

Employee Ownership and the Political Debate in Estonia 1987-1994.

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1. Introductory remarks and overview.

The present article seeks to address the actualization and practical application of employee ownership within the transition towards a market economy in Estonia. This development is divided into stages: from the erosion of the command economy to the period of economic reform. The article highlights the specific background of employee ownership in Estonia which largely differs from the traditional context in Western countries: The transition has been characterized by a privatization-centered economic reform alongside high inflation and declining production. Estonia's has also regained political independence in the process. There are special peculiarities because of the multi-ethnic environment. A new political spectrum and political power struggles connected to the emergence of a new political and economic elite have been observable. The ideology related to the so-called "restitutionist wave" underwent various and partly contradictory shifts and tendencies. That is, the restoration of the pre-war property relations, legal system etc. was a hot potato in the political debate. Certain equalization tendencies and a strong right-wing oriented economic ideology have also surfaced.

This article analyses the links between Estonia's privatization policy and the development of its political spectrum. In certain niches, these processes created possibilities for privatization schemes based on employee-ownership. The article is not an attempt to provide a detailed overview of all stages in the development of the Estonian privatization policy.

Employee ownership played a more pronounced role in the Estonian reform ideology in 1987-1989. In this period, employee ownership was seen as a useful tool in the de-etatization of state owned enterprises. The schemes drawn up at that time envisaged delegation of state owned enterprises to the work collective in the form of so-called "people's enterprises" or in the form of leasing by the work collective. As this article will show, such solutions failed to get a central position in Estonia's transition. From 1990, preference was given to wide-spread privatization of state owned enterprises. Management buy-outs became a phenomenon frequently observed in the following years, but employee-buy-outs where the majority ownership was not in the hands of managerial staff only happened very seldom..

The development of employee ownership as an aim was not stipulated by the Estonian legislation, but some legal acts or their drafts include a number of concessions and favorable conditions granted to workers' collectives. This article deals with these and tries to determine the spread of employee ownership as far as the very limited available statistical data permits. The article also discusses whether the privatization scheme promotes employee ownership in the broad sense or if it simply works as a scheme for supplementary accumulation of capital by the management for buy-out purposes.

The first part of the article focuses on the period 1987-1989, the second on the years from 1990 to 1994. In both cases, the economic-political and general political environment is first described. Thereafter, the reform ideologies emerging out of that particular context are introduced. Finally, the legal framework of employee ownership, its way of functioning, and the rate of its actual application are analysed..

2. Employee ownership in the preparatory stage, 1987-1989.

Up to the end of the 1980'es Estonia was part of the centralized economic complex of the Soviet Union. The Republic had an extremely low rate of autonomy and the conditions of economic activity was similar to what prevailed in other parts of the Soviet empire. A substantial proportion of enterprises were directly subordinated to the Union Ministries. The activities of the rest of the enterprises - the "Republican" and "Union-Republican" enterprises - were strictly regulated regardless of whether they formally were state or cooperative property. The so-called "self-supporting operation" of enterprises remained a formality. It is noteworthy, however, that in Estonia the number of loss-making companies was much smaller than in the USSR in general. Therefore, one could detect certain economic "niches" with a relatively high degree of freedom. Examples are: the Estonian Union of Consumer Cooperatives, The Estonian Rural Construction association, enterprises of the Fishermen's Union and Estonian Agricultural Machinery association, collective farms in agriculture and in particular, their auxiliary and subsidiary production units, and to some extent also enterprises in the jurisdiction of the Estonian Ministry of Local Industry.

After Gorbachov's rise to power semi-private enterprises were allowed to be set up under the name of "modern cooperatives" and "lease-based contracting". These types of companies were established at a more rapid rate in Estonia than elsewhere in the USSR. In the 1980s, some Estonian ministries had additionally got the permission to introduce special experimental enterprises not allowed in other regions. Already before the Gorbachov era these experiments included: "lease-based contraction in public-oriented services" as well as state-owned small enterprises in light industry

and construction. These small enterprises were independent production units established as spin offs from large state owned enterprises. They serviced on a contractual basis the parent enterprise and performed economic activities which did not have to meet plan targets. These small enterprises could themselves dispose over their profits. In this sense, these type of enterprises constituted in essence semi-private entities. The term "state-owned" served here more as a disguise since in practice the charter of these enterprises left the ownership issue unresolved.

Some attempts to modernise the activities of enterprises were made during the Gorbachov period as well as in the years immediately preceding his entry into government. Corresponding steps were undertaken in the name of increasing the autonomy of work collectives and stimulating worker initiatives. The attempts included the formation of work collective councils and the election of managers by the employees. At the same time, enterprise managers were given more freedom to act on their own. This was done in a way that did not contradict the best traditions of socialist phraseology. The discussions at that time about the transformation of property relations cannot be translated into the legal language used in the West. The work collective was to become the owner while the enterprise should remain in the possession of the socialist state.

In the fall of 1987, the first steps were made to draft an economic reform for Estonia. In the autumn of 1988, a more comprehensive and detailed reform concept was elaborated. Two distinctive features will be emphasized here. First, it was a reform concept where the progress toward a market economy was linked with the underlying aim of increasing the economic autonomy of the Union-Republic, Estonia. Secondly, the reform was not initiated by the top leaders of the republic. It was born as an oppositional platform directed against the devoid of authority and stagnant leadership of the republic. The plan was both reflected the ideas of reform-minded economists and was also a forerunner for the independence movements in other parts of the Soviet Union. The reform plan gradually gained support through debates in the press and through mass meetings.

