Privatization and the Consolidation of Democratic Regimes: An Analysis and An Alternative

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What is the relationship between privatization and democratization in the post-communist countries? Will privatization hinder or promote the consolidation of these infant democracies? In order to answer these questions, I will first develop a typology of privatization strategies and then explore their effects on the transition to democracy and the consolidation of democracy. My thesis is two-fold: first, privatization has eased the transition to democracy, in the sense that power is shifting from the old political elite into a new economic elite; second, privatization, as practiced so far in Russia and Eastern Europe, makes the consolidation of democratic regimes difficult. To solve this dilemma between transition and consolidation, we need an alternative strategy of economic transformation in the post-communist countries.

The privatization strategy a country chooses has a definite effect on the transition to democracy, as well as its consolidation.

A sketch of this alternative concludes this paper. Though my focus is on Russia and Eastern Europe, the conclusion of this paper will hopefully have broader implications for countries in Latin America and other parts of the world where political economies are experiencing the same kind of fundamental transformation.

A Typology of Privatization Strategies

Privatization has been topping the agenda of economic transformation in Eastern Europe and Russia for several years. Soon after they came to power, almost all post-communist gov-

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ernments in the region announced major programs for privatizing their state-owned enterprises. These privatization strategies can be classified along two dimensions: whether a given strategy advocates a rapid or slow privatization process, and whether a given strategy advocates privatization from below (spontaneous privatization) or from above (centrally directed privatization). This is illustrated in the following figure.

Figure 1: Typology of Privatization Strategies

	Slow	**Rapid**
Spontaneous	Private Sector Growing Out of State Sector	*Nomenklatura*/ Worker Buyout
Centrally Directed	Case-by-Case Sales	Free Vouchers

Although arbitrary, this typology enables us to focus on two crucial dimensions of the privatization debate and its relationship to the consolidation of democracy. The first dimension is the timing and pace of privatization, indicated in Figure 1 as "slow" versus "rapid." Democratic institutions vary in levels of efficiency; for example, resolutions are reached more quickly if all that is required is a presidential decree rather than a debate in parliament. A more rapid privatization strategy would require a more efficient state decision-making apparatus, and this could have important implications for the transition to a democratic regime. When the objective is to privatize as rapidly as possible, it can be argued that presidential decree power is needed to circumvent the obstacle of prolonged parliamentary discussion. The second dimension has to do with the types of privatization programs, indicated in Figure 1 as "spontaneous" versus "centrally directed." The concept of "spontaneous order" was introduced by Friedrich Hayek, one of the most influential Western economic thinkers in Eastern Europe, who considered a free-market economy without government intervention to be the most efficient. His theory has been invoked to counter any attempts to guide the privatization process through policy intervention from above, except in the form of general laws enabling the private sector to grow spontaneously

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and eventually outgrow the state sector. In contrast, a centrally directed strategy of privatization usually requires the government's privatization agency to sell state assets on a case-by-case basis or distribute free vouchers to the population.

Actual privatizations are almost always a mixture of these pure strategy types. For example, between 1992 and 1994 the Russian privatization program was a combination of insider buyout and free voucher distribution. From 1989 to early 1990, the strategy of spontaneous *nomenklatura* (Communist Party managers) or worker buyouts predominated in Hungary and Poland. Meanwhile, the strategy of case-by-case sales predominated in Hungary and the former East Germany after the middle of 1990. In the former Czechoslovakia, the government initially distributed vouchers for free, but the implementation of this strategy has been tainted by the restitution of assets to old pre-revolutionary owners. The strategy of case-by-case sales predominated in Poland under the first term of the Solidarity government led by Tadeusz Mazowiecki. The Bielecki government, which came into office in January 1991, changed this strategy to the free distribution of vouchers and allowed the use of mutual investment funds.

Effects of Privatization on the Transition to and Consolidation of Democracy

The privatization strategy a country chooses has a definite effect on the transition to democracy, as well as its consolidation. The thesis of the first part of this paper is that these two effects are different, and can even come into conflict with each other.

