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Research in Progress 3

**THE DISTRIBUTION OF ASSETS
IN TRANSITIONAL ECONOMIES**

Juha Honkkila

October 1996

UNU World Institute for
Development Economics Research
(UNU/WIDER)

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Research in Progress:
THE DISTRIBUTION OF ASSETS IN TRANSITIONAL ECONOMIES

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ABSTRACT

An equal distribution of assets is a crucial element in the process of economic transition from plan to market. In the socialist era most physical assets were owned by the state and private ownership was not very important for most individuals. When the state abandons the socialist system and privatizes most of the formerly state-owned property, it also gives up the provision of secure employment, low-priced housing and the subsidies to industry, agriculture and private consumption. The relevance of private ownership grows, but how fast it does and in which way the new 'culture' of property rights is created, depends widely on the initial conditions and on the different privatization approaches. Although privatizing state-owned assets involves a transfer of huge amounts of public property into the hands of private persons, this process may lead to an increase in poverty and inequality.

Empirical research on asset distribution in transitional economies has been limited, mainly because of the inaccuracy of statistical data in this area. Still, the increase in poverty and income inequality during the transition period seems to suggest an increase in asset concentration. This research analyzes the changes in asset distribution by comparing the performance of different transitional economies in terms of their initial conditions and different privatization programs, and draws some conclusions from the point of view of the distribution of assets. While this gives some information on how privatization can affect the distribution of physical capital over the short term, the long term effects are also briefly discussed at the end of this paper, where it is emphasized, that secondary markets for privatized assets can change radically the distribution of assets generated by the initial measure in the field of privatization.

1 INTRODUCTION - DISTRIBUTION AND POVERTY IN TRANSITIONAL ECONOMIES

Since the collapse of the planned economic system there has been a considerable increase in income inequality in the former socialist countries. Before the transition the Gini coefficient of the distribution of income per capita was around 20-25 in the European socialist countries and around 25-30 in the Central Asian economies. The first figure was comparable to the value of the highly egalitarian OECD countries like the Scandinavian countries and the second to the average of the OECD countries. After the transition the average income Gini coefficient for transitional economies has risen to over 30 and some countries like Russia or Armenia with Gini coefficients 48 and 51.5 respectively, have reached levels of extremely high income inequality¹.

Increasing inequality together with the fall of aggregate national income has caused a dramatic increase of poverty especially in the poorest transitional economies. The significance of increasing poverty cannot be understated, especially if we talk about a situation where a notable political and economic change is accompanied by a vast increase of people reaching the limits of non-sustainable living standards. It's not surprising if the public belief in a market economy system will be at stake, when a large amount of the population has to pay a costly price for the increase of political freedom and supply of goods in the form of sudden impoverishment.

There are several methods for determining poverty. It can be measured for example as a percentage of average income in the country or as a share of people under a dollar-specified income level. The first approach tells us more about the country's income distribution although it disregards the aggregate income level of the country, whereas the second approach gives a more specific volume of absolute poverty at least by western standards, although it largely overlooks the relation to the country's typical income level. In table 1.1 the share of poverty in some transitional economies is given first as the percentage of people earning less than 21-27% of the country's average income (poverty in relation to country), and then as a percentage of people earning less than \$ 120 PPP monthly income (poverty in relation to world). Although the poverty in relation to country-figures are on average a bit higher, the trend of increasing poverty and differences between various countries are visible in both cases. Both tables measure poverty from income, ignoring asset ownership.

Only Central and Eastern European countries, with the exception of Poland, have maintained a poverty level of under 10 % during the transition period. Of the 19 countries observed 14 have seen more than 1/5 of population entering the wrong side of the poverty line. The increase of poverty has been even bigger in the republics of the former Soviet Union. The dollar-income of more than half of Kyrgyz and Moldovan population has decreased underneath the poverty-line during transition, while the income of more than half of the Azeri population has collapsed to less than 1/4 of the country's average income.

¹ Figures from Milanovic (1996, 57-58), except Armenian Gini coefficient from CEPRA household survey.

Table 1.1 Increase of poverty and GDP decline during transition

Country	Poverty in relation to country ¹ (percent) 21-27 % of avg. income			Poverty in relation to world ² (percent) income < \$ 120 PPP			GDP change ³ - 1995 as % of 1989
	1989-90	1993-94	in-crease	1987-88	1993-94	in-crease	
Azerbaijan	11.1	65.2	54.1				34
Belarus				1	23	22	54
Bulgaria	2.0	32.7	30.7	2	33	31	73
Czech Rep.	0.2	1.4	1.2	0	<1	0-1	87
Estonia	1.0	27.0	26.0	1	40	39	66
Hungary	1.1	4.0	2.9	<1	3	2-3	85
Kazakhstan				5	50	45	46
Kyrgyzstan				12	84	72	42
Latvia	1.3	33.5	32.2	1	25	24	54
Lithuania	1.5	39.1	37.6	1	46	45	41
Moldova	2.4	40.6	38.2	4	65	61	40
Poland	5.8	10.9	5.1	6	19	13	99
Romania	7.0	25.3	18.3	6	39	33	84
Russia				2	45	43	54
Slovakia	0.1	5.1	5.0	0	<1	0-1	86
Slovenia	4.5	6.1	1.6	0	<1	0-1	93
Turkmenistan				12	57	45	63
Ukraine				2	41	39	40
Uzbekistan				24	47	23	83

Sources:

¹ UNICEF (1995). Poverty lines 21 % of average income for Czech Republic and Slovenia, 24 % of average income for Estonia, Hungary, Latvia, Lithuania, Poland and Slovakia, 27% of average income for Azerbaijan, Moldova and Romania.

² Milanovic (1996).

³ Calculated from EBRD Transition Report 1995.

In table 1.1 the change of GDP is measured as the rate of 1995 real GDP to 1989 real GDP. It shows that even the fastest recovering country, Poland, has a GDP slightly beneath the 1989 level in 1995, while five FSU-republics have experienced a more than 50% decline of the real GDP in the past six years. Increasing poverty seems to be correlated to a bigger decline of GDP during transition, although even some relatively fast-growing countries like Estonia and Romania have experienced a radical increase of poverty. The correlation between poverty increase and GDP decline is 0.93 or 0.81 depending on whether poverty in relation to country or to world is considered. The surprising feature of these correlation figures is, that the increase of poverty in relation to country seems to correlate more with GDP decline than the increase of poverty in relation to world. This means that declining production not only seems to be accompanied by increasing poverty measured in absolute income, but also by decreasing income equality.

Chart 1 presents the increase in income inequality on the vertical axis (Milanovic 1996, 58) and the extent of poverty measured in PPP \$ income in 1993-4 on the horizontal axis (Milanovic 1996, 93). In all transitional economies with the exception of Slovakia the Gini-coefficient rose in the beginning of the 1990's, and poverty has been normally more widespread in countries with more the decrease in income equality. In the socialist period poverty was at a quite equal level in different countries compared to the past few years, and the income Gini coefficient was between 19 and 28 in all countries observed. The transition has increased the inequality both between and within different countries.

A group of four countries, Hungary, Slovenia and the Czech and Slovak Republics, stands out with a more equal income distribution and less extensive poverty. The Asian FSU countries and Moldova are having more problems with poverty than others. Of the European transitional economies unusual inequality increases have occurred in Estonia, Lithuania and especially Russia. The Estonian case is an implication of the fact that a fast and stable transition performance doesn't necessarily imply equal transition results.

