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PRIVATIZATION IN THE FORMER SOVIET UNION AND THE NEW RUSSIA

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Key Issues in the Realignment of
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PRIVATIZATION IN CENTRAL AND EASTERN EUROPE

LONGMAN

CHAPTER ELEVEN

Privatization in the former Soviet Union and the new Russia

Alexander Bim, Derek Jones and Thomas Weisskopf*

In this chapter we present a survey of the policies, processes and results of privatization in the waning years of the Soviet Union and the first years of the independent Russian Federation. Section 1 begins by providing a simple analytical framework in the form of a classification of alternative privatization policy choices. Section 2 presents a brief history of the early moves toward privatization in the former Soviet Union in the context of Mikhail Gorbachev's economic reform policies. Section 3 discusses the more rapid development of privatization policy and its results in independent Russia under Boris Yeltsin. We conclude in section 4 with an overall evaluation of the process of Russian privatization to date.[1]

1. An analytical framework

In describing and analyzing the process of privatization in societies in transition from a centrally planned to a market economy, it is useful to begin with an understanding of alternative methods by which privatization may be accomplished. Toward this end we highlight a series of two-way choices between alternative privatization policy options and discuss briefly some of the considerations weighing in favour of one or the other option. Our formulation of alternative methods of privatization is designed to capture the key choices facing policymakers in the context of the former Soviet Union. We begin therefore by defining privatization very broadly to include any process which reduces the role of state-owned and centrally controlled enterprises in favour of the development of firms which are in various respects independent of the state.[2] This permits us to consider the full range of alternatives to the traditional state enterprise that dominated the Soviet economy, including mixed as well as full-fledged private forms of enterprise organization.

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First, the development of non-state enterprises can be accomplished either through the *emergence of new non-state enterprises* or through the *transformation of existing state enterprises* (or parts thereof) into non-state enterprises. The complexity of transforming existing enterprises whose economic performance has been unsatisfactory would appear to favour a policy of encouraging the formation of entirely new enterprises, whose competition with existing enterprises could eventually drive the latter to improve their performance or go out of business. In the rather chaotic economic conditions characterizing the transition from a centrally planned to a market economy, however, it is very difficult to form major new enterprises, and it is even more difficult to assure that the logic of market competition will encourage the survival of the fittest. The transformation of existing enterprises is therefore bound to be an indispensable element in economic reform, however successful entrepreneurs prove to be in establishing new businesses in response to new market opportunities.

Second, whether a non-state enterprise is an entirely new undertaking or the result of the transformation of a state enterprise, the bulk of the assets of the non-state enterprise may be *owned* by parties independent of the state or they may be *leased* from state agencies by independent operators. Economic theory suggests that in most circumstances economic efficiency is best served when enterprise decision-makers have ownership rights over the assets whose use they control. A case can be made for leasing state assets, however, when and where it is difficult to administer a fair and equitable transfer of state property into non-state hands and/or when the outright purchase of state assets imposes a huge financial burden on independent operators of an enterprise.

In cases of non-state enterprises whose assets are primarily owned rather than leased, it is useful to identify a third set of choices that illuminate different forms of property and entrepreneurship. Here we address first the choice between open and closed firms; then we consider a further distinction in each of these two cases. An *open joint-stock company* issues publicly traded ownership shares, the company's assets are owned by individuals in proportion to their share holdings, and the company is controlled by those who own a controlling packet of shares (who may be insiders — i.e., enterprise managers or workers — or outsiders). A *closely held firm* is owned and operated by a person or group of people closely attached to the firm as owner(s) and/or manager(s); there may or may not be separable ownership shares, but if there are they are not publicly traded and/or they carry no control rights.