According to Adam Przeworski, one of the most respected democratization theorists, the transition to democracy is "a process of institutionalizing uncertainty, of subjecting all interests to uncertainty."[1] In a democracy, no political forces or interests are protected from competition and uncertainty. If privatization gives the old communist ruling elite reason to believe that their economic interests will be supported under the new democracy, they may lessen their opposition.[2] In this sense, privatization eases the transition to democracy by reducing the degree of uncertainty

1 Adam Przeworski, *Democracy and the Market: Political and Economic Reforms in Eastern Europe and Latin America* (New York: Cambridge University Press, 1991) p. 58.

2 Of course, here I assume that other forces in favor of democracy, such as popular

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facing the former elites.

The consolidation of democracy is a different matter. As Adam Przeworski points out, "Democracy is consolidated when it becomes self-enforcing; that is, when all relevant political forces find it best to continue to submit their interests and values to the uncertain interplay of institutions."[3] There is no guarantee that a privatization program promoting the transition to democracy will also lead to the consolidation of democracy. Sometimes democratic institutions may generate outcomes that are offensive to some important political forces, who in return strive to subvert these institutions. Hence, the consolidation of democracy is only possible when important social, economic and political actors are not spending significant resources in an effort to circumvent formal democratic rules. In particular, whether a privatization strategy strengthens the consolidation of democracy depends upon whether it can realize its professed goals of revenue generation and efficiency enhancement.[4] These two goals are crucial to the improvement of macro- and microeconomic conditions in the new democracy, which in turn help to sustain broad public support for the new regime. Otherwise, disadvantaged groups will have strong incentives to subvert democracy.

Different privatization strategies have different effects on the transition to and the consolidation of democracy. First, consider spontaneous privatization, which requires general enabling laws, but not a specific government policy operation. Obviously, *nomenklatura* buyout—a form of spontaneous privatization in which the *nomenklatura* strip the state of its assets for their private benefit—favors the old ruling elite and may therefore ease the transition to democracy by reducing its opposition. However, this type

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mass movements and international constraints, are at work. Otherwise, there is no reason to think that the old ruling elite would open up the authoritarian system, even if they expect to become the property-owning class in the new regime. Historically speaking, the property-owning class has had the tendency of distrusting and opposing mass democracy because of their view of majority rule as a threat to their property rights (see Dahl, 1993).

3 Przeworski, p. 36.

4 Interestingly, these two objectives were also Adam Smith's argument for selling off the Crown lands: "In every great monarchy in Europe the sale of the Crown lands would produce a large sum of money, which, if applied to the payment of the public debts, would deliver from mortgage a much greater revenue than any which those lands have ever afforded to the Crown... when the Crown lands had become private property, they would, in course of a few years, become well improved and well cultivated."

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of spontaneous privatization weakens the consolidation of democracy. The public is dissatisfied with letting yesterday's political elite become today's economic elite, especially because economic conditions for the majority of the population are often made worse in the initial period of the new democracy. As the 1996 World Bank's World Development Report admits, "...there is little doubt that living standards fell in the early stages of reform in most countries."[5] In Hungary, Poland, the former Czechoslovakia and Russia, public frustration at seeing the elite benefit at a time when the economy as a whole was deteriorating provoked a reaction against *nomenklatura* buyout and a simultaneous push to establish central governmental agencies to lead the privatization process.

The other version of spontaneous privatization, worker buyout, gives incumbent workers a stake in the new regime, but also generates discontent among the non-working population, thereby diminishing public support for this form of privatization. The argument here is that, since state enterprises belonged to the people as a whole under the communist regime, they should not simply become the assets of incumbent workers without leaving any participatory role to the people outside the enterprises, particularly because their savings were used to finance them in the past. Then-Polish Minister of Industry Tadeusz Syryjczyk echoed these concerns in a speech in 1990:

> What can be said to the argument that an enterprise belongs to its workers? That farmers, who through a long period carried the burden of industrialization, do not now have any right to national capital? And teachers and doctors? That a young man who works in a factory for one year has a greater right to shares than a pensioner who worked in the same factory for 30 years? If this idea were put into practice, workers of rich enterprises would acquire huge capital, and others nothing.[6]

Clearly, the spontaneous privatization techniques of *nomenklatura* and worker buyouts have opposing effects on the transition to

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5 World Bank, *From Plan to Market: World Bank Development Report 1996* (New York: Oxford University Press, 1996) p. 25.