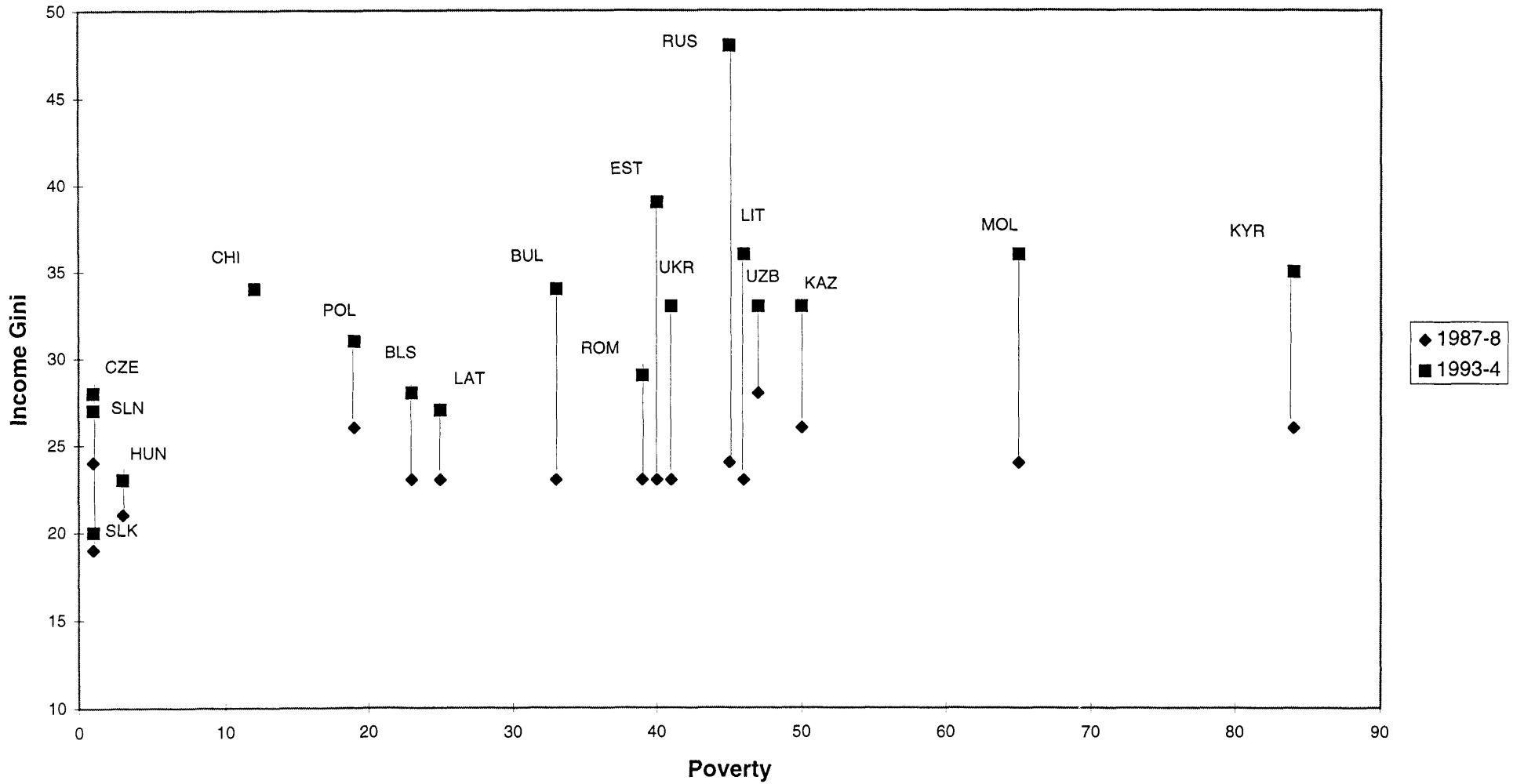
Reliable poverty and income estimates from Asian transitional economies are harder to acquire. In the case of Mongolia and Vietnam, which are both given lower human development indices by UNDP than any other transitional economy (UNDP Human Development Report 1996), some economic and social indicators like daily calory supplies or real GDP per capita signal for the existence of more than average poverty in those countries. Similar observations of countries not included in chart 1 strengthen the view that inequality and poverty are problems also in the Central Asian FSU republics.

In spite of the positive relationship between output decline and equality decrease, the decline of production can't be considered as being a main determinant of increasing inequality. The main causes for the rise of income equality have been changes in government transfer policies and, more importantly, the abandonment of centrally controlled wage regulations. A significant feature of the socialist economy was the equality of labour income. Minimum wages were high and the overall level of wage differences was small due to the fact that wages of the large public sector were set by the central government. When the demand for labour became market determined and wage regulations were removed more or less rapidly, the scope for an increase of wage differences became apparent.

In the course of transition the share of government expenditure in GDP has declined significantly because of the dismantling of the state. That leads to an expected fall also in government transfers to individuals. In general income transfers are directed to the low-income individuals, thus the fall in government transfers should have negative distribution effects. Surprisingly, during transition period the total amount of government transfers hasn't decreased in all countries in transition², although in countries struggling with government finances some decrease has occurred. Still, the total amount of transfers doesn't tell the whole story. For countries with an increase of income transfers changes in targeting of transfers can also increase inequality.

² In Central and Eastern Europe the share of income transfers in total income has increased (Cornia 1996).

Chart 1: Poverty and Income Gini coefficients in transitional economies



The changes in state transfer regimes have had various effects on income distribution. On one hand the creation of some transfers like unemployment benefits have had positive distribution effects. The same can be said about tax reforms. Income taxation in socialist economies played no significant role in the redistribution of income, while market economies use a progressive income tax which has a big effect in equalizing disposable income. But on the other hand the amount of some equalizing transfers, like child allowances, was much higher in socialist countries than in market economies. Maybe the most meaningful inequality increasing change in income transfer regimes concerns pensions. The pensions of socialist economies weren't very heavily based on past income (Milanovic 1996). The transition to a market economy -type pension system means that those who have high income while working, will also gain relatively higher pensions.

It's not only changes in wages and income transfers that cause the inequalities in income distribution. In socialist economies there were practically no possibilities to gain capital income. Nowadays in many transitional economies the share of capital income is quickly approaching the level of market economies, which is obvious, since the share of privately owned property is quickly increasing. This aspect is particularly significant since the distribution of capital income is predictably less equal than the distribution of other kinds of income.

This leads to the subject of this paper, inequalities in asset distribution. The relation between asset and income distribution is a crucial one. The distribution of assets will on one hand determine a part of income distribution. McKinley (1993, 127-132) writes about that relation in rural China. He recovers that the main source of income inequality has been the income derived from "sideline activities" for which capital that produce high rates of returns is used. This demonstrates, that at least in agricultural societies the distribution of assets is a major source for income inequalities. On the other hand, the extent of poverty is a sign of a large share of persons holding no or at most only very low-valued assets. A further point to be made is that the inequality of income and increase of poverty will also have its consequences to the resale of privatized assets. The privatization program will in most cases create a large number of asset owners. If individuals have an income that is under the subsistence level they will not only have strong incentives to sell the assets but they might be forced to do so. Therefore poverty and an unequal distribution of income will not only be a consequence of unequal asset distribution, but also a cause for it.

Research on asset distribution is an interesting issue especially in the transitional economies, since in planned economies most of the assets were owned by the socialist state. There was practically no private ownership, at least when it came to big enterprises or assets from which significant amounts of rent or interest could be profited. The existence of private ownership is a vital factor for establishing an efficient market economy. Therefore one of the first steps in transition for many countries was the privatization of state property. Privatization of assets will also influence the distribution of income, because of the increasing importance of capital income mentioned above. But more importantly, the distribution of assets will be newly determined during the privatization process.

An equal asset distribution is a very important factor in the transition process, because all income can be seen as returns to assets, either to tangible assets or to human capital. It's very hard to create a well-functioning market economy, if asset ownership is concentrated

in the hands of a very small number of persons. For individuals brought up in a communist society the loss of values like safe employment or other social benefits provided by the state sector cannot be compensated by minor possibilities to personal ownership. It has been already shown that transition has significant destabilizing effects to the equal communist time income distribution. If the effects on asset distribution will turn out to be even stronger and create a notable distinction between those who possess assets and those who don't, the economic restructuring process will lose even more of its social acceptability.

Although privatization of state-owned property will definitely increase the total wealth of households, the microeconomic benefits of the changes in wealth might not be as apparent. If the assets are distributed unequally, those on the lower end of the curve can be expected to be worse off than before the reforms. Because of the low initial level of personal property there can hardly be any decrease of personal ownership. Still deprivation might occur especially for those who are left out of the privatization process, or those who will sell themselves out of it through a resale of the achieved assets. With the emergence of the new owner class the poorest part of the population will find their relative status lowered.

A situation where the state has principally total control over all assets except human capital, should be an ideal one for creating a society with equal asset distribution. Still, in most of the transitional economies a quite distorted asset distribution seems to be developing. One decisive factor for the resulting asset distribution is the way in which privatization is carried out, but at least as important is, if the privatized assets are resold shortly after privatization, and in which way that can frustrate the privatization program's efforts to achieve equality. Also the initial amount and distribution of private property is meaningful.

When privatization programs were drawn up, the primary goals were increasing the efficiency of production and creating an enterprise management structure and legislation which would match the requirements of a competitive market economy. An equal distribution of privatized assets among all citizens was in most cases given less attention to or disregarded completely. The more privatization was delayed and the worse the economic depression became, the more crucial the need for finding competent enterprise management and ownership became and the easier equality aspects were to ignore.

The main topics of this paper are asset distribution and privatization. First the expression asset and ways of classifying different assets are defined. Then the difficulties in measuring asset distribution with purely quantitative methods are introduced. Chapter four analyzes the concept of property and the initial state of asset distribution in transitional economies. Since exact ownership data is available only in rare cases, the proceedings of privatization are essential in analyzing asset distribution. Before starting the actual analysis I bring up some points concerning the different role of privatization in transitional economies compared to market economies, which are vital for understanding the whole issue of private property in former socialist countries. By examining the initial conditions, privatization programs, results of the privatization process and finally also shortly the following secondary markets of privatization vouchers and privatized property this paper intends to make observations about equality differences in different transitional economies. Chapter six presents the theoretical background for equality effects of

privatizing tangible assets. With the help of this theorization differences in privatization paths and the following asset distribution equalities in various transitional economies are evaluated in chapter seven. Finally the significance of the secondary is discussed.