The case for open joint-stock companies — and an active capital market in company shares — rests mainly on the putative advantages of such a system in raising private capital funds, in allocating these funds flexibly among competing enterprises, and in disciplining enterprise managers. Critics question whether stock markets actually perform such functions effectively, especially in the context of formerly centrally planned economies with very undeveloped capital market institutions. Advocates of closely held firms argue that such firms are more likely to be characterized by a focused, tightly-knit, 'flesh-and-blood' ownership group with a strong stake in enterprise performance, as compared with the alternative of external shareholder ownership of joint-stock companies.

In the case of open joint-stock companies it is important to distinguish between two alternative possibilities with respect to the exercise of effective control over enterprise operation: control by *insiders* or by *outsiders*. Insiders include all the people working in the enterprise. An insider-controlled firm may be effectively controlled by its managers, by its workers, or by some combination of the two; in the case of workers control may be exercised either directly or indirectly through the election of representatives to a workers' council. Outsiders include those whose attachment to the enterprise is based on an ownership stake rather than on work within the enterprise. They may be individual owners or shareholders, or they may be institutional shareholders (i.e. financial intermediaries such as banks, mutual funds, holding companies and investment trusts). Individually owned firms can be controlled either by insiders or by outsiders, but of course collectively owned firms are necessarily controlled by insiders.

Outsider control means that enterprise decisions will be guided primarily by the objective of maximizing the return on investors' capital. The case for outsider control is based on its putative advantages with respect to economic performance. Outsiders can be expected to push more rapidly and more ruthlessly than insiders for the restructuring of an enterprise, forcing the liquidation of unprofitable assets and the dismissal of redundant workers. Outsiders may well also have better access to private capital markets to mobilize new resources to invest in their enterprises.

Insider control, on the other hand, implies that the security and stability of the enterprise and its work force will weigh more heavily in decision-making. The fact that insider control is more conducive to enterprise stability and long-term employment relationships may contribute to better economic performance in a number of ways. Greater enterprise stability may encourage more salvaging of still useful capital stock, and it may help to avoid a cascade of business failures due to the shutdown of one key enterprise in a productive structure still characterized by an inflexible network of input sources and output outlets.[3] More stable employment patterns may result in greater utilization of the accumulated experience and firm-specific knowledge of enterprise managers and workers, and they seem likely to enhance worker motivation to contribute to the long-term improvement of the firm. The case for insider control rests also on the proposition that there are significant social and economic gains at the society-wide level in reducing the burden of economic dislocation and unemployment through greater employment security and stability at the enterprise level.

In the case of closely held firms it is useful to distinguish between two alternative forms of ownership: *individual* and *collective* ownership. The assets of individually owned firms are divisible and separable; there may be one or many asset owners, these owners may be insiders or outsiders, and individuals may buy, hold or sell different kinds and amounts of ownership stakes. The assets of a collectively owned firm are indivisible and inseparable; all the people working in the firm (with the possible exception of certain categories of employees, e.g. temporary workers) *ipso facto* share in the ownership and control of the firm. Collectively owned closely held firms are thus the enterprise form in which workers are most likely to be able to exercise a significant degree of control over enterprise decision-making.

Economic theorists are generally very sceptical about the economic performance characteristics of firms that are collectively owned and controlled by their workers, arguing that the perceived interests of enterprise workers are likely to conflict in a number of important respects with the long-term interests of their enterprise and the economy as a whole. It is held that workers will have a bias against capital investment, that they will tend to push for wage increases at the expense of enterprise profits, and that they will resist layoffs when these are needed to increase micro-level productivity or macro-level rationality. Worker ownership and control, however, need not take the form of such a collective enterprise; the kinds of concerns just raised can be alleviated – if not eliminated – by vesting significant ownership and control rights in workers through individual rather than collective forms of ownership. Indeed, a growing body of theoretical analysis and empirical evidence suggests that worker ownership and participation in management can enhance economic performance through the stimulating of higher labour productivity – by promoting worker cooperation with managers, by encouraging mutual monitoring among workers, and by fostering a more positive attitude toward work in general.