Concerning the status of enterprises, two main principles were formulated: multiplicity of forms of property and organizational forms including permission for private ownership as well as independence of enterprises from the state bureaucracy. The spreading of private ownership over time was to take place. but a rapid and mass-scale privatization of large enterprises was not considered to be a realistic short-term goal. The independence of most enterprises, fast price and wage liberalization etc.were regarded as the fundamental preconditions for the efficiency of

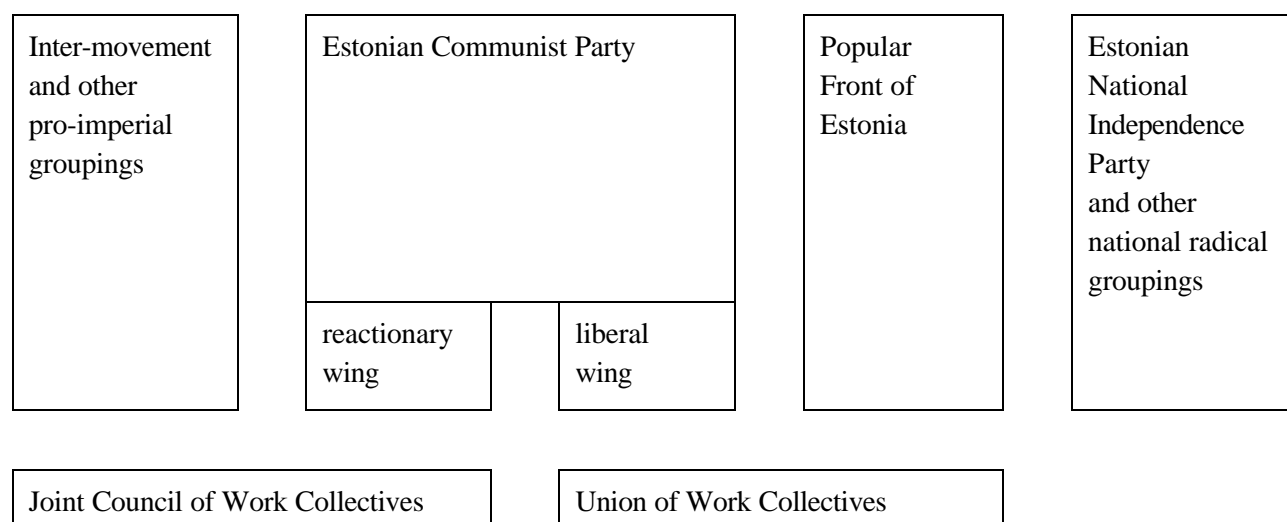
the new system. The principal objective of the reform was initially called "de-etatization" of enterprises. This should be done by transforming the state owned enterprises into so-called "people's enterprises". The concept was proposed by professor Uno Mereste. The state property should be transferred to the work collective of the enterprise without any charge. The enterprise should be run by the board elected by the employees according to the principle: "one person - one vote". The possibility of non-employee membership was not envisaged, but it was stipulated that a "people's enterprise" could hire non-member employees on a contractual basis. The property of the "people's enterprise" was treated similarly to the anglo-american "trust property". The "people's enterprise" was not under the command of central authorities and could dispose over the income of the enterprise, given that the following restrictions were adhered to: a) there should be an allocation to the founder according to the constitutive agreement; b) there was to be set a minimal ratio of investment and transfer to the wage fund; c) a risk fund for possible losses were to be established, and if this was insufficient, it should be possible to deduct up to a quarter of each member's salary for covering the deficit.

The concept of a "people's enterprise" is related to the idea of modern cooperatives and the earlier mentioned "small state owned enterprise". At the same time, it was better elaborated and not only designated for application in the periphery of the socialist economic structure but as a mass scale solution for "de-etatization" of the main part of the state owned enterprises.

In the beginning, the government of the Estonian Soviet Socialist Republic was opposed to these reform ideas. However, the political situation changed rapidly in Estonia, and in the summer of 1989 prime minister Indrek Toome decided to involve representatives of the opposition in the reform related responsibilities of the government.

When the initial reform was drafted in 1987, the different political groups were not formed officially. In 1989, the situation had changed and the political forces at that time can be shown in the following way:

Figure 1. Estonia's political forces in 1989.



The greatest support was rendered to the popular movement - the Popular Front of Estonia (Eestimaa Rahvarinne) which by their pressure largely directed the development of social processes in Estonia. In 1989, the formation process of different political parties was gradually triggered within the Popular Front. At first, however, the process was of secondary importance.

The country continued to be formally ruled by the Communist Party. From the autumn of 1988 and onwards, the more liberal and national wing dominated Estonia. It tried to take some of the heat off the excessive pressure coming from the Popular Front, using tactical, political manoeuvrings. At the same time, the liberal wing preserved tolerable relations with the central government in Moscow as well as with the Estonian pro-imperial communists. While in the treatment of certain issues, the Popular Front and the liberal wing of the Estonian Communist Party set up a certain coalition, they basically disagreed about the pace of the economic reform.

The Popular Front insisted on a quicker reform process. The movement proposed a package which included the idea of "people's enterprises" and that Estonia could undertake an independent and radical economic reform process. The acceptance of this reform from Moscow had in fact been promised by the Communist Party of Estonia. Instead, the Communist Party decided to procrastinate.

The national radical wing of the Estonian spectrum of political forces (the Estonian National Independence Party, etc.) started to gain strength in 1989. At the time, this wing was not involved in economic issues but focused on its main priority target; Estonia's independence. Moreover, the national radical wing feared that the economic

reform might be associated with a number of dangers enabling the Communist Party of Estonia to take the initiative and implanting illusionary hopes into the minds of Estonians. That is, that the economy could be improved within the existing Soviet economic system which again would blur the overall principal goal of reestablished independence.

The basic point of disagreement in the political spectrum was, on the one hand, related to the whole of the pro-Estonia wing (including part of the Communist Party of Estonia) and, on the other hand, the pro-imperial one. The Intermovement and the more reactionary faction of the Communist Party was fiercely opposed Estonia's separation from the Soviet economic complex, her likely return to national independence, attempts to restore capitalism etc. The sharp attacks by the pro-imperial side were primarily aimed against the Popular front as the proponent of Estonia's autonomy and independent economic reform. Estonian national radicals cultivating the legal-political ideology of the restoration of the pre-war Republic of Estonia was not considered as a serious threat.

The pro-imperialists in Estonia were made and backed up by Russian-speaking workers of large union enterprises, subject to manipulation by the management and reactionary communists. These threatened workers with closing down factories and bankruptcies initiated by the "Estonian nationalists", the disruption of economic relations with the Soviet Union, imminent unemployment, etc. Such propaganda was met with approval, because a great deal of enterprises in all-Union subordination were artificially established structures, largely based on distorted price policies (e.g. low prices of metals and energy). These enterprises were likely to suffer with the introduction of a market economy. One of the political manoeuvres was the foundation of the so-called "Joint Council of Work Collectives" on the basis of the enterprises under the jurisdiction of Union ministries. Despite the fact that the Joint Council of Work Collectives was initiated by pro-imperial politicians and the managements of enterprises, it skillfully applied the slogan of defending the interests of work collectives, i.e. workers. The actions undertaken included mass meetings and strikes to hinder an undesirable political developments in Estonia. These actions were initiated from above in coordination with reactionary forces in Moscow.