6 Radio Free Europe, 1990.

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and the consolidation of democratic regimes.

Second, let us consider the centrally directed privatization strategy of case-by-case sales. This strategy benefits the old *nomenklatura* and those who have become rich from black market activities, because they are the only domestic groups who can afford to buy state assets. These groups directly benefit from this privatization strategy, so naturally it reduces their opposition to the transition to democracy. However, this strategy hinders the consolidation of democracy, because for various reasons it generates only small amounts of revenue, leading to macroeconomic instability and thus motivating some disadvantaged social groups to search for solutions outside the framework of democratic institutions.

The strategy of case-by-case sales does not generate sufficient revenue for several reasons. One is the "lemon problem" of asymmetric information, which implies that there are no relatively objective ways of valuing the state assets to be sold.[7] This is particularly serious due to the underdeveloped state of the capital markets in transitional economies and their inherent macroeconomic uncertainty. A second reason for the low selling price is the weak bargaining power of the government vis-à-vis potential buyers. The government is eager to sell quickly in order to reduce the budget deficit, while buyers (both domestic and foreign) have the option of "strategic delay," waiting for the government to cut its price to the lowest possible level. The low selling price has two negative consequences: it only partially satisfies the objective of increasing government revenue, and it fails to elicit public support. In fact, the first director of the Hungarian State Property Agency was dismissed from his post in part because of public accusations that foreign investors were paying too little for the state assets being privatized.

An additional problem is that only the most profitable enterprises can be privatized by a case-by-case selling strategy, leaving unhealthy enterprises in the hands of the government and causing further detriment to the objective of revenue-generation. Essentially, the state loses its implicit tax base, as under the tradi-

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7 George Akerlof developed the "lemons principle" for the used car market, which marked the beginning of modern information economics. The upshot of the principle is that, under the situation of asymmetric information between buyers and sellers, it may be the case that there is no price at which any trade will take place at all. See "The Market for 'Lemons,'" *Quarterly Journal of Economics*, 84 (1970) pp. 488-500.

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tional socialist system there was no personal or corporate income tax, and the government depended on revenues from the state-owned firms. By controlling the prices at which goods were sold and keeping wages low, the government essentially withheld tax at the source. This strategy filled the government's budgetary needs because such a large proportion of the country's economic activity took place in the state sector.[8]

After privatization, this implicit tax base will be eroded. Taking microeconomic incentives into consideration, the government cannot set the new tax rate too high, especially if tax breaks are given to foreign companies. Even at low prices, selling off state-owned enterprises may bring some short-term revenues to government coffers, but the net effect on the state treasury might well be negative due to the loss of the implicit taxes of the old system. This is a gloomy prospect for macroeconomic stabilization and, consequently, public support for democratic consolidation.

Third, let us consider the privatization strategy of distributing vouchers to the population free of charge or at very nominal fees. This strategy has the advantage of generating initial political support for the transition to democracy by giving the population at large a stake in the ownership of the newly privatized firms. For example, in 1992 the Russian privatization program offered all citizens, including children, an opportunity to receive a voucher in the denomination of 10,000 rubles for a nominal payment of 25 rubles. For several reasons, however, this initially encouraging approach soon turned into a situation that was not substantively different from the "*nomenklatura* buyout" discussed above.

Ownership Rights Concentrated in Elites

In contrast to the Czech Republic, where citizens are required by law to hold their vouchers for some time before they can trade them, Russia allowed free trading of vouchers. Russia saw this as a positive aspect of the program. In their book *Privatizing Russia*, the three main advisers to the Russian government, Maxim Boycko, Andrei Shleifer and Robert Vishny, pointed out that, "tradability lets people convert vouchers to cash right

[8] Ronald McKinnon, *The Order of Economic Liberalization* (Baltimore: The Johns Hopkins University Press, 1991) p. 122.