A final key choice in privatization policy arises where an independently owned firm is formed by the transformation of a state enterprise; it concerns the mechanism by which the state divests itself of the enterprise assets. On the one hand, these state-owned assets may be turned over to the new owners via *market sale*. This choice includes various kinds of sales procedures; e.g. competitive auctions of enterprise assets or shares, commercial tender competitions, insider asset buy-outs. What is important is that the new owners provide a *quid pro quo* in the form of significant resources of their own in order to acquire assets previously owned by the state (though their purchase of these assets may be facilitated by various kinds of credit arrangements).

On the other hand, the assets of a state enterprise may be turned over to its new owners by way of *concessional transfer*. This choice includes outright gifts or transfers at a nominal charge well below any reasonable assessment of the value of the assets transferred. In the case of closely held firms the most likely beneficiaries would be insiders, because there is unlikely to be any justification for turning over state enterprises on highly concessional terms to outsiders. In the case of open joint-stock companies, shares are initially held by a state agency; concessional transfer involves the subsequent transfer of these shares to prospective shareholders free or at a concessional charge. The most likely recipients of such shares would be either enterprise insiders or citizens at large, in the latter case through mass distribution of 'vouchers', providing citizens with a means to purchase shares (either directly as individual investors or indirectly through financial intermediaries).

The sale of state assets at a market or near-market price may well involve time-consuming asset evaluation, credit extension and/or bidding mechanisms; indeed, there may be no prospective purchasers of the less attractive state properties. Market sale has the advantages, however, of raising state revenues from the privatization process, and of disposing of state property in a relatively fair manner. Concessional transfer, on the other hand, involves less of an administrative and organizational burden; share transfers to enterprise insiders can be achieved

ABLE 11.1 Key choices in privatization policy

Emergence of new non-state enterprises vs. Transformation of existing state enterprises
Assets owned by parties independent of the state vs. Assets leased from the state by independent operators
Property and entrepreneurship in owned non-state enterprises:
Open joint-stock companies vs Closely-held firms
(a) Joint-stock companies: controlled by outsiders or insiders
(b) Closely held firms: owned individually or collectively
Divestment of state assets via market sale vs. Divestment of state assets via concessional transfer

uite readily, and even share transfers to all citizens can be accomplished more uickly on a large-scale than the sale of shares to new investors. But concessional ansfer does not enable the state to receive significant receipts from the process of rivatization. And concessional transfer is highly inequitable unless all members f society — through some kind of *per capita* voucher distribution scheme — ceive equal shares of state property.

Table 11.1 summarizes our framework of key choices in privatization policy. subsequent sections of the chapter we will make use of this classification heme to characterize and distinguish various methods of privatization that ıve been proposed and/or implemented in the Soviet Union and in the Rus-ın Federation.

. Privatization in the Soviet Union

ikhail Gorbachev was appointed General Secretary of the Communist Party of e Soviet Union in March 1985, but it was not until 1987 that the economic forms associated with his programme of *perestroika* began to be implemented. terms of economic reform in general, and privatization policy in particular, it is eful to distinguish between an early *perestroika* period running from 1987 to 90 and a later period running from 1990 up to the demise of the Soviet Union in e 1991 (in the wake of the failed coup of August 1991). A third, clearly distinct riod in the history of economic reform begins with the collapse of the Soviet ıion in late 1991 and the establishment of an independent Russian Federation. e discuss the *perestroika* periods in the Soviet Union in this section and turn to : Russian period in the following section.