2 HOW TO DEFINE ASSETS?

Assets are described in the system of national accounts as "entities over which ownership rights are enforced by institutional units, individually or collectively; and from which economic benefits may be derived by their owner by holding them, or using them, over a period of time" (System of National Accounts, 217). There are many ways to classify various assets. They can be divided to financial and non-financial, produced and non-produced or tangible and non-tangible assets, which again can be divided into many subdivisions. The capital account of SNA uses a very extensive classification³ which divides assets into a few dozens of categories (see tables 2.1, 2.2 & 2.3). For the purposes of studying transitional economies' distribution of assets a more simple classification is sufficient.

Using a more simple classification assets can be divided for example only into land, dwellings, productive assets and financial assets. That kind of a division was used in the 1988 Chinese household survey⁴. The degree of classification is very much dependent on the statistical data available. For the total amount of assets a research with an SNA-type classification might be possible to perform, but for the purposes of asset and wealth distribution studies such a degree of exactness is neither achievable nor necessary.

In this research I will categorise the assets in a similar way to the Chinese household survey. The first asset category of assets is dwellings, the second one is land. The third category, productive assets, includes real capital, like machinery and equipment, that is owned by physical persons. The fourth asset class is financial assets, which includes most importantly personal deposits and shares of joint stock companies.

The first two categories are small subdivisions in the SNA tables, productive assets include practically all non-financial assets except land and dwellings, and financial assets is the second main category of assets in SNA. Every aspect from the SNA might be difficult to measure in transitional economies with limited sources of information. For example the existence and value of some intangible assets is extremely hard to find out.

In addition to those four asset types recognized by SNA a fifth class of assets, human capital, is certainly an important factor and it has to be taken into account in the future research. A person's human capital is the sum of intangible assets possessed by him. Its value depends on indicators like education, health and age. However, to obtain reasonable results, changes in the distribution of human capital has to be treated separately from other assets, which are easier to value in absolute terms. In this paper the distribution for human capital will though be disregarded. That kind of study is certainly worth a more detailed look than would have been possible in this context.

³ For more detailed descriptions of various classes of assets, see System of National Accounts (1993, 217-222 and 305 - 314).

⁴ The results from the Chinese household survey (McKinley 1993) will be briefly reviewed in chapter 7.

TABLE 2. CLASSIFICATION OF ASSETS according to SNA

Table 2.1 Non-financial produced assets.

NON-FINANCIAL ASSETS										Financial assets	
Produced assets										Non-produced assets	See table 3
Fixed assets		Inventories				Valuables				See table 2	
Tangible ¹	Intangible ²	Materials & supplies	Work-in-progress ³	Finished goods	Goods for resale	Metals and stones	Antiques and art	Other valuables			

¹ Tangible fixed assets consist of i) Dwellings, ii) Other buildings and structures, iii) Machinery and equipment and iv) Cultivated assets.

² Intangible fixed assets consist of i) Mineral exploration, ii) Computer software, iii) Entertainment, literary or artistic originals and

iv) Other intangible assets.

³ Work-in-progress inventories consist of i) Work-in-progress cultivated assets and ii) Other work-in-progress.

Table 2.2 Non-financial non-produced assets.

NON-FINANCIAL ASSETS								Financial Assets
Produced assets	Non-produced assets							See table 3
See table 1.	Tangible Non-produced assets				Intangible non-produced assets			
	Land ¹	Subsoil assets ²	Non-cultivated biolog. resources	Water resources	Patented entities	Leases and other transferable contracts	Purchased goodwill	

¹ Land consists of i) Land underlying buildings and structures, ii) Land under cultivation, iii) Recreational land and associated surface water and

iv) Other land associated with surface water.

² Subsoil assets consist of i) Coal, oil and natural gas reserves, ii) Metallic mineral reserves and iii) Non-metallic mineral reserves.

Table 2.3 Financial assets.

Non-financial assets	FINANCIAL ASSETS													
See tables 1 & 2	Monet. gold & SDRs	Currency and deposits			Securities other than shares		Loans		Shares & other equity		Insurance technical reserves		Other accounts	
		currency	transferable dep.	other dep.	ST	LT	S	L	T	T			Trade credits & advances	Other

4. Memorandum items: Consumer durables
Direct foreign investment

Certain durable consumer goods, like cars, televisions or washing machines are often used as indicators for wealth. In the system of national accounts consumer durables are a memorandum item and are thus not considered as assets. Because of the different nature of consumer goods compared to other assets, consumer durables can be left out of this research without loss of accuracy, although taking them into account would probably increase the observed equality. A more precise look at the SNA definition of an asset supports this view, no financial benefits can be obtained from consumer durables by using them or receiving property incomes, and they can't either serve as a profitable store of value.

A further classification problem evolves when state-owned companies are turned into joint stock companies. When the productive assets of a state-owned company are transferred to the joint stock company, in addition to the productive assets a new type of assets is being created: the shares of the company. The shares are classified as financial assets of physical persons. For this study, the value and distribution of shares is one of the most meaningful issues. The value of companies' productive assets is not necessarily directly measurable from the value of shares, but I will come to that point later when discussing generally valuation problems.

3 DIFFICULTIES IN THE MEASUREMENT OF ASSET DISTRIBUTION

There are several methods and parameters frequently used in wealth distribution studies, like Gini coefficient or decile ratio. Research on income distribution is done quite frequently and data for that purpose is reasonably easily available for example in tax statistics or household budget surveys (HBS). But same kind of numeric statistics about asset distribution are hard, sometimes impossible, to find. These problems are already present in countries with developed capital markets and high statistical knowledge. When studying countries where private ownership of assets has existed for less than a decade and where statistical registration is still in its infancy, the problems become even more perceptible. Estimating the distribution of assets requires a great deal of creativity in inventing research mechanisms.

A widely used method for collecting data about personal income and wealth have been HBS's. Surveys about wealth distribution have been done in many of the transitional economies. The benefit of a HBS is that the researcher can ask for exactly the kind of information that is needed for his project. But nation-wide household surveys always include the problem of reliability and validity. There are issues, that cannot be neglected, like picking the sample, drawing up the questions so that they are not suggestive or obscure and getting reliable answers. The last of those three issues is of great importance in former communist countries. Factors that are far beyond economics, like the historical and political background, explain the suspicious behaviour of individuals towards giving out any kinds of personal information. Even in countries with more liberal political regimes, interpreting survey data about income and wealth is never facile. Due to reasons like taxation survey data about personal income and asset ownership includes always the

danger of being underreported⁵. The biggest restriction of HBS data for examining asset distribution is though very simple, most of the household surveys on wealth distribution in transitional economies have concentrated on distribution of income, not assets. The only exception of the HBS's used for this study is McKinley's (1993) analysis on wealth distribution in rural China.

A second widely used method is using data from property taxation. The advantage of tax data is its availability, although even this advantage is less apparent in transitional economies. Spånt's survey about asset distribution in Sweden⁶ uses for the most part tax statistics. Property tax as a measure of asset distribution has many drawbacks. Not all assets are taxable, and the distribution that is the outcome of studying only taxable assets is not a representative one for the distribution of all assets. Spånt calculated that wealth tax is paid from only 9 % of financial and non-financial tangible assets (excluding human capital that is) in Sweden. The figure is probably even smaller in transitional economies with less developed taxation systems. The distribution observed from taxable assets is assumed to be more equal than the actual asset distribution (Spånt 1975, 66).

An even more significant limitation of wealth tax data is that there is normally a lower limit for the value of an individual's property for it to be taxed. To what extent that reduces the number of persons taken into account depends on the limit. In most market economies only a small percentage of physical persons possess an amount of wealth that exceeds the lower tax limit (for example 257 000 of 8 million in Sweden in 1969; Spånt 1975, 67). The transitional economies' share of property tax income in government's revenues⁷ is by no means bigger than in market economies. Therefore we can assume that property taxation is a possible measure of examining distribution of taxable assets only for a small segment of the wealthiest individuals also in transitional economies.

Since some assets yield income, statistics about capital income tax could principally be used to measure the distribution of some assets. Not only for the reasons mentioned above, but also for the fact that profits of an asset by no means tell the whole truth about the asset's value, capital income is neither an ideal measure of asset distribution.

Another point is, that one has to be careful in deriving the available information from the value of the assets. It's possible to find out how certain assets are distributed among certain groups of individuals, but one has to be careful in estimating the value of the assets. The taxation value of many assets is sometimes only a poor estimate of the asset's market value and therefore tax statistics are not a perfectly valid indicator of asset distribution. Valuation of privatized property will be discussed later, because the changes of value over time must be studied with care.

Spånt uses a combination of tax data and sample survey. He calculated estimates for asset distribution from capital tax settlements taken from a sample of tax return forms. That way all wealth classes were included and a more precise picture of distribution of different kinds of assets was achieved. A survey like this would bring more accurate results also in

⁵ The problem of underreporting is raised for example by Cornelius (1994, 9). He assumes that the amount of poverty in Lithuania is overestimated because of underrecording of income in HBS's.

⁶ For the results of the study, see Spånt (1975).

⁷ See IMF (1993, 43).

transitional economies, but just like in the case of household surveys, the question of underreporting must be raised. Furthermore, the problem with taxation data of transitional economies is not only unreliable reporting of asset ownership, but failures in statistical accounting matters and tax collecting itself.