To counterbalance the situation as well as to deprive the Joint Council of Work Collectives from the possibility to propagate itself as the sole representative of the workers, "The Union of Work Collectives" was established. This organization was initiated by managers of enterprises with an Estonian majority.

In this way, work collectives were dragged into the political arena and the collectives were drawn into a fight over the continuation or obstruction of national and democratic developments rather than just focusing on the enterprise level issues. "Playing out the card" of "interests of the work collective" by the reactionary politicians against the Estonian national and democratic movement constituted one factor seriously compromising work collective-centered thinking. The embroilment of enterprises subject to union jurisdiction in the political struggle gave rise to well-grounded fears that if the work collective's got control of the enterprise, this might serve as a basis for economic sabotage against Estonia's drive toward independence.

When the charter of the "people's enterprise" was finished and the plans for the actual transformation of state companies into these "people's enterprises" started to be drawn up in late 1989, it appeared that the original idea had lost part of its former attractiveness. Paradoxically, the charter was both considered too radical and too moderate at the same time. The objections raised in the discussions can be classified as follows:

a) "People's enterprises" may be difficult to run for the management and inefficient in economic terms constituting an entity resembling large industrial "kolkhozes" (collective farms in Soviet Agriculture).. Corresponding fears had been addressed by the reformers earlier with the ultimate conclusion that the independent operation of enterprises and encouragement of worker initiative would outweigh the likely decrease in efficiency. Furthermore, there were no reason to expect that "people's enterprises" would perform worse than the typical state enterprises of the command economy.

b) The formation of "people's enterprises" would, in the ideological sense, mean the abandonment of the idea of straightforward transition to a capitalist system and instead signal a search for "the third way". This statement was forwarded at the time when the self-management system in Yugoslavia was given up. Note, that such arguments had not been imaginable in the public debates of 1987 but at the end of 1989, a remarkable ideological shift had taken place.

c) Transfer of the assets to the work collective without any charge would prove unjust on social grounds and the corresponding decisions about which enterprises to transform into "people's enterprises" might pave the way for corruption. The specified fees to the founder and personal liability of the member-employees with up to 25 per cent of the salary (it was stipulated in the the statute of a people's enterprise) were not considered to be sufficient to counterbalance the social injustice. One work

collective, for instance, would obtain better technology than the other, and workers engaged in transformed enterprises would gain more respect than people employed in the social sphere for example.

d) Compared to the sale of shares into private hands, the establishment of "people's enterprises" would not serve as an additional source of state revenue,. This argument was associated with the introduction of Estonia's national currency. To stabilize the new Estonian KROON, the excessive quantity of money should be withdrawn from the hands of private persons. The selling of enterprise shares would be more appropriate and gentle than a simple depreciation of the value of savings by a devaluation of the KROON's exchange rate to the former Soviet ruble.

e) Some prominent Estonian lawyers considered the inclusion of the possibility of delegation of Anglo-American trust property or any other similar variant into the Estonian legislation as unjustified. The absence of such a legal conception threatened to pose a serious obstacle to the establishment of "people's enterprises". The conveyance of an enterprise to the work collective was acceptable in social terms when it was done in the form of trust property with the accompanying liabilities and restrictions. The free of charge "complete" transfer into cooperative ownership, for instance, was definitely not socially acceptable.

f) The accelerated abolishment of state control over a great number of enterprises might in the politically unstable situation prove to be too dangerous. It would produce reduced possibilities for handling resources in a political crisis, etc.

g) Associated with the former argument, some enterprises might be under control of forces advocating the ideology of the Joint Council of Work Collectives and become an instrument dictated by their political ambitions and performing economic sabotage.

The list contains the publicly used arguments. The analysis of pros and cons, however, constitutes only part of the discussion and do not cover all the practical implications of the debate. The other aspect pertains to the interest groups existing at that time and the impact exerted by them. Of relevance is the fact that the referred groups had started gradually to assume concrete form. The idea of "people's enterprises", when made public, was welcomed by the enterprises and looked upon as a "rescue of" enterprises from the "state's bureaucratic interference". The application of self-management principles seemed most realistic in the actual execution of the process.

In 1989, the interest groups acquired a more well-defined status because of the following three developments:

a) Joint ventures with the involvement of Western capital started to be set up. The more active managers of state enterprises as representatives of the interests of the state regarded the participation in businesses with foreign capital by far more fascination and expectations of personal gains than "engagements in squabbles" with the work collective of a "people's enterprise".

b) Within the reform package, of the fall of 1989, the charter of joint-stock companies had been completed. The managements of several enterprises, contemplating earlier business activity in the framework of "people's enterprises", saw in the shareholding mechanism a possibility to exercise personal control over a significant proportion of the shares of the enterprise. Owing to the absence at that time of a well-elaborated privatization program the general understanding was that, given the favorable conditions, the managers were able to obtain control of the company or at least part of the shares free of charge.

c) The government reform of late 1989 instituted a joint Ministry of Industry and liquidated some branch ministries: the Ministry of Light Industry, the Ministry of Forest and Timber Industry, etc. The branch ministries were substituted by associations with a quite unclear status. The lack of a clear status of these organizations gave the leaders a possibility simultaneously to act as entrepreneurs and to a certain extent as representatives of the state giving them governance and administrative control over the enterprises. Correspondingly, the members of these groups started to look negatively upon the idea of establishing "people's enterprises". Their interest shifted to shareholding schemes. Unlike the enterprise managers the representatives of associations considered their institutions as the axis round which the processes were to revolve.

The conclusion on the described development is that the social basis of the idea of "people's enterprises" was eroded over the last couple of years. The Popular Front as the initiator of the economic reform was in a complicated dilemma: on the one hand, as a broad-based popular movement, it could not approve the transfer of the control over the enterprises to the managers and top ranking men in the associations. On the other hand, since the idea of self-management was not popular among the masses, no pressure was actually exercised by workers about the "take over" of companies. The creation of owners through buy-outs was acceptable for the architects of the

economic reform on social grounds, but it was predicted to be highly time-consuming (which, by the way, has proved to be true). Therefore, at the end of 1989 and at the beginning of 1990, a certain balance was struck: the charter of "people's enterprises" was under the reformers' pressure adopted on December 11, 1989. The number of "people's enterprises" to be established remained, however, unspecified.

Later the disputes over the ownership of enterprises were continued based now on a new concept, the concept of privatization.