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away, which especially helps the poor who have great immediate consumption needs...it vastly improves opportunities for potential large investors."[9] But the result can be a very unequal distribution of assets, because the poor tend to sell vouchers to those who can pay for them, the wealthy end up owning the vast majority of the assets. The poor were giving up their property rights at such an alarming rate that in December 1992 Russian Prime Minister Viktor Chernomyrdin compared the voucher privatization program to Stalin's coercive collectivization of agriculture, when individual peasants were forced to give up their land to establish collective farms.[10]

Workers Deprived of Control

The Russian privatization legislation of 1992 gave each state enterprise three options. The most widely used was Option 2, in which workers and managers together could buy 51 percent of the voting shares at a nominal price of 1.7 times the asset's July 1992 book value, with any combination of vouchers and cash. Of the remaining shares, 29 percent were to be sold to the general public through voucher auctions. However, laws prohibit workers from holding shares in a block, meaning they can only trade shares individually. This was the deliberate design of Anatoly Chubais, the head of the State Committee on the Management of State Property, in order to avoid excessive levels of control by workers.[11] As a result, managers and large outside investors are eager to buy vouchers from workers, who are typically willing to sell. In some cases, workers have even traded vouchers for vodka.[12]

Undervaluation of Asset Value

Russia's privatization relied on valuations of assets of state-owned firms that were not wholly accurate. No adjustments were made for inflation or intangible assets. Chubais simply declared that the book value of Russian companies as of July 1992 would

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9 Maxim Boycko, Andrei Shleifer and Robert Vishny, *Privatizing Russia* (Cambridge, MA: The MIT Press, 1995) p. 87.

10 *ibid.*, p. 85.

11 *ibid.*, p. 79.

12 David G. Anderson, "The Novosibirsk Stock-Market Boom of 1993," *Anthropology Today* (August 1994) p. 12.

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serve as the base value without any adjustment. This decision enabled investors to purchase state assets at very favorable terms, whether through the voucher auctions or from within the firm. Not surprisingly, the end result was an extremely low asset value for Russian industry. When the voucher privatization program ended in June 1994, the aggregate value of Russian industry was less than $12 billion. Even Anatoly Chubais' economic advisers were shocked; in their book, they asked rhetorically whether, "the equity of all of Russian industry, including oil, gas, some transportation and most of manufacturing, was less than that of Kellogg?"[13]

Certainly, this valuation problem severely restricted the revenue-generating capacity of the privatization program, limiting public support for the new democratic regime. Ordinary people were outraged to see their savings and pensions wiped out by skyrocketing inflation, while at the same time state assets were sold at very low book values, without any adjustment for inflation, to the reconstituted elites. Even the World Bank is worried about this kind of "redistribution through inflation."[14] The conflict between Russian President Boris Yeltsin and the Parliament in October 1993 and the governmental crisis triggered by Yeltsin's dismissal of Alexander Lebed are two incidents that demonstrate the difficulty of the consolidation of democracy in Russia.

All major privatization strategies pursued in Russia and Eastern Europe have faced a serious dilemma: while they were initially able to facilitate the transition to democracy, they soon endangered the consolidation of democratic regimes. This dilemma between transition and consolidation may be part of a larger dilemma described by Przeworski:

> To bring about democracy, anti-authoritarian forces must unite against authoritarianism, but to be victorious under democracy, they must compete with each other. Hence, the struggle for democracy always takes place on two fronts: against the authoritarian regime for democracy and against one's allies for the best place under democracy.[15]

Given the huge income inequalities and social dissatisfaction gen-

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[13] Boycko, Shleifer and Vishny, p. 117. Kellogg is an American food products company

[14] *World Bank*, p. 38.

[15] Przeworski, p. 67.

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erated by privatization programs, there is no guarantee that democratic regimes in Russia and Eastern Europe will be consolidated. As World Bank polls point out, just over a quarter of Russians disagreed with the proposition that ordinary people would benefit from the introduction of private property in December 1991. By March 1995 over two-thirds disagreed.[16] Moreover, as Przeworski reminds us:

> Democracy restricted to the political realm has historically coexisted with exploitation and oppression at the workplace, within the schools, within bureaucracies, and within families. Struggle for political power is necessary because without it all attempts to transform the society are vulnerable to brutal repression. Yet what we need, and do not have, is a more comprehensive, integral, ideological project of anti-authoritarianism that would encompass the totality of social life.[17]

Given the aforementioned difficulties associated with privatization and consolidation of political democracy, an alternative program of economic transformation is hereby proposed. Such a program may be more conducive both to the consolidation of political democracy and the more comprehensive social and economic democracy that Przeworski envisions.