To summarize, there are some major problems concerning the collection and analysis of exact numeric data from property taxes or investigations on tax return forms. The infancy in tax legislation and statistical compilation in transitional economies will make it extremely difficult to find sources that would cover all categories of assets and population classes required. And even if this kind of data is available, the results will be biased for the reasons stated above, like valuation of assets, differences in tax legislation and problems related to giving out personal information. The accuracy of the results would most probably not match the difficulties involved with the research.

Hence, it's useful to think about the option of giving up attempts to achieve precise results with restricted validity, and try to find out in a more analytic fashion what causes inequality in transitional economies and how various policy-related factors have affected the outcome of asset distribution. The ideal way to start this analysis is to look at the backgrounds of asset distribution, mainly at the privatization process. The rest of this research concentrates on analyzing different privatization paths and their effects on wealth equality.

4 THE INITIAL CONDITIONS: PRIVATE OWNERSHIP IN CENTRALLY PLANNED ECONOMIES

Before starting with any asset distribution analysis, the whole concept of property rights in socialist economies has to be clarified. Defining the ownership of assets in centrally planned economies is certainly not a simple task. The communist economy recognized three kinds of ownership: state-owned, collective and private. One of the most distinctive features of the centrally planned economies was that almost all assets were owned either by the state or collectively. The legal principles from the "western" point of view would classify state-owned assets as not being possessed by any private person and collectively-owned assets as being owned evenly by all members of the collective. For determining actual ownership such definition is certainly insufficient.

The degree in which different members of collectives controlled certain assets was everything but equal. Although the term collective ownership was used indicating an equal status for example for all employees of an enterprise, no individual had private property rights to the productive assets of that enterprise, at least in the sense of the likes in a market economy. The control over collective enterprises was in most cases still firmly in the hands of the central government⁸. On the other hand, the difference between state-owned, collectively and privately owned housing was meagre. Housing was in most cases free or at least the rents were heavily subsidized, which made costs of living almost equal for everyone. Lifetime tenancy in state-owned houses was seen as a public right (UNICEF 1995, 77).

⁸ See for example Frydman & Rapaczynski (1994, 102 - 106) or Demekas & Khan (1991, 3 - 9).

Due to the unique notion of ownership, privatizing state-owned assets meant more than a distribution of assets from the state to individual persons. A completely new system of private property rights had to be developed in the society. The change of the ownership regime will be discussed later in chapter five, before the distributional effects of privatization are discussed.

The possibilities for creating a society with new kind of ownership rights were largely influenced by the initial conditions in every country. In spite of similar principles concerning public ownership, the structure of enterprises and possibilities for private economic activity before transition varied in different centrally planned economies especially in the last years before the transition. Some countries made attempts to move towards a so called socialist market economy and in those countries a limited amount of private property was permitted. Those private property rights were mainly applied to agricultural land, small enterprises or dwellings. Big enterprises remained in the possession of the state, but even in that matter the amount of state control and intervention varied in different countries.

Even the most fundamental communist governments had allowed minor private land ownership or at least long leases of land by the end of 1980's. Albania and Romania were the most tightly controlled and centralized economies in Europe and in these countries no other kind of private ownership was legalized. The amount of private farming was tiny. The size of private farms was limited, for example in Albania only plots smaller than 200 square metres could be cultivated privately (Eastern Europe and the CIS 1992, 80). Production, prices and inputs in other branches of the economy were almost completely determined by central planning authorities, leaving no room for decision making for enterprises. In Romania even labour mobility was under state control, since the rigid wage policies were not capable of allocating the labour force efficiently (Demekas & Khan 1991).

The situation in Bulgaria and Soviet Union wasn't much more liberal. Some degree of private farming was allowed, although the plots were not directly owned by private farmers, but taken on a long lease. In Bulgaria the share of private farming was not very significant, 10 % of agricultural land consisted of private plots. In the Soviet Union the so called private small rural residents gave about 30 million persons a slight possibility for asset ownership in the begin of 1990, but agricultural production was still largely dominated by huge collective farms (Eastern Europe and the CIS 1992, 109). Enterprises had some degree of autonomy, which was used mainly by company managers. Ordinary workers had no power in state enterprises.

German Democratic Republic permitted the presence of a small private sector consisting of companies predominantly in labour-abundant branches. There also was a small share of cooperative ownership, but within the cooperatives no private ownership existed. Still, practically all industry and agriculture was state-owned. The share of private farms was even smaller than in Romania. The only exception of the rule was the handicraft sector, of which 72 % of output came from the private sector. Of less than half a million private sector workers 200.000 were employed in handicraft activities. Some of the pre-war housing stock was partly privately owned, but modern dwellings were entirely state-owned (Lipschitz & McDonald 1990).

The countries that made most attempts to reduce the state's control over the economy during socialist times were Hungary and Poland. Czechoslovakia's similar efforts towards more liberal economic regimes were dejected to a big extent by the armed intervention of the Soviet troops in 1968. Until early 1990's Hungary, Poland, and also Yugoslavia were the only socialist countries that introduced laws that gave notable management rights to enterprise managers and in some cases even workers' unions (Frydman & Rapaczynski 1994, 102-112; Rapacki 1996).

Also personal ownership legations were most developed in these countries. Poland's market-oriented reforms during the last decade before the transition enabled the birth of a comparably big private sector. By the end of 80's 814.500 small or medium sized firms employed 1,5 mio people. Private farms occupied 75 % of agricultural land, but the size of private plots was small, limited to 100 hectares.⁹ The situation was similar in Hungary, although the share of private farming was smaller. Only 11 % of arable land were private, auxiliary or household farms (Boote & Somogyi 1991). In both countries a significant amount of dwellings was privately owned. In Hungary 73 % of total housing was owner occupied, in Poland 43.5 % housing was individually owned.

Also in Czechoslovakia almost 50 % of housing stock was privately owned. The developments in private enterprise and agricultural sector were though lagging behind Hungary's and Poland's performances. Private farms produced only 4 % of agricultural output in the late 1980's and the size of private plots was restricted to maximum 50 hectares. Only small family enterprises employing less than 20 persons were privately owned (Prust 1990).

A consequential feature of the Asian centrally planned economies was the major significance of agriculture and rural population. The share of non-urban population in China, Mongolia and Vietnam was 82 %, 48 % and 78 % respectively (World Bank 1993). Therefore the distribution of agricultural land in these economies was of special importance. China and Mongolia had private property regimes similar to the strictest East-European countries. There were no privately owned companies prior to the reforms and housing was public-owned and rents heavily subsidized. Practically the only form of private ownership were small agricultural plots and restricted possibilities to breed cattle. In China though the share of these private activities in a rural commune was estimated to be as high as 20-40 % of total income. The share of commune land given for private farming was 5-7 % (Griffin & Saith 1981, 125).¹⁰

Vietnam was by far the most liberal of the three Asian countries dealt with in this study. Although the concept 'private ownership' had no politically acknowledged status before early 1990's the share of private production was estimated to be as high as 44 % of GDP. Not only the possibility for private ownership, but also employee control in SOE's was bigger in Vietnam compared to China, Mongolia, or more orthodox East-European communist states, although the scope for outside-of-plan activities of enterprises was

⁹ See Warsaw School of Economics (1994, 195 - 197).

¹⁰ Throughout this study the share of private assets is sometimes estimated from the share of private production or share of income from private activities in some branch. As can be seen from this example, this approach has at least two shortcomings: private production was in most cases more productive than the public or collective one; and the income from collective work wasn't necessarily connected to neither productivity nor the value of assets used for creating that income.

possible largely because of the complex structure of enterprise governance. (Probert & Young 1995.) The consequences of weak enterprise management control are not necessarily positive, as can be seen in chapter five for example from the spontaneous privatization. The situation of Vietnam's private agriculture was similar to China with 5 % of collective agricultural land permitted for private use, and in some cases more than half of villagers' income coming from these private activities (Tria Kerkvliet 1995).

As can be seen, the ownership structure varied in different socialist economies. The consequences of the initial conditions will become even clearer when divers aspects of privatization are added into consideration. In the remaining chapters I will try to build up a model of asset distribution determinants. For that model these differences of initial conditions are essential.

5 THE SOCIAL SIGNIFICANCE OF PRIVATE OWNERSHIP IN TRANSITIONAL ECONOMIES

"Property [...] is a much vaguer and complicated concept that is usually imagined and, as such, it is more a subject of inherently 'unscientific' historical and political inquiry than an object of theoretical economic analysis." (Frydman & Rapaczynski 1994, 172).

As an intuitive and naive statement it could be said, that privatization will cause a major shift of asset ownership from the state to individuals, increasing the total wealth and welfare of the private sector. By examining the complete transition process, it's easy to see though that there is much more included than just a change of ownership.

For individuals, private ownership was not perceived an essential need in socialist economies. Indeed, secure housing was provided at very low prices, full employment was guaranteed and the state subsidy system kept the price level of most consumer goods low. When the state gave up most of its assets and abandoned the planned economy system, it no longer could provide secure employment, cheap housing and large subsidies for industry, agriculture and private consumption. Therefore privatization alone as an event increasing the total amount of private property gives a too rosy picture of the process. The significance of private ownership for individuals is in most cases far smaller than the importance of the material and social advantages provided by the socialist state. It's not at all clear that each individual understands the possibilities of possessing for example the house he lives in or a part of the enterprise he works in.