3. Employee ownership and the privatization policy 1990-1994.

3.1 The political development - working toward privatization.

In the early months of 1990, an essential shift occurred in the political and economic-political consciousness of the Estonian society relating to a more radical stand taken toward the future of state-run companies and state ownership. The key words characterizing the period were privatization and property reform. Different political forces started to rapidly draw up schemes of accelerated transfer of state property to private ownership. This tendency was typical for a great majority of the political forces of Estonia. On the one hand, it was dictated by the general development in Eastern and Central Europe with the abandonment of socialism, also in its reformed version. On the other hand, it was determined by Estonia's strive toward a completely independent future and a reaction against the continued use of socialist phraseology and the reform limitations set by Moscow.

The Estonian political spectrum of the summer of 1990 can roughly be described as follows. Estonian national radicals proposed different schemes of rapid redistribution of state property with emphasis on the restitution element - physical return of property to pre-war owners, their successors and heirs. The enterprises established in the Soviet period were interpreted by them as so-called reserves (substitution property) which could be used as a compensation when the expropriated property had been destructed or changed in such a way that it could not be directly restituted. Subsequent to the spring 1990 elections, the Popular Front formed a new government. Privatization was addressed in the context of the economic reform programme of the government. Different categories of sales were the preferred type of privatization. However, several new political parties which had their roots in the Popular Front movement campaigned for redistributive schemes, rather than sales in exchange for money. This was done in an attempt to create "a distinct political face" different from that of the government and broaden their electoral base. They wanted to combine the return of property to pre-war owners, their successors and heirs, and

compensation to all Estonian citizens and residents, by way of free-of-charge distribution of vouchers.

The liberal wing of the Estonian Communist Party propagated in its official documents a relatively slow, gradual mode of privatization, oriented toward the interests of the working people. However, after the defeat in the 1990 parliamentary elections, a number of the Communist politicians - most notably members of the liberal wing of the Estonian Communist Party - resigned their party membership and joined business circles (e.g. real estate, banking, etc.). Therefore, it is hard to provide a clear-cut definition of the Party's attitude toward privatization.

The so-called imperial wing of the political spectrum derived its main support from the management of Union enterprises. They were publicly and officially against privatization and capitalism as such, but in practice many of them started to apply all-Union, Soviet, privatization schemes in order to safeguard personal beneficial transfer of property, thereby forestalling the regulation in the Estonian privatization legislation.

The described shift was coupled with two major changes in the debate on entrepreneurship and the transformation of enterprises: a) Whereas earlier the emphasis had been on the preparing the enterprises for the market economy, the focus was now on how to sell and break-up enterprises. The focus of the debates shifted to problems such as: by whom should enterprises and land be bought and should it be paid by monetary means or freely distributed vouchers. b) Related to entrepreneurship, such phenomena as leased "people's enterprises", participation of foreign capital, or broadening of share capital of state-run companies started to be addressed in the context of future privatization.

Instead of concentrating on the economic effects, the debate and evaluation of the reforms focused on the type of property transformation and whether it proved beneficial or detrimental to the interests of the groups concerned. Correspondingly, the debates developed on two levels: the open public debate on one side and on the other side a debate provoked by hidden interests. Yet again, the debates were influenced by the interests of different groups and how the political parties perceived that different groups would react. The "classical" example being appeals to the concerns of "the work collective" or "producers". Influential groups such as managers of enterprises were keen to acquire "their" enterprise and state or industrial producers were fearful of losing control. Also the appeals to national endeavors and interests of

Estonian citizens played a crucial role. Some of the political parties wanted to create "a new elite" and hence to expand their constituency.

To grasp the impact of Estonia's changing political landscape on solving these issues, let us take a closer look at figure 2 (below) demonstrating the property reform platforms proposed by major Estonian political parties in 1993. With some caution in mind, it could be claimed that this scheme was valid for the entire period of 1992-1994. Drawing parallels with the distribution of political forces in figure 1, we can point to the following:

a) The so-called national radical bloc is accountable for a number of political forces. Figure 2 shows the Estonian Independence Party grown out of the dissident movement of the Soviet-period and the Fatherland Party representing similar views of the younger generation. The latter emerged a bit later and triumphed in the 1992 parliamentary elections. We can distinguish between a more liberal and a more national-conservative wing.

b) The political forces with roots in the Popular Front movement are: The Center Party, the Rural-Center Party and the Social-Democratic Party, the last two parties moved closer to the national-radical bloc, especially in relation to the property reform.

c) The Coalition Party (which in 1993-1994 was the most popular party) have some relations back to the Union of Work Collectives (shown in Figure 1). It is backed by the managers of state companies.

d) The Labor Party (which did not win any seats in the elections of 1992 and has not done so later on) is the legal successor of the former Estonian Communist Party which have lost many of the prominent members since the late 1980'es.

Figure 2. The Estonian political spectrum and attitudes toward privatization.

	Parties which formed the Government					Opposition		Not represented in Parliament
	Independence Party	Fatherland (Conservative wing)	Fatherland (Liberal wing)	Rural Center Party	Social-democratic Party	Center Party	Coalition party	Labor Party
Employee ownership	-	--	--	-	-	(+)	(+)	+
Restitution and compensation	++	++	?	+	n	-	n	-
Czech-type vouchers	n	-	n	++	+	(-)	-	?(+)
Participation of foreign investors	-	n	++	-	(-)	+>+/-	(+)	(-)

++ very positive, + positive, n neutral, - negative, -- very negative.

The figure reflects a situation where the government coalition and the opposition stand clearly apart in their approach to property reforms. They have different interpretations of the economic reform. The fundamental divisive issue being the problem of restitution, whereas the problems and possibilities of employee ownership remained in the background. The disputes over restitution and free-of-charge distribution of vouchers were already from 1992 onwards significantly more heated than over employee ownership. As shown in Figure 2, employee ownership receives presently only modest support. In a paradoxical way, even the Social-Democratic Party was negative toward employee ownership declaring that the formation of a well-defined relationship between employers and employees, as parties with specific interests, is of primary importance given the actual stage of societal development.

Public opinion polls indicate that the general attitude of native Estonian residents toward participation of work collectives in the privatization process is rather indifferent, and preference is plainly given to individualistic ideologies. The Russians residing in Estonia, by contrast, tend to be more work-collective oriented and are, therefore, more sympathetic to the principles of employee ownership. Owing to the defeat of imperial forces within Estonia's independence restoration process, the political parties defending the interests of local Russians began to be formed before the 1995 elections. They were not represented in the parliament in 1992-1995.