An Alternative Economic Program

Since all existing strategies of privatization fail to solve the dilemma of transition to and consolidation of democracy, we need an alternative economic program that can build wide public support by virtue of its efficiency as well as its justice. While the basic theory behind this alternative comes from J.E. Meade, the 1977 Nobel Laureate in Economics, I will provide some additional arguments in line with his institutional design.

Meade's program aims to combine the best features of traditional capitalism and traditional socialism and has two main components: the labor-capital partnership and the social dividend.

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16 World Bank, p. 12.
17 Przeworski, p. 63.

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Labor-Capital Partnership

To appreciate Meade's notion of the labor-capital partnership, we should first get rid of the misleading concept of private property. There is nothing private in the contemporary world of big corporations. As Robert Dahl, a leading American political scientist, points out, if General Motors can claim "what is good for General Motors is good for the United States," we should think of General Motors as a public instead of a private institution.[18] Of course, the notion of "public" is not, and should not, be equated with the notion of "state." The pitfalls of conventional socialism arguably lie in this equation, and people in the post-communist countries would do themselves harm if they moved to the other extreme by denying the essentially public nature of modern corporations. The crucial point here is not to hold on to the old dichotomy of private property versus state property, but rather design a better governance structure for inherently public corporations. We must ask ourselves: who should have what control rights and what cash flow rights with regard to assets?

The Russian privatization strategists have a clear picture of the best corporate governance structure: cash flow rights and control rights should be consolidated in one group of decisionmakers, namely, outside shareholders. The three main advisers working on the privatization program maintained that, because outside shareholders are the only actors truly interested in maximizing profits and reducing risk, an ownership structure that gives them cash flow and control rights is the only structure that will be truly efficient.[19]

Contrary to this proposition, outside shareholders in Western corporations do not hold both control rights and cash flow rights. Because shareholders have only limited liability, they do not bear the full costs of a firm's actions and therefore cannot claim to be full risk-bearers. The employees of a firm—the human capital—also bear certain risks. Moreover, while outside share-

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[18] J.E. Meade, *Liberty, Equality and Efficiency* (New York: New York University Press, 1993)

[19] Robert A. Dahl, *After the Revolution? Authority in a Good Society* (New Haven & London: Yale University Press, 1990) p. 100.

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holders can diversify their stocks and reduce risk through a portfolio of shares in different companies, one worker cannot work for several companies at the same time. In this light, it can be argued that the human capital actually runs a higher risk due to the lack of diversification. Hence, if we follow the principle advocated by the Russian privatization advisers—that any person who decides how to employ any asset should bear full costs and enjoy full benefits of such employment—workers should be partners with outside shareholders in sharing control rights and cash flow rights over corporate assets.[20] If we accept this line of reasoning, we quickly conclude that the Russian government's fear of the slightest possibility of worker control in its privatization program is unfounded, even on pure efficiency grounds.

In his research on U.S. compensation patterns, economist Robert Topel of the University of Chicago pointed out that as much as 10 to 15 percent of the total compensation of employees of large corporations in the United States is for firm-specific skills. In fact, when employees are laid off through no fault of their own, they take, on average, a 10 to 15 percent cut in pay when they are re-employed. Margaret Blair of the Brookings Institute has drawn a further implication from Topel's estimates. She noted that 10 percent of the total compensation paid to employees by corporations from 1990 through 1993 was about $850 billion. This compares with corporate profits during those years, measured with standard accounting methods, of about $991 billion. She wrote: "In other words, what we call corporate profits account for only about half of the total economic surplus being generated by corporations. The other half is typically paid out to employees."[21]

The most important point here is that, when we take firm-specific human capital into account, the conventional argument that corporations should be managed solely for the benefit of outside shareholders falls apart. Blair's explanation on this point is worth citing here at length:

> The first thing we have to understand is that corporate profits, as measured by standard accounting rules, provide a very incomplete measure of the total economic surplus generated by corporations. As

[20] Boycko, Shleifer and Vishny, p. 65.
[21] *ibid.*, p. 19.