Furthermore, the whole issue of privatization must be handled very cautiously. The experiences from privatizing state-owned enterprises in western market economies cannot be applied to transitional economies as such. First of all, the extent of privatization includes not one or two big companies, but, as mentioned above, practically all assets in a state. Even more importantly, privatization in transitional economies means much more than just a legal transfer of ownership. The importance of private property for a nation not having experienced such thing for generations is extremely hard to evaluate.

Frydman and Rapaczynski (1994, 174-176) mention three factors that cause complexity in the ownership transformation process in transitional economies. First of all, the conveyance of particular "vested type of entitlements" may be hampered by the dual role

of the state as both rulemaker and a player in the privatization process, and by the absence of certain self-enforcing mechanisms that are essential for the ownership institution. The state or former officials of the state might be unwilling to give up all of their control over some assets, leaving the new owners insecure of their rights towards the privatized assets. Therefore a pure legal ownership change won't be enough to bring about a new kind of culture for respect of property and the incentives for reasonable economic behaviour. Frydman and Rapaczynski claim rightfully, that these features, that are included in the self-enforcing mechanisms and which already exist in market economies, are more important for the new ownership culture than any changes in the legal system.

The second cause for complexity is the political aspect of privatization. The changes of ownership must not be seen as a purely economic event. In the centrally planned economies the allocation of scarce resources between different industries and enterprises was distorted by the noxious behaviour of state officials. There is no reason to believe that this kind of behaviour will vanish immediately after a legal change of the form of ownership. Instead, the possession of assets must be seen not only as an economic, but also a political benefit. The last distinctive factor in the privatization process of transitional economies is, that not only ownership is changing, but also the form of management and governance has to be completely reorganized. Again, there isn't a superior way to do that, but the way in which ownership and management will be connected will be important for the future significance of private property.

The significance of private property in transitional economies is not easily determined, but in the first years after transition it certainly is different from what has been experienced in western market economies. This means that the economic behaviour of individuals must be interpreted with care. In some situations acquiring private property might not be preferred to present consumption even if the prospects of increasing future wealth through asset ownership might seem unquestionable. The differences in time preferences will affect especially the resale markets of privatized assets and can lead to huge increases in wealth distribution during the first years after privatization.

6 THEORETICAL PATTERNS OF ASSET DISTRIBUTION DURING THE TRANSITION

The next section builds up a theory for determining the changing of ownership structure in transitional economies. The chapter sums up indicators that are equality-increasing or equality-decreasing. These indicators are divided into three categories: the change in poverty and income distribution, and indicators derived from initial conditions and from the privatization program.

Because of the accelerating importance of capital income after transition, the changes in income equality and poverty will certainly give the direction of changes in asset distribution. The distribution of assets in centrally planned economies was already introduced in chapter four, the second part of this chapter repeats the conclusions from that chapter. The regulations according to which that state-owned property is privatized will be the third major factor in determining the outcoming asset distribution. The last part of this chapter sums up in which way certain characteristics of the privatization program

and its proceedings will affect equality. That requires an examination of not only the programs but also of how precisely the privatization process follows its targets.

6.1 Initial conditions

Before examining the distributional consequences of policymaking in the transition period, it's important to know the economies' starting points. Possibilities for private ownership in various socialist countries were already compared in chapter four. From the aspect of equality in asset distribution two different measures from the period before the transition are important. First of all, the share of private ownership and private activity in the economy, secondly the amount of enterprises' autonomy in their production and decisionmaking.

Since all private property in socialist economies consisted of small farms, small family business and private housing, the chances for individual persons to attain large amounts of assets were minor. Therefore a growth in the total amount of private ownership can be assumed to increase equality. The more private property existed in an economy, the more people were sharing it, and the less people were left as "drop-outs" when it came to possessing assets. Not only ownership in the legal sense, but also possibilities to control assets, were important. This aspect is of special importance for the privatization of state-owned enterprises. The more power one has in the decisionmaking of an enterprise, the more one is willing to be financially involved in the enterprise. When big enterprises are privatized and turned into joint stock companies, possibilities to have control over the enterprise can be a decisive incentive for maintaining the ownership.

Rapacki (1996) claims, that those countries that had strong labour unions and management control in big SOE's were in a disadvantaged position, because the possibilities for a fast top-down privatization were restricted. At least if equal asset distribution is considered, that disadvantage is debatable. What is lost in speed and efficiency of privatization, will be gained in attaining shareholders with expertise on enterprise management and stronger incentives for retaining ownership. Although delays in starting the privatization are generally harmful, in cases where the future shareholders have some insight for running the company and if delays are caused by negotiations about efficient ways of share distribution and future management and not by bureaucratic or political issues, the lag won't cause much damage.

The amount of private ownership can be in most cases measured separately for different assets, or at least estimated from the share of private activity in various branches of the economy. The hypothesis that the aggregate wealth was distributed equally can be proved by looking at restrictions for private activities and ownership, for example by comparing the maximum size of private plots. The legislation about employees and managers power in state-owned enterprises tell for the most part, in which way control over some assets was spread.

6.2 Possible privatization models

Some assets, like agricultural land or housing, that are not liquid, are not expected to be resold very quickly after privatization or their resale in the first couple of years might even be prohibited by the law. Therefore results from the privatization process will give reliable facts of the distribution of those assets even in the longer run. Other assets that are more liquid, like shares of newly formed joint stock companies, might change hands many times after the initial privatization. For those assets, in addition to examining the privatization process, a closer look at the functioning of the resale or secondary markets is required.

Privatizing small companies, collective farms and dwellings of workers doesn't change the character of the assets in question, as it does when the ownership of joint stock companies is being registered in the form of shares. In the former case the tangible assets are privatized as tangible assets and the individuals do not only get the ownership but also direct control of the obtained asset. In the latter case individuals become owners of financial assets and get often practically no control of the productive assets. Getting control of the asset is a strong incentive for keeping the asset. The motives for keeping the asset are even stronger if the asset was controlled by the new owner already before privatization.

This means, that differences in the distribution of housing or small agricultural plots shouldn't be very big within the same country, within the sectors actually using these assets, even in the longer run, if privatization has proceeded in a fair and equal manner. These kind of assets are not very profitable, there are no functioning secondary markets for them and they have a non-financial utility value for their owners. The positive equality effects of privatizing these assets fast are similar to those of having a bigger initial share of private activities. Privatization is likely to create an unconcentrated wealth distribution.

The resulting equality of the privatization of these relatively low-valued assets mentioned above will be mainly determined by the number of people involved in the privatization. A giveaway or below-market-price sale of small enterprises to persons controlling the company or plots of land to small-scale farmers will exclude those individuals who are not working, like children, pensioners and students. Therefore certain groups will lose when others benefit from being able to purchase assets for a price less than its value.

The speed in which the small privatization was started and is proceeding is an important determinant for the developments of ownership structure. A fast privatization of land, housing and small enterprises will not only enable the rise of the market economy-type ownership rights and economic environment but also create a huge number of asset owners in a very short time. Delays in the privatization process will give more possibilities for corruptive behaviour of the decisionmakers.

The issue that causes most inequality in asset distribution is though privatization of big state-owned enterprises (SOE). The short-term distributional effects of this so called mass privatization, where a large part of state-owned property is being privatized for a large number of citizens, are not unimportant, although the distribution of shares of big joint stock companies will be mainly determined after the secondary markets have developed. A major issue in the privatization process is the use of special privatization vouchers,

compensation notes, ownership certificates or some corresponding assets¹¹. Almost every transitional economy used some kinds of vouchers as means of privatizing assets at some stage of the reform. The magnitude of voucher privatization is certainly an equality-increasing component. A free giveaway of vouchers means that all individuals receiving vouchers have the same possibilities to purchase privatized assets, even if they possessed no initial wealth. In some countries all citizens are not involved in the voucher programs, because of the legislation or because vouchers are sold, not given out.

The effects of voucher pricing must not be mixed up with the effects of asset pricing. One could think that the lower the prices of assets is, the more possibilities persons with lower income level have to purchase assets and the more equal the distribution will be. Chilosi (1996) points out that it's those who are wealthier and better endowed with financial resources that benefit most from the possibility to purchase assets for a cheaper price than the maximum price they would be willing to pay. This aspect will be proved further when the secondary markets are taken into account in the next section. Maximum-profit pricing of state-owned assets is the best possible solution not only for the state budget but also for distributional consequences.

One significant issue particularly in Russia is insider privatization. Chilosi claims that insider privatization has "the seeds of what could become a very skewed distributional structure". The primary fears are the absence of outsider investors and the privileged position of enterprise managers. When shares are given out to employees free of charge or for a severely cheap price (for example to compensate the loss of employment security and relaxing working conditions) those working for these big enterprises will benefit from insider privatization. Insider privatization in Russia enabled the nascence of a group of 40 million Russian share owners¹². Because experience has not yet proved that insider ownership is only a temporary form of ownership which is vanishing, it's useful to think of the long term effects of insider privatization, which will be discussed in the next chapter.