After the victory for the Popular Front in parliamentary elections in the spring of 1990, a new government was formed. The privatization concept introduced by the new government was finished by early autumn the same year. The Popular Front government believed that the main privatization method should be the government controlled sale of the assets of enterprises or shares into private hands. The objective

was to have a core investor in each privatized enterprise. Due to the pressure from the new political parties emerging from the Popular Front this model of privatization was on a limited scale supplemented by the restitution concept and application of privatization vouchers. In respect to employee ownership, the model contained two main aspects:

a) Granting the employees the preemptive right of buying shares and preferential treatment in the form of reduced prices. Although considered acceptable in principle and necessary on grounds of improved incentives, these measures were nevertheless only permitted on a restricted scale. For instance, the number of shares to be sold to the employees was limited to 20% of the total amount for sale and limitations on the discounts were also imposed. Behind these steps was an in-depth analysis of the economic practices in Poland.

b) It was recognized that the method of outright privatization had to be applied simultaneously with the so-called intermediate forms of privatization due to shortage of capital: One form was leasing of enterprises and subunits with an option for a future buy-out. Such lease arrangements concerned work collectives as well as more "narrowly" defined groupings. Another form was the so-called delegation of the enterprise into the usage by the work collective - the idea underlying the "people's enterprises" referred to above..

3.2 Employee ownership in small privatization.

The term "small privatization" refers to the sale of small trade, catering and service establishments. Starting from the spring of 1992, the term also covered all small- and medium-sized companies to be privatized according to a simplified procedure (primarily by way of auctions). The law on small privatization, adopted in December 1990, stipulated that the enterprise's employees had the preemptive right to buy the place in which they worked provided they received the support of the local or regional government. In case of the absence of multiple claimants, the preemptive right allowed the purchase of the property at its initial offering price. The local governments were presumed to provide the necessary approval of the application by the enterprise's employees only if it rendered the local population high-quality services. Employees of well-functioning trade and service establishments could thus receive certain privileges designed to contribute to political and social stability. In a politically tense situation characterized by two concurrent processes: the transition to a market economy and the withdrawal from the Soviet Union, even a minor protest action by retailers would have been highly unwelcome. The buy-out of a cafe, a hairdresser and the like was the overwhelmingly dominant method of small

privatization. During 1991-1992 over half of the buy-out cases of small service, trade and catering establishments took place. More than 80% of the total number of units sold fell into the category of employee buy-outs. This concerned 600 small- and medium-size enterprises.

Typical were the cases in which three or four employees of the enterprise set up a private joint-stock company upon which this new entity bought out the state or municipal owner. In many cases the price was paid by installments. It is hard to determine which of the buy-out cases were actually management buy-outs with minor participation of some employees and which were "pure" or broad employee buy-outs. No precise data exist about what proportion of the employees participated in the buy-out or what percentage of the shares of the joint-stock company buying the unit were possessed solely by the manager.

The practice of giving the employees privileges was met with much public distrust, because the voluntarily fixed-discount prices permitted the employees in some cases - in the absence of competitive biddings - to purchase the units at rock-bottom prices. The preferential treatment of work collectives within the small-privatization scheme was further criticized because of the following reasons: the local government "filter" failed to perform an effective control function. Local authorities accepted without objections the vast majority of the applications seeking preemptive right. In quite a few cases it was later discovered that outsiders had bought a favorably-located service establishment at a low price, by making skilful use of the employees. The subsequent checking of the source of the funds proved to be highly complicated. Those who identified themselves with the Estonian right-wing disapproved whatever preferential terms granted to the work collectives.

In the spring of 1992, Estonian legislators abolished the preemptive sales to employees in the form previously applied to small privatization. Maintained, however, was the opportunity for the insiders to purchase units at the final competitive bidding price. The new version of the Estonia's privatization law, from 1993, declared this clause null and void. Thus abrogating all the previously existing privileges. However, small privatization in Estonia was at that time already approaching its final stage. The amendments introduced into the legislation in spring 1993 slightly reduced the number of units sold at excessively low prices.

3.3 Employee ownership in large privatization.

Within large scale privatization we shall treat separately the two following questions: First, the preferential terms created for the employees buying out their enterprise and second, the actual spread of management and employee buy-outs.

Because of the delay in privatization of large enterprises caused by several factors, the major one was internal policy battles - the adoption of the basic "rules of the game" occurred here in the period when the ideological shift made the interest of the work collectives politically "old-fashioned". We may speak of preferential terms granted to work collectives only in respect to some unimplemented legal initiatives and a few solutions with very indirect impact. The legislation governing large privatization in Estonia included no direct preferential terms for employee ownership.

In May 1991, the Popular Front government submitted a bill to the parliament, permitting the sale of up to 20% of the shares in state-owned joint-stock companies. The bill did not envisage the employees of the enterprise direct preferences in terms of discount on the buying price, but the proposal included privileges for the insiders in terms preemptive rights of buying shares. In addition to accelerating the privatization process and motivating the workers the step was conditioned by the galloping inflation imported from Russia. The opportunity of the employees to invest fast-devaluing Soviet rubles in the shares of their company was supposed to strengthen stability and serve as a more efficient instrument of blocking the foreign inflow of rubles into domestic companies than public sales of shares. The bill was rejected by the parliament with a margin of only a few votes.

In the following years, the sale of large enterprises was either blocked or carried out as the sales of entire enterprises or sales of a controlling interest. In 1994 the sale of minority shares started to be used as a separate privatization channel, but the rules contained no preferential terms for the employees.

The main reasons for the rejection of the 1991 bill were the following:

a) Several of the political fractions disapproved in principle the sale of state assets for money. Their preferred technique was the restoration of pre-war property relations and redistribution dictated by other national political goals. Therefore, every attempt by the government to apply alternative privatization methods was doomed to failure, especially those likely to increase popular support of the government.

b) Distrust in the Soviet ruble which at the time was legal tender in Estonia and fear of a massive inflow of rubles as payment for the assets to be privatized. Postponement of the sales until the introduction of the Estonian KROON would have reduced to nought the basic motive behind the sale of minority shares, namely the hope to rescue part of the personal savings from the grips of inflation.

c) It was mentioned that allowing the employees of the enterprises certain preferential terms was termed "socialist" in nature, and consequently, inappropriate.