E EARLY PERESTROIKA PERIOD

ıe most important pieces of reform legislation bearing on issues of privatiza-n in the early period were: the Law on State Enterprises, introduced in mid-87 to cover the activity of all state units; a series of laws regulating coopera-es culminating in the final Law on Cooperatives, passed in mid-1988; and the cree on Leasing and Lease Relations, enacted in mid-1989.[4] The Law on State terprises paved the way for a considerable degree of decentralization in the eration of the centrally planned Soviet economy, giving greater autonomy to

state enterprise managers and greater influence over enterprise affairs to employees (organized in each enterprise into a 'worker collective', which includes all employees working within a given enterprise except for top administrative officers). The laws on cooperatives in effect served to legalize much of the 'second economy' of semi-legal private and cooperative enterprises, which had already been operating on a substantial scale primarily in the service sector. The final such law legalized the operation of cooperative enterprises in virtually all fields and gave a significant boost to the non-state sector, although it still required that non-state enterprise assets be leased from the state or owned collectively by all the workers engaged in production. The Decree on Leasing (along with related acts and decrees) spurred the development of enterprises in which enterprise managers and workers could independently operate assets leased from the state.

What Gorbachev was clearly trying to accomplish with his early *perestroika* reforms was to revitalize the Soviet socialist economy by altering the pattern of operational control and thereby the incentives facing managers and workers, but without any changeover to capitalist forms of property ownership in productive assets. In effect he was trying to convert the system from a centrally planned to a more marketized form of socialism, while encouraging the development of new 'hybrid' forms of enterprise organization whose structure lies somewhere between the traditional Soviet state enterprise and a conventional capitalist firm.[5]

Between 1987 and 1990 the most important hybrid enterprise forms to develop in the Soviet Union were the new *producing cooperatives* (the adjective serves to distinguish them from the collective farms and consumer cooperatives which had long operated in the Soviet Union under close state supervision) and the new *leased enterprises*.[6] In terms of the classification introduced in the previous section, the new cooperatives represent entirely new non-state enterprises, whose assets were sometimes primarily owned by the independent cooperators and at other times primarily leased from the state, constituted as closely held firms and characterized by collective ownership and effective control by insiders. For the most part they were relatively small enterprises, averaging about 25 workers, operating principally in construction and service industries. Leased enterprises represent a case of transformed state enterprises (or parts thereof), whose initial assets were entirely leased from a 'parent' state enterprise (although newly formed assets could be collectively owned), under the control of insider managers (usually) and/or workers (occasionally). These leased enterprises were typically much bigger than cooperatives, averaging close to 700 workers each, and their spheres of activity ranged widely across all sectors of the economy.

Table 11.2 presents official data on the changes in enterprise organizational form which took place in the Soviet Union between 1985 and 1990. During this time the share of traditional forms of state enterprise dropped by roughly 8 percentage points. Most of this change was accounted for by the emergence of new producing cooperatives and leased enterprises (3.8 per cent and 2.7 per cent of total employment in 1990, respectively); while the proportion of people primarily engaged in family farm plots also registered an increase (from 3.2 per cent to 4.6 per cent).[7]

TABLE 11.2 Distribution of employment by enterprise organizational form in the Soviet Union, 1985–1990

	1985		1990	
Total	100%		100%	
Traditional Forms	96.8		88.6	
State enterprises		81.4		74.0
Collective farms		12.2		11.2
Consumer cooperatives		3.2		3.2
Hybrid Forms	0.0		6.5	
Producing cooperatives		0.0		3.8
Leased enterprises		0.0		2.7
Joint ventures		0.0		0.1
Private Enterprise	3.3		4.9	
Family farm plots		3.2		4.6
New private farms		0.0		0.1
Individual working activity		0.1		0.2

Source: State Statistics Committee of the USSR, Narodnoe Khoziaistvo USSR v 1990 g (Moscow, 1991), p. 51, and *Ekonomika i Zhizn'*, No. 43 (October 1991), p. 7 (for leased enterprises and joint ventures)

THE LATE PERESTROIKA PERIOD

The new forms of property and entrepreneurship which began to develop in the Soviet Union up to 1990 – notably cooperatives and leased enterprises – did not emerge from any clearly articulated conception or government programme of privatization. During this early *perestroika* period the goals of economic reform were not envisaged in such a radical manner. The first call for privatization as an urgent economic reform task was sounded in the well-known '500-Day Plan' of Stanislav Shatalin and Grigor Yavlinsky in the autumn of 1990. Yet even this plan did not contain any detailed programme of privatization, and in any event it ultimately failed to receive political support.

