imports and exports for industries offering supplies and services related to electricity generation and transmission. After being privatized, Elektrim used its export revenues to fund a large number of acquisitions in Polish industries; at one point, the conglomerate owned controlling or substantial stakes in over 100 firms. It was able to purchase dominant stakes in many of these firms through the privatization process, after offering wage, employment, and investment guarantees. More strikingly, Elektrim was able to use sales of minority stakes in enterprises it had acquired to fund further acquisitions (Michaels 1995). This strategy would have been completely unimaginable in the Russian context, where majority owners scorned the desultory receipts available on the stock market, and would have had a hard time finding sufficiently large blocks of shares to purchase with these receipts, in any event.

Elektrim management did sometimes find itself in conflicts with shareholders. In late 1998 the company revealed that it had failed to disclose an obligation to sell an asset cheaply. Regulators' reaction to this incident has been cited as an indicator of the effectiveness of Polish securities law enforcement (Glaeser, Johnson, and Shleifer 2001). The Polish SEC did indeed levy a fine of $133,000 against the firm, and instructed prosecutors to inquire into possible criminal consequences. Nevertheless, compared to the $150 million in market capitalization the firm lost in the aftermath of the scandal, these factors seem relatively trivial. Immediately after the scandal broke, and well before the enforcement action, the firm's CEO was in London, seeking to reassure investors. His fairly quick subsequent resignation (despite an assertion of legal innocence) and replacement by a new manager who began a forceful campaign to reassure investors are further signs of the crucial influence of the market. Given that Elektrim was trading at a very large price-to-earnings ratio of roughly 40 before the scandal, there was a great deal of wealth to be lost by angering investors.[39]

The contrast to the behavior of large Russian firms in the same period could not be more striking. Their disregard for shareholders was manifest, but the costs of angering shareholders were correspondingly low. When in March 1999 the Russian oil conglomerate Yukos used a dubious court order to exclude minority shareholders from a meeting in which assets were diverted from the firm, it was trading at P/E ratio of around 4, one tenth of Elektrim's.[40] It no longer had anything to lose from offending stockholders.

Evidence suggests that such situations of an enormous split between the market price of stock and its value to majority owners were infrequent in Poland. Indeed, a study of the premia investors pay for large blocks of shares on the Polish stock market revealed them to be "substantially lower than in well developed markets" (Trojanowski 2002). Debate over the amendments to the bankruptcy law in 2002–03 in no way echoed the Russian discussions of bankruptcy as a mechanism of property transfer. Instead, discussions focused on more familiar creditor-debtor issues, and resolving the collective action problems of creditors.[41] These developments all suggest that the characteristic situation in which Polish corporate and bankruptcy law operates does not involve the particular incentives to contest shareholders' property rights that are found in Russia.

Conclusion: From Sociology to Politics

This article has presented an "economic sociology of law" argument about the ways in which Russian and Polish privatization shaped the subsequent destiny of corporate governance in the two countries. By enabling embedded relations among stockholders, and avoiding a huge undervaluation of stock in the course of privatization, Poland created contextual factors that supported the legal facts of ownership. Russian privatization procedures isolated shareholders from one another and involved extraordinarily low stock valuations, a set of contextual factors that set the stage for long-running, zero-sum conflicts over the legal facts of stock ownership.

An economic sociology of law approach can improve one's account of the politics of making property rights secure. In particular, the ESOL approach avoids the assumption that only the strengthening of the state's commitment and/or capacity to enforce property rights will make them secure. This assumption can take various forms. In the context of a game-theoretic analysis, the issue of state capacity is frequently analyzed using an argument about the potential feedback between the prevalence of violation of law and the state's ability to contain it. The implication is that either the state collapses in a downward spiral of lawlessness that increasingly overwhelms authorities, or law-abiding behavior by the many makes containment of the law-violating few ever simpler (Sachs 1994; Johnson 1997; Roland 2000). A similar argument regarding Russia is that the absence of effective post-privatization regulation fostered the spread of majority owners willing to flout minority property rights, since such owners were able to extract more from the firms under their control (Black, Kraakman, and Tarassova 2000: 1735).[42] The prevalence of such unscrupulous majority shareholders means that Russia "needs a serious, top-down effort to control corruption, organized crime, and self-dealing [by corporate insiders]," and even "selective renationalization and reprivatization" (Black, Kraakman, and Tarassova 2000: 1798).