The rejection of the bill did not provoke any large-scale public protests. The opposition managed to "drown" the debate with its claim that it was a "sacred" duty to restore the pre-war property relations. Even the leftist opposition with roots in the Estonian Communist Party struck an alliance with the national conservative wing and joined the chorus of critics declaring that although the restitution-biased mentality of the majority in parliament was ill-founded, it was nevertheless the prevalent parliamentary approach. The government had better to denounce its attempts at imposing privatization projects unapproved by the parliament. The behavior by the leftist opposition can be interpreted as the Estonian Communist Party's revenge on the Popular Front for the latter's refusal to co-operate with the Communists back in the 1989 and 1990 elections.

An indirectly beneficial impact on management and employee buy-outs was exercised by the possibility for Estonians of instalment purchase of enterprises introduced in 1992. This option cannot actually be considered as a preference designed specifically for the employees of an enterprise. It simply meant preferring any domestic buyer over a foreign one. Such distinguishing between domestic and foreign buyers was relatively widely practiced until the sale of the "Viru" hotel in 1994. In this case it became apparent that the implementation of the system was not well designed. The foreign buyer succeeded in obtaining an asset of high value on beneficial instalment terms by using an Estonian intermediary.

Our estimate is that approximately 40% of large industrial and more than 60% of large transportation and construction enterprises privatized in Estonia have been bought by a buyer inside the privatized enterprise. The typical buyer is, for instance, a private joint-stock company formed by the top-management of the enterprise to be privatized. Among the minor shareholders is often a certain proportion of the other employees of the enterprise, and as additional source of financing, some private trading company.

The Estonian statistics unfortunately does not provide any detailed information about the structure of the ownership of the stock of shares. It does reflect what proportion of the shares is owned by the insiders - managerial staff and other employees - and what is owned by external shareholders.

It might be presumed, however, that the share of employee-ownership was higher at the outset of privatization in the beginning of the 1990'es than later in the process. The reasons for this are: In the majority of the cases the buy-outs were executed by the management. In the beginning of the 1990s, managers had very limited private savings. Pooling with the means of the employees was often the only way to raise the necessary capital for buying the enterprise. Today's changed situation is attributable at least to three developments:

- a) A substantial proportion of managers has been engaged in private business simultaneously with running a state company and they have often combined the two activities so that profits have been transferred to their personal ownership. In this way they have accumulated a personal capital-base. This explains the strong reaction against the so-called "nomenclature-privatization".
- b) Since 1992, people born in Estonia have been given comparatively favorable terms through the possibility of paying by installments.
- c) Commercial banks have to some degree developed their credit possibilities.

The above developments may be supplemented by the influence of certain psychological factors. At the beginning of the 1990s, the involvement of employees in privatization was considered by the general public to be a positive and appropriate behavior. In the later changed psychological atmosphere with strong focus on capitalistic values, employee-ownership started to be considered as a museum piece dating back to former socialist times.

Employee shareholding played a comparatively great role in the so-called experimental privatization of the first seven large enterprises taking place in 1991 and the early part of 1992. The teams designing the buy-outs had not got clear prescriptions about the possible participation of employees. However, the experts from the Estonian Ministry of Economics and Department of State Property drawing up the respective schemes did recommend employee involvement. It constituted the "first wave" of Estonia's large privatization with previously applied rules still in effect. Those responsible tried to carry it out in a socially acceptable way to create a favorable

climate for the continuation of the whole process. Five out of the seven cases followed the designated route. Two, however, failed to do so. In the first of the less successful cases the top managers attempted to secure for themselves a significant amount of control over the company as well as guaranteed dividends. This sparked discontent and resulted in the creation of a rival buy-out team consisting of younger managers and professionals. The two teams then went into competition about attracting savings from the rest of the employees. In the other case, one buy-out team, composed of one part of the managerial staff, attempted in the preparation stage - in the name of protecting the interests of workers - to eliminate all likely rivals by initiating a campaign against prospective internal and external competitors. Many of the workers, however, chose to invest their savings with other buy-out teams. In both cases the press got involved and in effect represented one buy-out team against the others. One of the cases resulted in a protracted series of court actions.

The private joint-stock companies which were established by the management-controlled buy-outs of state-owned enterprise in the initial stage of privatization gave workers a stake at a reduced price. The discounts could be interpreted as a compensation designed to dampen dissatisfaction with the managers' privileges. This could as an example entail multiple-vote A-shares entirely for the managers. The participation rate of Estonian employee-shareholders in distribution of dividends, control over the company, etc. have in practice remained largely unstudied. We assume that it is not significant. The press has exposed a couple of conflicts involving minor shareholders and primary owners, but when considering the weakness of the Estonian legislation about guarantees for minor shareholders and the wide-spread manipulation by primary shareholders with different rights to A and B-shares, the number of open confrontations has been surprisingly small.

The introduction of vouchers in converting enterprises into private ownership in the fall of 1994 is obviously not going to produce any major changes in the established practices since: a) obtaining or use of vouchers is not made more congenial to insiders; b) sale of shares for vouchers will evidently concern only minority stakes; c) the number of state-owned enterprises where part of the shares shall be sold for vouchers will apparently not be very high.

Experience from other countries show that an essential motive behind employee buy-outs might be the workers' fear of losing their jobs. In this case the question is if other measures should be applied? Given Estonia's privatization context with buyer guarantees for the volume of investment and the number of employees this motive is apparently not going to be that relevant. However, there has been some increase in

labor unrest, strike warnings etc., provoked by the fear of unemployment especially in connection with the sale of bankrupt enterprises. In the case of bankruptcy, no employment guarantees can be given.

3.4 Broadening the share capital of state enterprises

- a management initiative.

The advantages of employee ownership has in Estonia been promoted by some industrial circles in connection with broadening the capital base of state-run companies. The motives of state managers were less than pure, however. Managers of state companies realized that their hopes of having full control with the privatization procedures were slipping away and the whole process was likely to be centralized. Buy-outs were to involve competitive bidding, and the influence of management on the buy-out price would be reduced. Privatization itself was at the same time blocked owing to disagreements between the government and parliamentary parties. The former propagated sale in exchange for money and the latter restitution and free-of-charge distribution. Under these circumstances, a group of industrial-circle leaders tried to compel the Government and the Parliament to permit the emission of additional shares in a number of big state-owned enterprises. Although this situation occurred under a parliament-initiated suspension of ownership transformation and with no authorization by the government these quick decisive steps were expected to give the process an irreversible nature. The government and the parliament would have to accept the changed property relations of the enterprises. In most of the enterprises concerned the subscription for shares followed the procedure whereby multiple-vote A-shares would end up exclusively in the hands of the management. Furthermore, because of the high inflation the non-indexed assets of enterprises became extremely cheap.