The economic programmes of the last two administrations serving in the Soviet Union under (then) President Gorbachev – those of Nikolai Ryzhkov (autumn 1990) and Valentin Pavlov (spring 1991) – contained calls for privatization at the rhetorical level. But in both cases what was primarily intended was the autonomization of government enterprises by means of their transformation into leased enterprises or into various forms of government joint-stock companies under the continuing strong regulatory influence or control of branch ministries. The Law on Ownership in the Soviet Union passed in 1990 envisaged a type of collective enterprise resembling the Yugoslavian model of quasi-worker-ownership, as opposed to Western models of employee ownership in which workers actually own separate shares of their own enterprises. This law did go further than earlier reform measures under Gorbachev, however, in providing the operators of leased enterprises with the opportunity to buy out the assets they leased from the state and thereby create independent collectively owned enterprises.

The first government of independent Russia – the administration of Premier Ivan Silayev, under President Boris Yeltsin – proposed in mid-1991 a whole series of concrete measures for privatization within the framework of a programme to overcome the ongoing economic crisis. These measures have generally been associated with the name of Yevgeny Saburov, who drew up an ambitious privatization plan that included a scheme of individual privatization accounts to enable citizens to acquire company shares.

In July 1991 the Supreme Soviet of the Russian Federation (the Russian Parliament) enacted a major Law on the Privatization of State and Municipal Enterprises in the Russian Federation, setting out general principles of privatization and authorizing the establishment of implementing agencies. This marked the first practical step in a systematic process of privatization in Russia, to be based on the Saburov plan. The next steps were never taken, however, because the failed coup attempt against Soviet President Gorbachev in August 1991 set in motion events that led to the collapse of the Soviet Union as well as to the resignation of Russian Premier Silayev and his administration. In its stead Russian President Yeltsin appointed a new administration with an economic team led by First Deputy Prime Minister Yegor Gaidar, who spearheaded new and more radical approaches to economic reform.

In spite of the absence of a systematic program for widespread privatization of state enterprises, the overall process of privatization did move forward in the Soviet Union in the last year before its collapse. As far as small-scale establishments are concerned, the growth of non-state enterprise came primarily as a result of the formation of new businesses. The number of producing cooperatives peaked in 1990, but during the following year a significant minority of these cooperatives were able to drop the facade of cooperation and convert themselves into private firms under new legislation on the formation of 'small enterprises'. In addition, some new private small enterprises – including private farms – were also formed directly by individual entrepreneurs. The transformation of small-scale state establishments was begun in 1991, largely under the auspices of municipal and local authorities. Such small-scale establishments as shops, restaurants, and service outlets (many of which were previously operated by larger state enterprises or agencies) began to be 'commercialized' – i.e. given independent juridical and economic status – and a few of these were even sold to their worker collectives or to individual entrepreneurs.

The transformation of medium to large-scale state enterprises proceeded slowly, but there were a number of significant developments before the end of 1991. First, under the provisions of the 1990 Soviet Law on Ownership the managers and workers of a small number of leased enterprises were able to buy out their leased assets on rather favourable terms and form independent collectively owned enterprises. Second, the phenomenon of *nomenklatura* privatization, which had already emerged in 1990, increased significantly in 1991. This phenomenon takes different forms. The most common is the conversion of state enterprises into joint-stock companies, in which the major shareholders are insider managers and/or closely affiliated public officials and agencies. Another is the formation, out of former branch ministries, of new corporate complexes of related state enterprises – now labelled 'concerns', 'consortiums', 'associations', etc. This

TABLE 11.3 Distribution of employment by enterprise organizational form in the Soviet Union: 1990–1991

	1990*		1991*	
Total	100%		100%	
Traditional Forms	90.7		84.8	
State enterprises		78.7		72.9
Collective farms		10.7		10.6
Consumer cooperatives		1.3		1.3
Hybrid Forms	5.7		10.4	
Producing cooperatives		2.9		2.4
Leased enterprises		2.7		6.6
Joint ventures		0.1		0.2
Joint-stock companies and corporate complexes		0.0		0.5
Private Enterprise	3.6		4.8	

Source: *Ekonomika i Zhizn'*, No. 43 (October 1991), p. 7.
*The figures are for January–September of each year.

is done in such a way that the old ministry bureaucrats and enterprise managers end up acquiring significant property rights in state assets on very favourable terms.