Other analyses emphasize not state capacity to secure property rights but rather the political will to do so. One technocratic version links good corporate governance to "strict enforcement of securities law by a highly motivated regulator," arguing that the secret to Poland's success was reliance on a regulator handsomely rewarded for enforcement, rather than weak courts without such incentives (Glaeser, Johnson, and Shleifer 2001: 853). Alternatively, the requisite political will might be sought among property owners. Some of those closely involved with Russian privatization, for instance, argued that the political clout of the outside shareholders created by privatization would successfully prod the state to secure corporate legality, an expectation that proved unfulfilled (Boycko, Shleifer, and Vishny 1995: 128; Black, Kraakman, and Tarassova 2000: 1753; Shleifer and Treisman 2000: 38).

Both the arguments from feedback loops and those from political will posit an unmediated interaction between state and society, taking conflict over corporate property rights as a given. The ESOL approach recognizes property rights as situated in concrete social and economic interactions, which may or may not be marked by conflict. Transcending a binary approach to law-consistent behavior (i.e., law-abiding or law-violating equilibria; presence or absence of political will for enforcement) enables the mapping of more intricate trajectories of legal and political change.

Such a trajectory has unfolded in the Russian case. An unstable configuration of legal facts and contextual factors gave rise first to an effort to use loopholes to alter the legal facts. Yet changing patterns of property distribution eventually prepared the ground for new laws that would increase the security of property.[43] The trajectory is especially clear in the case of debt-for-equity takeovers. In the fall of 2002, Russia passed new legislation weakening the rights of creditors and minority shareholders while strengthening those of owner-managers.[44] The new bankruptcy code, in particular, contained many provisions designed to hinder forced debt-for-equity exchanges. These provisions force creditors to try vigorous measures to collect debts before initiating bankruptcy proceedings, and allow firms to exit bankruptcy proceedings by repaying outstanding debts. Furthermore, management and the creditors must jointly agree on the bankruptcy administrator, selected from a list proposed by an independent association of qualified administrators, making it less likely that the administrator will be willing to shift assets from management. Related legislation regulating commercial courts now makes it harder for minority shareholders to interfere with management decisions than previously.

Representatives of big business, who had used debt-for-equity takeovers to expand, did the most to shape the new laws.[45] For instance, when President Putin vetoed the initial version of the bankruptcy bill, passed by parliament in the summer 2002, he did so in part to include longstanding suggestions of big business lobbyists to eliminate provisions preventing firms from paying their debts when able to do so.

The position of big business, a number of observers plausibly suggest, reflected the fact that displacement of the entrenched insiders created by privatization was all but complete. The vast bulk of the country's most valuable private enterprises had been subordinated, both de facto and de jure, to a handful of conglomerates run by Russia's richest and most powerful (Dolgopiatova 2002: 1–90). These empires grew based on their ability to disrupt the flow of controllable legal events that constitutes the exercise of property rights. Their behavior during the debate on the new bankruptcy law suggested that as the new owner-managers, they were not eager to see others repeat their accomplishments.[46]

From an ESOL perspective, it is entirely intelligible that in line with changes in the legal facts of property, conglomerates would shift from manipulating extant laws to destabilize others' property rights to promoting legislative change stabilizing their own. However, this transition does not fit easily with approaches highlighting the impact of feedback effects or political will on enforcement. For instance, relying on equilibrium arguments and feedback effects, one scholar asserted in 2000 that "the relative irreversibility created [by mass privatization] has locked the Russian economy in an inefficient situation where interest groups who gained most from mass privatization (the famous oligarchs [phrase in original]) have become so powerful as to block further reform such as tax reform, government reform, stronger law enforcement, and stronger security of property rights" (Roland 2000: 337).[47] Yet, just three years later, the "famous oligarchs" have become among the most active promoters of all the values mentioned.