Definitely an equality-decreasing factors is the amount of spontaneous privatization done outside the official privatization program by former communist-time enterprise managers based on not much else than personal interests. This was mainly a specific problem for Russia, but also for Vietnam. The so called business-nomenclature, that consisted of certain managers of state-owned enterprises¹³, was in the final years of socialism able to collect wealth and political power around them. Instead of taking part to the legal privatization program, some managers declared themselves as owners of the companies. In countries in transition with a weak central government and corrupted local leaders, that kind of activities were possible to carry out, especially when the significance of private property hasn't been understood by the majority of the population yet. It's obvious that those kind of activities triggered the creation of a new privileged class.

Regional differences in the timing of privatization are important. Chilosi says that privatization "can lose momentum" if not started quickly enough. Besides, both voucher distribution and privatization of enterprises have been carried out with regional lags.

¹¹ From now on the term voucher will be used to describe any coupon that can be used only for purchasing privatized property.

¹² Figure taken from Higgins & Binns.

¹³ See for example Saizew's (1994) study of the new Russian entrepreneur class.

Therefore high inflation will erode the purchasing power of the vouchers in the slower regions, and decrease equality. Not only in Russia, but also in some other countries like Moldova delays of privatization processes were a cause for spontaneous privatization and misuse of managerial power. Managers of an enterprise, who know that the enterprise is going to be privatized but don't know the exact time of privatization, have the motive to take care primarily of personal interests and "not be committed to enterprise development before property questions are settled" (Wang 1994).

7 AN EMPIRICAL CLASSIFICATION OF CHANGES IN OWNERSHIP IN TRANSITIONAL ECONOMIES

7.1 The Starting points

Different possibilities for acquiring ownership of agricultural land and small enterprises and of control rights in state-owned enterprises in socialist economies are summarized in table 7.1. Housing was provided by the state or by the state-sector employer in most countries and the rent was way below the free market level. The significance of the ownership of housing wasn't very big and the privatization procedure of housing differed in most cases from that of other assets. Therefore, although the share of personally owned housing varied a lot, from the Hungarian 3/4 to practically non-existent in China, the differences in the ownership structure of housing will not be discussed more detail. A more vital welfare issue concerning housing, which is not directly related to this study, would be the question of maintenance of private housing stock after the state has given up these duties with it's ownership rights.

By studying various statistics of private income and production, and analyses of state-owned enterprises in socialist economies, different transitional economies can be categorised according to their initial possibilities for personal ownership. I have used three criteria: the importance of private agriculture, the share of income from private activities (or private output) and the extent of employee participation in enterprise management. The transitional economies are classified in table 7.1 according to the fulfilment of these criteria. Besides that I've identified three countries that had a relatively strong private income from the rural sector, but a negligible private sector in other branches of the economy.

Although the categorisation seems rough, the differences between categories are quite evident. Only two East European countries, Poland and Hungary, did visible moves towards more liberal ownership regimes before the end of 1980's, while in Vietnam the communist ideology never reached the level of the most orthodox centrally planned economies. Besides those countries, the income from private sector activities rose to more than ten percent only in the former Yugoslavian republics and in Lithuania (Milanovic 1996, 49). In Yugoslavia the employees control rights were also at a similar level with Hungary or Poland; Lithuania also had an important private rural sector.

The countries that didn't introduce private property rights are also easy to identify. In Europe Albania and Romania were most centralized both economically and politically with no possibilities for any other kinds of personal ownership than small farm plots. The situation was similar in China and Mongolia. Still, the Chinese private agricultural sector

was estimated to produce as much as 1/5 of the rural population's income (Griffin & Saith 1981, 16). In addition to China, the share of the private rural sector was around 20 % in Moldova and Georgia.

TABLE 7.1
Initial conditions of the private sector in transitional economies

	Private agriculture ¹	% of rural pop.(90) ²	Private production ³	Management control of employees
Good possibilities for private ownership				
Hungary	11% of land	39	income 10%	significant
Poland	75% of land	38	income 22%	significant
Vietnam	income up to 75%	78	output 44%	practically good
Reasonable possibilities for private ownership				
Croatia	n.a	44	income 10%	significant
Lithuania	output over 1/3	32	income 12%	very limited
Slovenia	n.a	44	income 10%	significant
Small possibilities for private ownership				
Belarus	1/4 of output	34	income 5%	very limited
Bulgaria	n.a	32	income 9%	limited
Czech Republic	4% of output	22	income 4%	not much since 68
Estonia	6000 private farms	29	income 8%	very limited
former GDR	output 1.5%		employment 5%	comparably good
Kazakhstan	n.a	42	5% of capital	very limited
Kyrgyzstan	n.a	62	n.a	very limited
Latvia	2% of land	31	income 7%	very limited
Russia	income 3%	26	income 3%	very limited
Slovakia	4% of output	22	income 4%	not much since 68
Ukraine	income 4%	32	income 7%	very limited
Uzbekistan	n.a	60		very limited
Repressed possibilities for private ownership				
Albania	plots<200 sqm	64	employment 0%	none
Mongolia	n.a	48	negligible	negligible
Romania	small plots	47	income 3%	none
Strong private agricultural sector				
China	20 % of income	44	output 0.5 %	small
Georgia	18% of land	44	n.a	very limited
Moldova	output 20%	53	income 5%	very limited

Sources:

¹ IMF and OECD country reports, Eastern Europe and the CIS (1992), Griffin & Saith (1981), Probert & Young (1995).

² World Bank (1993).

³ Milanovic (1996), IMF country reports, Monck (1995).

7.2 The Chinese approach: Marketization vs. privatization

China has been changing its economy towards a more market oriented system more or less since the beginning of 1980's. Because of the uniqueness of China, I will discuss it separately from the other countries. The Chinese HBS in 1988 was the first effort to study the asset distribution in an economy in transition from socialism to market economy. Although the research was done only in the rural sector, and although the results from China are hard to apply to other transitional economies as such, I will also point out some results and aspects from that survey summarizing McKinley's article.

The Chinese land reform distributed small plots of agricultural land to families without a legal transfer of full property rights, but through long leases. In the research on asset distribution leased land is though treated like private property. Of the four groups of assets (housing, land, productive and financial assets) land and housing were most equally distributed. The same results can be expected from other rural societies in transitional economies, because those two assets were essential for each individual's personal purposes and in their privatization process equality aspects will have a bigger preference. For the urban population we can assume at least an equal distribution of the housing stock.

The most inequally distributed assets in China were financial assets, a fact that again is also observed in other transitional economies. When stock markets emerge with huge speed and large market imperfections, the rise of inequality is more probable in areas where fast profits can be made, and where a new type of ownership rights has to be born without the existence of the self-enforcing mechanisms mentioned in chapter five. One must keep in mind though that also the privatization of enterprises has been done quite differently in China than anywhere else. In China collectively owned township and village enterprises play a significant role, especially in evaluating asset ownership.

A further result of the Chinese study was, that all four groups of assets were less equally distributed than assets on aggregate. That too is a very reasonable assumption to generalize. In the privatization process there was no intention to distribute all groups of assets equally, but to give the ownership of different kinds of assets as an alternative to every citizen. The mass privatization programs were a good example, usually privatization vouchers could be used for purchasing either housing, land or shares of enterprises. Therefore an unequal distribution of one asset group does not necessarily mean that the assets in general are inequally distributed.

7.3 Privatization in Eastern Europe and the FSU: Legal transfer of property rights

In all other transitional economies except China, the legal transfer of property rights through privatization has been the way of increasing the efficiency of the old state-owned capital. Different privatization methods have been used: restitution, auctions, privatization to insiders and voucher regimes. Besides that especially in the former Yugoslavian republics a significant number of new small companies were formed as a result of a more liberal enterprise law. All countries used more than one approach, but in most cases one or two methods were dominant. The next section goes through the privatization policies and

proceedings. Because of the distributive importance of the mass privatization scheme, it will be discussed separately.

The growing share of private output is an outcome of successful privatization. However, for determining the ownership structure the developments of different privatization schemes are at least as important as the aggregate privatization results. Table 7.2 shows, that the private sector produces more than half of the economy's output in about a dozen transitional economies. Different countries though have problems in different areas of privatization. The neglect of one sector can have dramatic distributive effects. For example, in spite of otherwise promising privatization results, the land reform of both Russia and Estonia is lagging behind. Privatizing small and medium enterprises was clearly the main objective of practically all transitional economies (probably with the exception of only Moldova). The relative success of privatizing that sector goes hand in hand with the aggregate privatization results.

So the results to be derived from table 7.2 are as follows:

-In Albania, Hungary, Latvia, Czech Republic, Lithuania, Poland, Slovakia and Slovenia the share of private sector output has already risen to over 50%. In all of those countries privatizing small enterprises has also proceeded successfully, which means that a large class of asset owners has evolved in those countries. Privatizing big SOE's has proceeded with various velocities. In the former GDR and Hungary also the privatization of big enterprises has been successful, while especially Albania is having problems with that.