Table 11.3 presents data on changes in enterprise organizational form in the Soviet Union between 1990 and 1991. According to these data, the share of traditional forms of state enterprise dropped by about 6 percentage points within this one year. This change was accounted for largely by a jump in the proportion of employment in leased enterprises from 2.7 per cent to 6.6 per cent; but the emergence of joint-stock companies and corporate complexes (reflecting the rise of *nomenklatura* privatization) also contributed over a percentage point to the increase in employment in hybrid enterprises. Finally, the proportion of employment in full-fledged private enterprises also rose by more than a percentage point between 1990 and 1991.[8]

Nomenklatura privatization accelerated sharply in the last quarter of 1991 (beyond the period represented in Table 11.3), because of the collapse of central authority in the Soviet Union and the generally chaotic political and economic conditions surrounding the transition of the former republics to independence. As effective authority moved not only from the centre of the old Soviet Union to the former republics, but also from the centre of the newly independent republics themselves to their own regions and localities, regional and local authorities increasingly asserted ownership rights over state assets. This enabled regional and local bureaucrats to participate in the process of *nomenklatura* privatization of medium- and large-scale enterprises; it also enabled many localities — e.g. the major Russian cities of Moscow and St Petersburg — to step up the process of privatization of small-scale establishments as well as residential housing.

3. Privatization in independent Russia

The second administration of President Yeltsin, under the economic leadership of Acting Prime Minister Gaidar, rejected the earlier Saburov plan for privatization. Some elements of the 1991 Russian Law on Privatization, however, were maintained, for example, the entrusting of the State Committee for the Administration of State Property (*Goskomimushchestvo*, or GKI), to the leadership of Chairman Anatoly Chubais, with primary responsibility for organizing the whole process of privatization. Prior to developing a comprehensive programme for privatization of state enterprises, the new administration in late 1991 tried to speed up the existing processes of privatization of small establishments and to reclaim government ownership rights in the large enterprises that had undergone *nomenklatura* privatization, so as to prepare these latter firms for an orderly process of privatization. Further, it undertook the work of assigning government property to federal, regional/local, or municipal authorities, and it sought to develop regulations governing the reform of property relations in land and in housing. In these efforts the administration was only partially successful; further progress would have to await major new legislative initiatives.

A first important step toward implementation of systematic mass privatization was the issuing in December 1991 by President Yeltsin of a decree on Basic Provisions of the Privatization Programme for the Russian Federation in 1992. This document determined the composition of enterprises to be subject to privatization, dividing state enterprises and organizations at all levels of government into those subject to compulsory privatization, those subject to voluntary privatization, those whose privatization had first to be approved by a particular governmental authority, and those whose privatization was prohibited. In the first three cases some practical procedures for carrying out the privatization were also spelled out; primary emphasis was given to the acceleration of privatization of small-scale enterprises by a variety of methods, while mechanisms for the widespread privatization of larger enterprises remained to be worked out in detail.

In June 1992, after protracted debate and numerous modifications and compromises, the Russian Parliament passed the final Government Programme of Privatization for the Russian Federation in 1992. This is the single most important policy document governing the privatization process in Russia; it spells out in great detail the procedures and options available for the privatization of the great bulk of small-scale state enterprises and a substantial proportion of the larger ones. Later decrees and provisions issued by the second (Gaidar) and third (Chernomyrdin)[9] administrations under President Yeltsin have clarified and elaborated many provisions of the 1992 government programme, but all of these subsequent documents have remained close to the spirit and the letter of the June 1992 programme. The key provisions of this programme are examined below.