The large employee-involvement could be interpreted as a mean to secure the irreversibility of the process. Moreover, the high inflation increased the worker-interest in investment opportunities. The action fell to some extent short of the expected result. A government commission, established to examine the affair, proclaimed the share-capital broadening action illegal in the autumn of 1991.

The investment-behavior of the employees was termed "a bona fide deed", and the status of the money invested remained unclear. The juridical settlement of the invested capital and the accompanying rights has already been the concern of three consecutive Estonian governments.

3.5 "People's enterprises" - an intermediate stage toward privatization.

As mentioned in the previous chapter, the idea of establishing "people's enterprises" started to lose its popularity in 1989-90. The completion of the statute of joint-stock companies generated increased interest in joint-stock companies rather than "people's enterprises". The managers believed (having been talked into this by some consulting firms) that the reorganization of a state-run company into a joint-stock company provided the management with the shortest way to a discounted or free-of-charge acquisition of a substantial proportion of the shares of the enterprise. This was understood as a compensation for their previous work contribution. The hopes were nourished by decentralized or "wild" privatization in Hungary 1989-90. However, it is impossible retrospectively to assess the spread of hopes among the broad group of employees about a beneficial acquisition of shares in their enterprise.

The term "people's enterprise" became after a period identified with outdated socialist values and, therefore, the target of propagandistic attacks. This resulted in a decrease in the number of enterprises willing to reorganize into this type of company. The ultimate number of companies assuming the status of a "people's enterprise" in 1990 and early 1991 was only five. This figure indicates that the cooperative-like ownership and management principles had lost their appeal and were merely considered a way to escape the former administratively imposed governance system. In the majority of the five enterprises the choice of the ownership form was motivated by the desire to operate as an independent enterprise. This motive was coupled with the fear of falling under the control of holding companies and associations set up on the ashes of liquidated ministries and administrative boards. In terms of performance, the five "people's enterprises" proved to be fairly successful. Whether this is attributable to the greatly increased employee-activity is questionable.

The majority of the "people's enterprises" in 1994 expressed the wish to be privatized. Their advantage of being privatized were based on the so-called "newly created value". The statute of the "people's enterprises" qualified this "newly created value" as joint property of the members of the enterprise. The employees could use this accumulated capital and the capital accumulated in the risk funds to buy out their enterprise. The government also expressed interest in the privatization of "people's enterprises". This was partly because the new Estonian business legislation is to be harmonized with western standards which do not have provision for "people's enterprises". The transformation of the "people's enterprises" into joint-stock companies and their final privatization was in progress in the autumn of 1994.

The experts of the Estonian Finance Ministry in conjunction with representatives of the "people's enterprises" worked out in detail what proportion of the assets were to

be considered state property, and what property the members of the "people's enterprise" could keep because it represented "newly created value". If the value of the property possessed by the state was the greatest the state would keep the majority of the shares and give shares in proportion to the newly created value to the members of the former "people's enterprise". The members would as a collective entity receive their part of the shares of the re-nationalized enterprise. If the "newly created value" was greater than the property possessed by the state, the members of the former "people's enterprise" would form a private joint-stock company, keep the majority of the shares, and return the minority share-holding to the state. The state would in neither instance interfere in the distribution of shares among the members of the previously existing "people's enterprise". Of the two possibilities, the former may be termed an organic way of privatization. The latter might pose several problems for the members of the former "people's enterprise" if the controlling stake belonged to the state, which would be under no obligation to consider the interests of the former members of the enterprise. Moreover, Estonia's current legislation do not contain clauses which give them preference in the future privatization of the remaining state owned shares. Fortunately, the calculations gave the majority control to former members of the five "people's enterprises". In one of the cases the premises of the company remain the property of the state. The new venture is guaranteed a five-year lease of the building.

3.6 Lease enterprise of a work collective - a controversial situation.

The so-called "lease enterprise of a work collective" where the state owned enterprise is leased to a collective-based entity is fairly similar - in principle - to a "people's enterprise". This concept, however, has been more widespread. Over 20 such arrangements exist. If supported by at least two-thirds of the employees of an enterprise or a subunit, the legal entity called "lease enterprise of a work collective" (LEWC) could apply for the lease of a state enterprise or a subunit of it (decree approved by the government in January 1991). Within one month after the founding meeting, everyone working at the state enterprise could become founding members of an LEWC. Those not interested could continue to work on the basis of a labor contract. Later admittance of new members occurs in compliance with the statute (charter) of each particular LEWC. The LEWC is the legal successor of the former state enterprise. When comparing the statutes of "people's enterprises" and LEWC two aspects should be underlined:

a) In case of a LEWC, the ownership has been more clearly determined since it has been unambiguously fixed that the assets leased by the LEWC are under state ownership and usable by the work collective only on the basis of a lease. The legal

lease relations have been defined in the Estonian Law on Lease. As for the property of a "people's enterprise" (or more precisely, property delegated into its usage), the ownership remained somewhat unclear enabling different interpretations since Estonia did not have a law on trust property;

b) The statute of a LEWC, despite containing more pages and being more detailed than that of a "people's enterprise", has fewer prescriptions. There is no stipulation demanding the creation of a so-called risk fund nor reinvestment of a certain percentage of the profits. The statutes share common features in relation to the highest body which in both cases is the general meeting of members which adopts the bylaws of the particular enterprise, elects the management, the auditing commission and defines their responsibilities. In the case of a LEWC, member-employees have ownership rights. Employees leaving the LEWC are entitled to the share of the accumulated capital which they have put into the venture.

The popularity of leasing arrangements culminated after the set-backs in the reorganization of state enterprises into state-owned joint-stock companies. The status of a state-owned joint-stock company did not in the majority of cases mean a green light to rapid privatization. Having abandoned the former ministerial control, the enterprises found themselves under the supervision of the board of management appointed by the state as the owner of the enterprise. The management in several enterprises started under these circumstances to view leasing as an opportunity to benefit their own interest.

The legislation regulating leasing of state-owned enterprises, passed in the second half of 1990 and early 1991, conferred one privilege to the employees. The legislation governing leasing arrangements stipulated that the equity capital invested by the lessee into the enterprise should at least be 20 percent of the book value of the enterprise. This requirement was to function as a guarantee against misconduct of the leased assets. If the work collective was the lessee it was exempted from this requirement. It was taken for granted that the wish to secure jobs would prevent risky transactions with leased assets.