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> we have seen, a large part of the total surplus is paid out to employees in the form of higher wages; but the employees' share of the economic surplus, when paid out in this form, is treated as a cost of operation....
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> But when accountants record the entire package of payments to employees as a cost, shareholders see the return to employees for their firm-specific investments as something the firms should be trying to cut.
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> [Therefore], firms that focus solely on share value will have an incentive to shut down operations that are not generating profits for shareholders even though those operations may still be generating substantial real economic rents. From the point of view of society at large, this is, obviously, inefficient.[22]

Meade's labor-capital partnership can be understood as an effort to reconcile the interests of outside stockholders and inside workers for the social benefit of what Blair calls "total wealth maximization," a concept that is very different from the maximization of shareholders' value.[23] In Meade's program, outside shareholders own capital share certificates, and inside workers own labor share certificates. The operational design is roughly as follows:

> The Labor-Capital Partnership, whereby the workers and those who provide risk capital jointly manage the concern as partners. The capitalists own Capital Shares in the business, which are comparable to Ordinary Shares in a Capitalist Company. The worker partners own Labor Shares in the partnership; these Labor Shares are entitled to the same rate of dividend as the Capital Shares, but they are attached to each individual worker partner and are canceled when he or she leaves the partnership. If

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[22] Margaret Blair, *Wealth Creation and Wealth Sharing: A Colloquium on Corporate Governance and Investments in Human Capital* (Washington, DC: Brookings Institute, 1996) p. 8.

[23] *ibid.*, pp. 8-12.

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> any part of the partnership's income is not distributed in dividends but is used to develop the business, new Capital Shares, equal in value to their sacrificed dividends, are issued to all existing holders of Labor as well as of Capital Shares. These partnership arrangements greatly reduce the areas of conflict of interest between workers and capitalists, since any decision which will improve the situation of one group by raising the rate of dividend on its shares will automatically raise the rate of dividend on the shares of the other group.[24]

In addition to this benefit of bringing the interests of outside shareholders and inside workers into alignment, Meade's labor capital partnership has another main advantage of introducing flexibility into the labor market. The current Western European style of social democracy suffers from a great problem: the high wages that workers are paid are gained at the expense of rigidity in the labor market, thus implying an inefficient reduction of output and employment below the potential full-employment level. When the labor-capital partnership uses labor share certificates to replace fixed wage arrangements, a degree of flexibility is introduced in the labor market.

These two features of Meade's labor-capital partnership—reducing the conflict of interest between outside shareholders and inside workers and bringing flexibility into the labor market—might be very attractive to people in post-communist countries. As we described above, all existing programs of privatization are, in the final analysis, biased toward the benefit of the new class of outside shareholders and managers, but there is no efficiency rationale for this bias. In fact, for reasons given by Blair above, total wealth creation will be increased if governments adopt the labor-capital partnership.

Meade's specific proposal for constituting the board of directors may also turn out to be useful for the people in Eastern Europe and Russia. The outside shareholders and worker shareholders each separately elect the same number of members to a

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24 The formal result proving this proposition is so-called Holmostrom impossibility theorem, which shows profit maximization is in conflict with Nash equilibrium under the condition of budget balance for the team. See Gary Miller, *Managerial Dilemmas* (Cambridge: Cambridge University Press, 1992) p. 134.

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board of directors. These directors appoint the chairman with the power to cast a tie-breaking vote, who acts as an arbitrator in the case of a conflict between the two sets of directors.

As for the issue of flexibility in the labor market, it is important for progressive forces in the post-communist countries to avoid simply imitating the social-democratic policies pursued in Western Europe. The social-democratic parties of Western Europe have long lost the radical transformative goals that inspired them at their birth. Instead of challenging and reforming the existing institutions of the market economy and representative democracy, the Western European social-democratic program merely seeks to moderate the social consequences of the structural divisions and hierarchies that it has come to accept. Such a conservative social democracy defends the relatively privileged position of the labor force in the capital-intensive, mass-production industries at the social cost of the exclusion of large numbers of people in the disfavored and disorganized second economy. If the division between people in the first and the second economy is already a formidable problem in Western European social democracies, its proportions and effects are far more daunting in countries like Poland and Russia. We need more radical institutional innovations like the labor-capital partnership to make up for the deficiencies of conventional social-democratic policies.