-In Slovenia, and to a big extent also in the former GDR, creating new small enterprises particularly in the service sector has been more important than privatizing old SOE's. That might be good for efficiency but the relative unimportance of privatization might close out a large share of the population from the process of getting ownership rights. Most of the new private sector enterprises are small (< 50 employees) and efficient enterprises, but they employ only 14 % of the work force (Böhm 1995, 387) and probably even a smaller share of the capital stock, so the majority of the asset distribution is though determined by privatizing state-owned companies.

-In Estonia and Russia the agricultural reforms are lagging behind. The share of private production is over 50%, but privatizing old and inefficient collective farms has been difficult so far. The bad situation of the agricultural sector has certainly added to the vast increase of inequality in those two countries. There is not only a falling trend of the rural sector's relative wages (World Bank 1995, 185 and 449) but the possibilities for private ownership are hampered by lags in privatization.

-Bulgaria, Croatia, and Mongolia have had fair privatization results especially in the small enterprise sector and the share of private production is around 1/2. Still, the growth of the private sector is not as fast as in the most advanced transitional economies.

-The other European transitional economies, Belarus, Moldova, Romania and Ukraine are having difficulties with the privatization process. The difficulties are mostly related to the big SOE sector, but for example in Belarus the implementation of the land ownership law was delayed while in Moldova the problems culminate on the small enterprise sector, the privatization of big enterprises was seen more privileged (Böhm 1995, 266).

TABLE 7.2
Privatization proceedings in transitional economies

	Share of private output 95	Big SOE privatization 95	Small & medium enterprise privatization	Housing and land privatization
Albania	60%	started 95	95%	completed
Belarus	15%	10% (94)		no land ownership
Bulgaria	45%	10%		<50%
China	14% (92)		80%	
Croatia	45%		47% (92)	almost completed
Czech Republic	70%	50%	100%	almost completed
Estonia	50% (94)	74%	90% (93)	slow
former GDR	~100%	~100%	100%	
Hungary	35%	75%		1/2 mio land owners
Kazakhstan	25%			
Latvia	60%	46%	70%	
Lithuania	55%	57%	70%	completed
Moldova	25% income	27%	<10%	about 1/2
Mongolia	50%	41%	65% (92)	housing: slow
Poland	60%	32%	70%	
Romania	30% (94)	13%	25%	land completed
Russia	55%	55%	70%	slow
Slovakia	60%		75%	
Slovenia	86% (94)	*	*	
Ukraine	35%		20%	
Vietnam				fast, corrupted

* In Slovenia the emergence of new small enterprises had a bigger significance in the early transition years than the privatization of state-owned companies. Privatization accelerated in 1994-95 (See Böhm 1995, 386-387).

Sources: IMF (1996), OECD (1995), CCET, Böhm (1995), Tria Kerkvliet (1995), Abeywickrama (1996), Monck (1995), Wang (1996), Warsaw School of Economics (1994)

-Privatization in the Central Asian FSU-countries is lagging way behind other transitional economies. Wars and less liberal political regimes on one hand, and difficulties with government budgets and the overall economic performances have delayed the start of privatization processes. In many cases it's too early to draw any conclusions of the future asset distribution, since most assets are still being more or less controlled by the state.

-Vietnam is the country that has the largest rural sector of all transitional economies. Although the agricultural privatization process is proceeding relatively fast and principally in a fair manner, problems with corruption have complicated the process.¹⁴

¹⁴ See Tria Kerkvliet (1995)

TABLE 7.3
Mass privatization in transition economies.

Countries that have a voucher program				
	Value of vouchers	Price of vouchers	Coverage of voucher program†	Success of voucher program
Albania	50-100.000 lek	2% of value	A, "urban", 60%	50% of eligibles covered
Belarus			94:24%, 96:65%	94 program unsuccessful
Bulgaria	25.000 lev	100/500 lev	A, 80%	poll: 1/3 won't participate
Czech Rep.	1000 "inv. points"	1000 korun	A, 77%	75% of adults, 58% of pop.
Estonia	300 ekr/year labour	free	A (15yrs), 73%	
Georgia		free	E	
Hungary	compensation notes	free	10%	42 of 118 bio forint used
Kazakhstan			E	87% of privatization
Kyrgyzstan	1000 rbl+labour		E	
Latvia	28 lats	free	E	slow, inequal distribution
Lithuania	640-3200 litas	free	E	
Moldova	depends	free	E	0.45 pf 4.35 in 94
Mongolia	tot. value/population	free, equal	E	95% obtained vouchers
Poland		<1/10 mthly wage	A, 70%	
Romania	23-27.000 lei	low	A, 70%	67% distributed 92
Russia	10.000 rbl	free	E	97% vouchers used
Slovakia	1000 "inv. points"	1000 korun	A, 77%	
Slovenia			E	1.8 of 2 mio included
Ukraine	17.000 rbl		limited	by 94 9.4%
Countries that have no voucher program				
China				
Croatia	Autonomy of transformation			
GDR	Direct sale to strategic investors			
Uzbekistan	By end 94 only 4.400 investors in joint stock companies			
Vietnam				

Source: Böhm (1995), Abeywickrama (1996), American Embassy, Sofia (1996), Monck (1995).

† A= adult citizens over 18 years, percentage of people over 18 (demographic data from UNICEF 1995).

E= every citizens regardless of age

Most problems though are caused by the privatization of big SOE's. In some countries the mass privatization scheme has been very successful, but in others it hasn't been advancing at all. Table 7.3 collects the data from voucher programs and their successes in transitional economies. Only China, Croatia, the former GDR, Uzbekistan and Vietnam didn't introduce or haven't yet introduced a voucher regime. Other countries included in this study have published some kinds of vouchers.

The voucher regimes of Hungary and Ukraine can hardly be classified as "mass privatization" programs. The participation was very restricted and vouchers were primarily given as compensation to property lost during the communist era. In Hungary vouchers were not a way to privatize large amounts of state property to a large number of citizens, but rather a substitute to restitution of physical assets (OECD 1995, 113).

A free giveaway of vouchers to all citizens regardless of age was the case in nine FSU countries, Mongolia and Slovenia. The mass privatization of Kazakhstan, Russia, Slovenia and Mongolia was the most successful one at least from the point of view of equality. A major part of privatization was done by giving away assets for free, equally and for every citizen. Other free-giveaway voucher programs were less equal, because there were problems in distribution, lack of attractiveness or because the value of distributed vouchers was not equal but dependent on age, years of labour or other factors.

Most Eastern Central European countries restricted the mass privatization to the adult population, leaving out some 25-30 % of the population. In addition, obtaining vouchers in Albania, Bulgaria, Czech Republic, Poland and Romania included a fee, which discouraged the participation of many individuals. Belarus had two different voucher schemes, mainly because the first one was not a big success. The second one covered about the same share of population then the Eastern Central European programs.

7.4 The initial change of ownership structure - different paths

The process of transforming state-owned assets into private property has been one of the main objectives in the former centrally planned economies since the begin of economic transition. This is a process that can be separated neither from the overall economic progress of the countries nor from the change of the political climate and the psychological meaning of personal asset ownership. During this period the performances have not surprisingly varied between different countries. The process of ownership change has not been completed in any of the countries, but the events so far allow us already to draw primary conclusions about the way the assets are being distributed among citizens.

Path I (Hungary, Poland, Slovenia)

The state of the private sector was good already before the economic transition. The fast privatization of small enterprises and agricultural land has created a large number of private ownership of productive assets. The amount of poverty is at a very low level compared to other transitional economies, which is not least due to the quick overall recovery of the economic shock. Small privatization created little problems which is a promising sign for equality, and the climate for the foundation of new enterprises is

favourable. In Poland and Slovenia the mass privatization program was successful in distributing the assets of big SOE's to the majority of population, in Hungary the compensation notes were given as substitutes for those who couldn't take part in the property restitution.

Path II (Albania, Czech Republic, Slovakia, Latvia, Mongolia)

The private sector was largely depressed by the communist regime, but after the breakup of the old system transition has been fast and the emergence of private economic activities amazingly fast. The privatization of small enterprises, land and housing has been practically completed, but a majority of big enterprises still remain under the control of the state. The consequences of the entire privatization process remain to be seen, but poverty and income equality figures indicate, that the reforms so far have been relatively successful in maintaining equality.

Path III (Estonia, Lithuania, Russia, Vietnam)

Privatization is proceeding with a satisfactory speed, but the increase in poverty and inequality is alarming. In spite of successful mass privatization programs (except in Vietnam) the privatization process doesn't seem to distribute the property in the most equal manner. A specific problem for Russia and Vietnam is the size and heterogeneity of the country, which already makes inequality a more probable phenomenon. In those two countries also spontaneous privatization and corruption have been major problems. Also the Russian agricultural reform is not proceeding, and the same can be said about Estonia. In the two Baltic countries, maybe more than anywhere else, integration to western markets and fast reform of the enterprises has been preferred to equality.

Path IV (Belarus, Bulgaria, Moldova, Romania, Ukraine)

The share of private production is still less than 1/2 and problems remain in many sections of the privatization program. The starting point for the new ownership culture wasn't ideal either, and also the political developments have been much weaker than in the North-Western neighbour countries. Rising inequality is reflected by the dissatisfaction to economic reforms and, most extremely in Belarus, by an urge back to the old regimes has been expressed by parts of the population.