There were two predominant versions of privatization through leasing: Leasing of an enterprise by the management and leasing by the work collective. It was exceptionally rare with external lease applicants or even applicant outside of the top management. Leasing was interpreted as a deviation from the basic route of privatization. The application to establish a lease enterprise should be submitted to the ministry exercising governance over the enterprise (the Ministry of Industry, the

Ministry of Construction, the Ministry of Transportation) which, in turn, was to coordinate the approval procedure with the Ministry of Economics functioning as a controlling "filter". If the individual or group of individuals applying for the lease of an enterprise or a structural subunit were unfamiliar to the governing ministry, the request was in most cases rejected. The ministries concerned were more cordial toward lease applications from managers than to those submitted by the work collective. Perhaps, they were in the latter case afraid of creating "kolkhoz"-type enterprises which had a quite bad reputation.

The bulk of lease applications by the work collective receiving the ministry's approval concerned Russian-dominated enterprises. Most wide-spread were lease arrangements in areas such as transportation, construction and production of building materials, as well as technical services for agriculture. The greatest number of enterprises with the work collective as the lessee were set up in construction and the production of building materials - areas under the governance of the Ministry of Construction.

In retrospect, it is difficult to determine to what extent the establishment of a lease enterprise of a work collective was prompted by motives related to employee ownership and to what extent by the attempt to avoid the mentioned equity capital requirement. In the following case, for instance, the motives lay not in the attribution of importance to employee ownership. The employees of several enterprises of a huge trust applied for a joint lease from the state of the trust as a whole. They elected the managerial group largely from among the managers of the former trust. This management group in turn subleased the enterprises of the trust. Such an action was impossible to carry out without planned guidance from the managers.

Apart from the the lease of an enterprise by the work collective, another wave of such arrangements occurred in Estonia. In the period from 1989 to 1991, it basically concerned the enterprises which earlier operated under Soviet jurisdiction and were now established in compliance - not with Estonian legislation -but with the Soviet Law on Leasing. Note, that this law included the option to buy for the lessee. The corresponding practices involved approximately 12 large industrial enterprises. In the "second wave" it was possible to choose between leasing by the work collective or leasing by the management. The "first wave" allowed only leasing by the work collective as the sole option envisaged by the Soviet legislation. However, also here the management could try to manipulate the workers to the benefit of management.

About the "first wave" enterprises, we have also to consider the so-called "battle of laws" between Estonia and the Soviet Union. Estonia declared that it would not recognize the transformation of enterprises and property according to Soviet legislation. Consequently, a part of the opposition to Estonia's independence came from the managements of enterprises under all-Union jurisdiction (see the above treatment of the Joint Council of Work Collectives). They tried to ignore Estonia's independent oriented policies. In this "race of ownership" the Union ministry and the management of "Soviet" enterprises regarded the transfer of property to the employees of the Russian-majority as a smaller evil than handing it over to the "Estonian nationalists". To re-nationalize the enterprise and get it back from the employees in order to privatize it according to Estonian laws would on social grounds have been much more dangerous for the Estonian leaders than to re-nationalize the enterprise from its management.

In summary, we have all grounds to maintain that leasing of enterprises (including leasing to the work collective) was in Estonia a relatively controversial process. On the one hand, it helped more active enterprises to overcome the shortage of capital for privatization and when privatization was blocked due to discords between different political forces the leasing system permitted them to make some improvements. On the other hand, it resulted in a number of big scandals where excessively low rentals discredited the process. The rental was determined by the governing ministries and thus, lease arrangements had less public oversight than privatization. In legal terms, the future of enterprises with for instance a ten-year lease period remained largely unclear. The lessee might even be interested in buying the enterprise out, but since the Estonian legislation provides only for the privatization with the involvement of multiple competitors, many economic entities operating under lease arrangement did not dare to break off the lease for the purpose of privatizing. By mid-1994, out of the initial 90 lease enterprises and roughly 200 structural units nearly one third had been privatized.

3.7 The role of The Estonian Privatization Agency.

The speed of privatization of large enterprises was increased considerably after the start of the Estonian Privatization Agency. In December 1994, the Agency reported that in 1993 and 1994, 237 object of varying size had been sold through tenders and 340 mainly relatively small objects through auctions. The total number of enterprises privatized in small privatization were around 1600. Now the total assets privatized clearly exceeds 50% of the assets to be privatized. In a relatively short period the Agency has changed the Estonian privatization process to one of the fastest in

Eastern Europe. However, the agency is quite ill-famed because of some scandalous privatization cases.

The Agency has given high priority to sale of enterprises as a whole to core investors. However in the autumn of 1994, sale of minority shares mainly for vouchers has begun. As earlier mentioned the current privatization legislation gives no preferences to insiders. Estonians have an advantage since they can pay part of the price through installment. This is the main reason why official estimations say that around 20% of the assets have been bought by foreigners while unofficial estimates state that foreign ownership in privatization is certainly over 30%. The higher number includes foreign capital behind the official Estonian buyers. There are at present no estimates on the percentage of insider takeovers. It makes probably most of the cases of enterprises taken over by Estonians. Most of them are management take-overs. Perhaps a small group of the privatized enterprises are taken over by a broader group of employees.

Most of the employee-takeovers will probably be found in the group of privatized lease-enterprises already discussed in section 3.6. The sale of lease enterprises are very complicated. The Agency has right now no intentions to break off the lease to perform the sale. Then the lessee would probably demand a high compensation. Instead the enterprises are offered for sale together with the lease in operation. However, in this case there is, as a rule, only one potential buyer - the lessee. After the sale contract has been concluded the lease is terminated. In the negotiations the lessee tries to beat down the price as much as possible and because of the lack of competitive bids the Privatization Agency is in a quite weak position.

The voucher privatization, started in the autumn of 1994, might give some limited opportunities for employee-take-overs. The main idea is to sell minority share-holdings to the broad public. However, the Agency has allowed that vouchers can be used to pay part of the price of a controlling interest in enterprises put up for tender. Again this might mainly be used for management takeovers. Trading of vouchers started in August 1994 and the price has been much lower than the nominal price. This means that potential buyers of an enterprise will get a discount if they pay part of the price by vouchers. We have not yet had any cases where a broader group of employees have used vouchers.

Appendix:

Different views about whose opinion should be considered in privatization

(Public opinion poll, EMOR Ltd, 1990)

percentage of the respondents	Estonians residing in Estonia	Non-Estonians residing in Estonia
Estonian movements and political parties	14	7
Estonian economic experts and specialists	56	36
foreign economic experts and specialists	27	20
local authorities, counties and towns	26	17
employees in enterprises to be privatized	21	37