Whether workers should accept the variable income from shares rather than a fixed wage for their work is controversial.[25] This leads us to Meade's notion of the social dividend as a fixed income for every citizen, which is the second major component of his program.[26]

Social Dividend

In Meade's program, every citizen is paid a tax-free social dividend according to the citizen's age and family status. There are two basic reasons for instituting a social dividend: promotion of equality by providing everyone with the same basic unconditional income, and the reduction of risk by providing some part of income that is unaffected by fluctuations in the labor market. The intuitive core of the idea of the social dividend lies in the

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25 Meade, 1993, pp. 85-86.
26 *ibid.*, p. 87.

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attempt to replace the demand for job tenure by an enhancement of the resources and capabilities of the individual worker-citizen.

One of the advantages of the social dividend over conventional social-democratic programs, which essentially boil down to a policy of conditional benefits that are received in cases of unemployment or illness, is that the former improves the incentives for recipients searching for low-earning jobs. This may seem counterintuitive at first, because an unconditional social dividend seems on the surface to reduce the incentive to accept low-paying jobs. However, Meade disproves this intuition with the following example:

> A recipient of a Social Dividend of 80 supplemented by a Conditional Benefit of 20 will have an incentive to take outside earnings so long as those earnings after deduction of Income Tax are greater than 20; but if he or she had relied for the whole 100 on a Conditional Benefit, there would be no incentive to accept any outside earnings less than 100.[27]

How could the regime of social dividend be financed? Taking a Western market economy as the base, Meade envisions five stages of tax system reform, the final stage being the socialization of 50 percent of national assets as a source of revenue for financing social dividends. Recognizing the inefficiencies inherent in state-run monopolies, Meade's plan provides for the state to be only minimally involved in the socialized assets:

> The government plays no direct part in the management of the partnership enterprises or other private concerns whose capital it owns indirectly. There is a free and very vigorous competitive capital market and Stock Exchange on which private individuals and institutions freely deal in respect to the 50 per cent of the real assets of the community which they own. The government invests its ownership of the other 50 percent of the community's real

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27 John Roemer, *A Future for Socialism* (Cambridge: Cambridge University Press, 1991) and Roberto Mangabeira Unger, *False Necessity* (Cambridge: Cambridge University Press, 1987) have also independently proposed the idea of social dividend.

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> assets in competitive unit trusts and similar competitive investment institutions which merge the government's fund with the private funds in the search of a high yield on the funds so employed.[28]

Such a mechanism of financing the social dividend would be revolutionary in the West, because, as Meade emphasizes, "at present, in the typical capitalist economy, the State, far from being a new owner of capital assets, in fact is often on balance a debtor to the private sector of the community."[29] It is not within the scope of this paper to discuss the feasibility of instituting social dividends in the West, although Senator Daniel Moynihan proposed a similar program in the early 1970s in the United States. The nascent state of the post-communist countries' market institutions gives them a comparative advantage in institutional innovation, and they may be uniquely positioned to take this kind of revolutionary step. The strategy advanced here would alleviate some of the current conflict between privatization and democracy in the post-communist world.

The trick of history is this: given the failure of privatization to generate broad public support, its implementation remains slow in several post-communist countries. As a result, many firms' assets still remain partially in the hands of the state. At this juncture, if these countries decide to pursue Meade's labor-capital partnership program, including the social dividend, they would have a greater chance of success than would the West. In the face of unstable democracies and inequitable economies, it will be useful to consider the value of alternative strategies that would play to the advantages of the post-communist countries. We may find that none of the privatization strategies implemented so far have successfully solved the conflict between privatization and democracy. The constraint is not entirely material. While Russia's asset value on the books was low after it completed its auctions, the real asset value is high; one indication is capital flight, which amounted to $15 billion after 1992.[30] The real issue here is spiritual: will the people and the leaders of post-communist countries have the courage and vision to strive for institutional innovations,

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28 Meade, p. 152.
29 *ibid.*, p. 157.
30 Boycko, Shleifer and Vishny, p. 119.

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thereby consolidating their democratic regimes on a new institutional footing? They should consider Meade's strategy of offering a social dividend and unconditional benefits as a viable alternative.[31] ♔

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[31] I would like to extend special thanks to the *Journal* editors for their comments and revisions, in particular Senior Editor Nancy Schwalje for her considerable patience with my limited experience of writing in English.

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