Path V (Asian FSU countries)

Although these countries are everything but alike from many aspects, a common feature in these countries is, that physical assets are still for the most part state property. Any far-reaching conclusions about the asset distribution are impossible to make, but after long delays in the liberalization of physical capital, the possibilities for creating a fair and credible ownership structure are certainly diminishing.

Special cases:

-former GDR has by large been integrated to the German Federal Republic. Regional differences in wealth will definitely exist for some time, but basically the country is living under the rules of modern market economy.

-Croatia, Macedonia, Bosnia-Herzegovina, Yugoslavia: Although some information about Croatia has been presented in this paper, the developments in all these countries have been severely affected by the long war period and can't be judged neutrally at the moment.

8 THE ROLE OF THE SECONDARY MARKETS

When we are in the situation where most countries have yet to privatize most of the formerly state-owned assets, it's too early to make any final analyses of the emerging distribution of physical assets. Although already the process of privatization is producing everything but an equal ownership structure, it will only determine the asset distribution for a short period. Some assets are given out for free or sold for an extremely low price and can be resold. The resale process will have serious equality effects. In this context the term "secondary markets" will be used to describe any resale of privatized formerly state-owned property or privatization vouchers in transitional economies. In spite of its importance to the changing ownership structure, the process of reselling and purchasing privatized property is in its infancy in most transitional economies and any further conclusions could turn out as being dangerously hasty. In addition to the conclusions from above I will make only short tentative comments about the importance of the secondary markets.

The redistribution of wealth after the privatization process is dependent on the change of the prices of assets and on the behaviour of individuals. Because of different time preferences some shareholders are more willing to prefer present consumption to future consumption than others. Fast inflation and fall of output caused a decline in real wages. Therefore an increase in current wealth might seem more attractive than private ownership and possible increase in future incomes. Besides, people who had lived in socialist economies all their lives weren't used to private ownership and couldn't possibly have perfect information about the future values of their assets, as the discussion in chapter five indicated.

The rise in income inequality can easily create a viscous circle. When some people get more productive capital than others, their relative capital income will rise, and they will be more willing to operate on the secondary markets, which are imperfect in the first transition years, and can give almost limitless opportunities for making fast profits. This means that failures in the privatization program and restructuring of the government transfer system can in the worst situation serve as a trigger to even widening asset distribution.

The way in which active secondary markets affect the asset distribution depends on the profitability of holding shares. There are a few strong reasons to assume that holding shares is definitely profitable during the transition process. High inflation has accompanied the transition processes, which means that real assets keep their value much better than cash. Socialist industries were also less efficient because more weight was given to the quantity of production and full-employment rather than the efficiency of production. The move to market economy introduced competition to the enterprises of transitional economies forcing these enterprises to tighter budget constraints and more efficient production. Actually the sheer possibility of asset resale can be a more inequality increasing factor than the privatization process itself.

It's not only differences in income that determine the incentives to resale the privatized shares of enterprises. One reason to sell one's assets or to make bad investments in assets is lack of knowledge. Since the whole concept of future gains of private ownership was vague, there was no way that all individuals could have had perfect information about the allocation of privatization vouchers. In many transitional economies investment funds were an important institution in the privatization process. Many private persons distributed the privatization vouchers to different investment funds and minimized the risk of losing profits. The existence of investment funds certainly encouraged many individuals with less information about capital markets to invest in asset ownership, as long as the investment funds are working efficiently and have no other purposes than the maximization of the profits and/or minimization of risk of their portfolios. Many transitional economies encouraged the formation of these funds, but in some countries the significance of investment funds has been minor.

A second motive for not reselling the assets is the already mentioned control over the asset. For liquid, easily resaleable assets like shares of joint stock companies, control over the asset is not an obvious element. Even though ownership of the company was in some cases thought as a compensation of lost benefits for the worker, like secure employment and relatively easy working conditions, the ownership might not have been seen as a benefit, if the worker could not influence any decisions concerning the company. The problem concerns not only keeping insiders as shareholders but also attracting outsider investors in the case of a very strong insider or manager control.

Especially in the case of insider privatization the control aspect is important if the intention is to maintain a large group of shareholders. The fear of enterprise ownership being concentrated into the hands of insiders in the long run is actual and can be shown from the data of Russian enterprises collected by Blasi. Then again, the fear of enterprise managers taking over the ownership from employees doesn't seem to be as evident, although the managers would prefer a much stronger top management share of ownership¹⁵. The whole item would require lots of separate studies to be understood completely. The initial purpose of insider privatization was an efficient and equal distribution of shares of the new joint stock companies to people who had incentives to maximize the enterprises' profitability and best possible information about the management of the company. Opinions about the ways in which insider privatization has served its purposes are certainly manifold.

In a few cases the resale of vouchers themselves is forbidden or limited. What can be purchased with the vouchers in auctions usually is not. Voucher resale was prohibited in Belarus, Estonia, Romania and Slovenia, Mongolia permitted the resale of only the so called pink vouchers, that were used for purchasing shares of small enterprises. All other countries that had a voucher scheme, also had active secondary markets of privatization vouchers. Some privatization laws also include prohibitions of the immediate resale of some assets. If countries introduce these kind of prohibitions or stronger incentives for

¹⁵ According to Blasi, the average employee ownership in the big and medium joint stock companies included in his interviews was 67 %, the average top management ownership only 10 %, the desired top management ownership (opinion of directors) 24 %. The latest research has shown a trend towards a stronger manager ownership.

keeping the shares, it will increase the resulting equality of shares distribution. If the privatization vouchers however are considered as financial assets of a similar kind than bonds or securities, a part of the population will sell themselves out of the privatization process already in the beginning.

The unwillingness or disability of some individuals to keep the assets will lead to a situation, where the share of asset owners in the economy is very small. Another reason for inequality is the difference between the initial price and the value of assets, which will widen the wealth gap between those who own assets and those who don't when the prices of shares increase. A concentrated asset distribution as a cause of selling assets alone does not necessarily mean rising inequality in wealth distribution, since the asset sellers get a payment for what they sell. A problem typical for transitional economies was, that the value for which some assets were sold, was way beneath the profits that could be attained with the ownership of that asset.

The nominal value of shares will partly be determined according to privatization policies. The initial valuation of an enterprise is the basis for the valuation of assets. There is no certain way to determine the exact book value of a state-owned enterprise of the socialist countries and in most cases that wasn't even the intention. On aggregate, the price for which shares were sold during privatization was undervalued. In the previous section the maximum-profit pricing of assets was said to be the ideal solution also for distributional purposes. That can be proved by examining the profits that can be gained from attaining and possessing assets during the transition process.

Let the real value of an asset be V and the price for which the asset can be purchased during the privatization process P . The profit won in the privatization process by the purchaser of the asset is $V - P$. In some cases P was equal to zero, which meant that the individual who gets the asset in the privatization process, will get a profit equal to the value of the asset. A zero value for P has two kinds of negative distributional effects: first of all those persons who are left outside the privatization program will lose relatively more. Secondly, let the resale price in the secondary markets for the same asset be S . The profits that can be gained by buying in the secondary markets is $V - S$. If P is low, it will be a signal for the secondary markets with imperfect information about the asset's value and keep also S low¹⁶, enabling more profits for the even more limited group of persons operating in the secondary market. S is though assumed to be higher than P , so that the assets won't be resold with loss. Inequality caused by changing value of assets will occur in two stages.

If the value of the assets is known already during its privatization, and maximum-profit valuation is used, $P = V$ and $V - P = 0$, so privatization has no distributional effects. In most cases both P and S were significantly lower than V , a fact that gave the secondary markets a more important role. P will be determined either directly by the privatization funds or by the supply and demand during the privatization auctions or tenders. The determination of S is a more complex issue. One factor is the supply and demand of assets

¹⁶ Another view is, that a free giveaway of a large amount of shares to insiders will make it possible for the privatization funds to increase the price of the remaining shares. The distinction between only giving signals to share markets and significantly reducing the supply of certain assets (which in extreme cases will turn an excess supply into excess demand) is an important one.

by individuals, which is determined by income, savings rate, information and motives for possessing assets. Those factors have been described before. Another important factor is the functioning of secondary markets. Since the shares of joint stock companies are the most important matter in this case, especially stock and capital markets are of extreme importance. The faster capital markets are liberalized, the more people have the possibility to operate in the secondary markets and the faster S moves towards V weakening the likelihood of the secondary markets to become a major root for an unequal asset distribution.

A final point is to be made concerning the role of foreign investors. The external liberalization of capital markets will bring important investment capital from abroad, which will speed up economic growth. Therefore the existence of foreign investors is seen mainly as a positive thing, but that can be said also from the distributional aspect. The sale of shares to foreign investors does not account to the formation of the country's internal social structure and that way foreign investors can be seen preventing the wealthiest classes from improving their status. The appearance of foreign investors will also increase experience and knowledge in the financial markets and will help to bring the prices of assets closer to their real value.

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