In a defense of historical institutionalism, Thelen has argued for a conception of politics "as a dynamic process that frequently produces unintended consequences as different, ongoing processes interact. Perspectives that conceive of change as the breakdown of one equilibrium and its replacement with another do not capture this well."[48] Explaining institutional order through equilibrium fetishizes stability and eviscerates investigation into the roots and forms of change. One can add that the modeling of institutions with game theory, which requires a self-contained description of actors' interests and options in an indefinitely repeated game rules out investigation of "the contingent temporal alignments and simultaneous movement of relatively independent institutional orderings that riddle political action" (Orren and Skowronek 1994: 321).[49] The arguments presented above suggest that these historical-institutionalist points apply as much to economic institutions as to straightforwardly political ones, and to the interactions between the two categories of institutions as well. Incompatibilities between legal facts, contextual factors, and law can touch off evolutionary processes that eventually give rise to demands for legislative reform.

In Russia, this took place only after a reconfiguration of context made it feasible for law to be an effective tool in constraining action. The process by which demands moved from society to politics was mediated through the local arenas in which the meaning of law was determined.[50] This causal pathway is quite unlike the reformers' presumption that shareholders automatically would become a coalition for the strengthening of property rights once they had been granted them.

Thus, a decade after privatization, the outcome in Russia is tending toward a reconciling of law and context. In a "trajectory of improvement," loopholes that destabilized property rights are being closed. Former villains of corporate governance are now its heroes as they seek to convert their vast holdings into the liquid currency of market capitalization (Whalen 2002; Chazan 2002). Although an ESOL approach makes sense of these developments, it also cautions against reflexively celebrating them. As Weber and many of the other authors he mobilized have emphasized, law is only superficially a neutral instrument: "[C]onditions of formal freedom are officially available to all; actually, however, they are accessible only to the owners of property and thus support their very autonomy and power positions."[51] Stated differently, law stabilizes distributions of property and bargaining power arising from social and economic resources (Kennedy 1993). It in no way provides security for the justice of these distributions.

Notes

1. For instance, Glaeser, Johnson, and Shleifer (2001).
2. For a different perspective on how privatization strategies in the two countries affected property rights, see Goldman (1999).
3. This argument is influenced especially by Spicer, Kogut, and McDermott (2000); Kogut and Spicer (2002); McDermott (2004); and Ellerman (2001). Polish privatization involved a number of variants capable of encompassing the specifics of these accommodations, unlike Russia which practiced something very much like "institutional monocropping" in its privatization format. On institutional monocropping, see Evans' contribution to this volume. Compare also the discussion of the difficulties of formalizing property rights, in Scott (1998).
4. I use "embedded" in the sense of Granovetter (1985) and Somers (1993).
5. There is something of a consensus linking conflictual Russian corporate governance to the form of privatization; see Black, Kraakman, and Tarassova (2000); Fox and Heller (2000); Pistor (1997); Shleifer and Treisman (2000); Spicer, Kogut, and McDermott (2000). Where the present article differs is in its focus on identifying a configuration of factors that made property rights

subject to contention, rather than presuming Russian managers' propensity to steal as a given inevitably requiring enforcement.

6. For a classic text of the "old institutional economics" that makes these points, see Commons (1957). "Old institutional economics" was closely allied with the school of "legal realism" within studies of the law (Fried 1998), and the arguments of both schools have more recently been taken up in the Critical Legal Studies movement (Kennedy 1993).
7. In another example, as Granovetter (1985) notes, firms may decline to enforce contracts against partners whose future cooperation they need.
8. Compare Messick (1999) and Upham (2002). On the older law-and-development movement, which was closely linked to modernization theory, see Tamanaha (1995).
9. For an example pertaining to Russian corporate governance, see Fox and Heller (2000, 1725).
10. For an important discussion of the multiple reasons rules are invoked, using an example of traditional rather than legal rules, see Bourdieu (1977, 33-52). See also Swedberg (2003, 8). Scholars sometimes argue that people's beliefs about the normative validity of law influence laws' effectiveness (North 1990, 6; Cooter 1997). However, this modification does nothing to address the distinction between law-consistent and law-motivated behavior. Law is still obeyed because it's the law. Indeed, in Cooter's game-theoretic analysis, normative commitment to the law is modeled as an increase in the payoff to obeying it, which is structurally equivalent to an increase in the cost of enforcement. Thus, there is no contextual "embeddedness" of law-consistent behavior.
11. Compare Granovetter (1985); Somers (1993).
12. Klein (1997) includes many relevant papers. However, the question of when reputational concerns mandate law-abiding behavior and when they do not is still empirical. See Sinyagina-Woodruff (2003).
13. This is a problem with game-theoretic accounts of law-conforming behavior, which seem invariably to model the potential material payoffs to violating the law as the same in all circumstances. See, for instance, Cooter (1997).
14. Compare Swedberg (2003, 2, 8).
15. This last point is especially central to the OIE-Legal Realist-Critical Legal Studies line of thinking.
16. Kennedy (1993, 93) notes that legal tactics "are constantly invented by smart people looking for ways to modify the balance of power without a change in the intractable, large, general determinants of strength."
17. The account that follows is thoroughly influenced by Stinchcombe (2001, 76-99), who gives a pellucid reading of Llewellyn (1960).
18. I have not been able to locate a precise definition of situation-type in Llewellyn (1960); my definition as "actors and motives" is abstracted from his uses of the term on pp. 212, 271-2, 426-8 and elsewhere.
19. Compare Llewellyn (1960, 274) on "bad law."
20. This process requires that judges have substantial flexibility in deducing decisions from extant law. That they do is a key legal realist argument; Llewellyn (1960, 129, cf. 75-76) argues that judges regularly have a "choice among [a] plethora of correct doctrinal possibilities."
21. This in and of itself is a challenge to any game-theoretic understanding of law (e.g., Cooter 1997), which requires that actions be definitively legal or illegal.
22. For documentation on the Poland-Russian contrast, see the first paragraph of this article.
23. For important insights on this point, in the context of a discussion of implications for entrepreneurship and restructuring, see Spicer, Kogut, and McDermott (2000).
24. For further discussion of the contrast between Poland and the Czech Republic, see Spicer, Kogut, and McDermott (2000) and McDermott (2004).
25. For similar pictures see Clarke and Kabalina (1995); McFaul (1995); Radygin (1995). On the parallel situation in Poland, see Orenstein (2001); Levitas (1994).
26. At the time when Russia's privatization program was being designed, conventional wisdom held that the Czechs' voucher privatization had successfully avoided the privatization stalemate dogging Poland. For the Russian reformers' close attention to the Eastern European experience, see Rosett and Liesman (1995); Anonymous (1992); Boycko, Shleifer, and Vishny (1995, 83).
27. On Poland, see below; for Russia, see Boycko, Shleifer, and Vishny (1995, 75). Very few firms found a way around this ban.

28. This interpretation may be considered undisputed, since it has been offered by Anatolii Chubais, who designed and managed the auctions (MK-Daily, 23 September 1998, 2; as translated by the Federal News Service, supplied by DowJones News Retrieval).
29. Compare McDermott (2004).
30. For a key early perspective on this joint transformation, see Levitas (1994), who argued that enterprise insiders "are trying to wean themselves away from the state by simultaneously redefining the ownership structures of their firms, their productive profiles, and the markets in which they expect to function."
31. Some leasing arrangements apparently did not terminate with property transfer, although it is unclear how many (Kozarzewski, Krajewski, and Majak 2000, 38). See also Levitas (1994, 107-8).
32. This changed after passage of a new law that came into force in 1997, which allowed outsiders to initiate privatization, and also tried to promote the inclusion of more outsiders in the new joint-stock company created out of the dissolved SOE. However, by this point at least 80 percent of all direct privatizations had been accomplished (Blaszczyk et al. 1999, 307; Dabrowski 2001, 140; Kozarzewski, Krajewski, and Majak 2000).
33. Although both studies draw some useful links the difficulties of corporate governance to privatization, neither suggests that other ways of embedding or contextualizing the relations between insiders and outsiders would have avoided the issue.
34. An alternative to exploiting loopholes to solve the mismatch between legal and contextual factors would be to seek to change the latter—embedding shareholding relations in other forms of cooperation. This also took place; for an insightful analysis, see Pappe (2000).
35. For discussions, see Radygin (2002); Deriabina (2002); Volkov (2002).
36. Based on press reports and the text of relevant laws available from the Emerging Markets database at www.securities.com.
37. The price was supposed to be what an "uncoerced buyer" would pay; evaluation was supposed also to "take into account" public quotations of the stock's price—none in this case—as well as what an uncoerced buyer would pay for the entire outstanding capital stock. The latter provision appears designed to capture the possibility of an undervaluation due to the presence of a control bonus, but it did not offer any detail on how this control bonus was to be calculated.
38. For discussions of the prevalence of these mechanisms and examples of their use, see Radygin (2002); Deriabina (2002); Volkov (2002).
39. Elektrim appoints outsider (1999); Poland's Elektrim appeals to Polish SEC over fine (1999); Laidlaw (1998); Michaels (1998); Warburg Dillon Read (1999). Elektrim eventually failed for unrelated reasons.
40. On the incident see Black, Kraakman, and Tarassova (2000), which also describes the abysmal valuations of Russian firms in this era but describes them solely as consequence, not cause, of poor corporate governance; for the P/E ratio see Troika Dialog Research (2000).
41. Niemirska-Fido (2003).
42. Note that this argument portrays the division of firm revenue as a zero-sum process.
43. Boone and Rodionov (2001) described the process of business conglomerates' consolidation and argued that big business was embracing law as a means of stabilizing property rights. For a vigorous counterargument—based, however, on evidence pre-dating the most recent legal changes—see Barnes (2003).
44. See Andreev (2002); Medvedeva, Timofeev, and Iukhnin (2003).
45. Medvedeva, Timofeev, and Iukhnin (2003) describe the preparation of the bill. For an example of the intense interest of the country's largest business lobby in the bill, see Rossiiskii soiuz promyshlennikov i predprinimatelei (2002); Liubimtseva (2002).
46. Medvedeva, Timofeev, and Iukhnin (2003) describe the multiple interests involved, noting that while some big businesses wished to secure extant acquisitions, others opposed the law in hopes of maintaining their ability to acquire new assets through bankruptcy. Also: author's interview with Tatiana Medvedeva, Moscow, June 2003; author's interview with Aleksei Iukhnin, Moscow, June 2003.
47. For a similar (but more influential) formulation, see Hellman (1998).
48. Thelen (1999, 383-384), drawing on Orren and Skowronek (1994).
49. For similar points in the context of economic institutions, see Woodruff (2000).

50. Compare Kennedy (1993, 95). For a similar dynamic local struggle to national struggle dynamic in contention over the definition of Russia's legal means of payment, see Woodruff (1999, 110-202). For related points in a comparative corporate governance context, see Roe 1996; Skeel 1998.
51. Quoted in Swedberg (1998, 102).

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