In early 1993 the (third) Yeltsin administration presented to parliament a government programme of Privatization for 1993 to succeed the 1992 government programme. This document proposed to widen the scope and accelerate the pace of privatization of state enterprises. After a somewhat unfavourable

reception in the Russian Parliament, the government undertook to introduce further modifications and prepared to submit a revised version of the 1993 programme to the parliament in the summer of 1993. The ultimate fate of the 1993 programme will hinge on the outcome of the continuing struggle with opposition forces in parliament over the nature and speed of the privatization process. In the meantime, the 1992 government programme continued to govern the privatization process in 1993.

THE STRUGGLE OVER PRIVATIZATION POLICY IN RUSSIA

From the launching of Gorbachev's *perestroika* policies in the Soviet Union to the current efforts of Yeltsin's economic reformers to bring about a fundamental transformation of the Russian economy, there have been sharp clashes and conflicts over the direction of economic reform in general and over the question of ownership in particular. While almost everyone now accepts the inevitability, if not always the desirability, of the transition from a centrally planned to a market economy, and the transition from public to private forms of ownership, the precise nature, speed and outcome of the latter transition remains highly contested.

The 1992 government programme represented the outcome of a protracted struggle over privatization policy between major forces in the Russian political arena. The complexity of contemporary Russian politics defies any easy categorization of such forces, but as far as economic policy is concerned it is useful to distinguish three camps. The 'radical reformers' are led by new-generation economists such as Gaidar and Chubais and enjoy strong backing from international agencies such as the World Bank and the International Monetary Fund; they favour the most rapid possible transition to a capitalist market economy. The 'gradual reformers' are strongly supported by the so-called 'industrial lobby' (led by the Union of Industrialists and Entrepreneurs under Arkadii Volsky) and also have considerable support among trade union and worker collective leaders; they favour a gradual transition to a market economy, retaining a mix of different forms of enterprise organization. The 'conservatives' are supported by many old Communist Party apparatchiks and some elements of the new nationalist right wing; they favour a strong role for the state both in political and in economic affairs.

As President Yeltsin took the reins of power in newly independent Russia in late 1991, he entrusted the formation of economic policy to a group of radical reformers; they spearheaded the policy of 'shock therapy' (comprehensive price liberalization and stringent macroeconomic policy) in early 1992, and dominated the preparation of the administration's mass privatization policy. The latter policy, however, could not simply be implemented by administrative decree; it called for the passage of enabling legislation in the Russian Parliament, where the radical reformers constitute only a minority. The majority in parliament are supporters either of gradual reform toward a market economy or of a return to an economic system dominated by the state. Because the conservatives are relatively weak, both in parliament and in terms of public support, they have tended

to align themselves on issues of economic policy with the gradualists among the reformers. Thus the struggle over privatization policy shaped up as a battle between the radical and the gradual reformers over the nature and the pace of the transfer of state enterprises into non-state hands.

With respect to the privatization of small-scale enterprises there was general agreement on the desirability of proceeding rapidly with the process of commercialization and privatization. Differences of opinion centred mainly around two questions: (1) whether small establishments should be sold via auctions and tender competitions to the highest bidder, or be transferred on concessional terms to worker collectives; and (2) whether new private farms should be formed on the basis of full-fledged private property in land or long-term leasing of land from governmental authorities. By and large the radical reformers prevailed with respect to the first issue, ruling out highly concessional transfer of enterprises to their workers. They failed, however, to prevail on the second issue: agrarian reform legislation passed by the Russian Parliament in November 1992 finally legalized the purchase and sale of land, but only under rather restrictive conditions with respect to the size, price, and use of the land parcels.[10]

With respect to the privatization of larger-scale enterprises there have been continuing sharp conflicts between radical and gradualist reformers. The radicals wish to turn these state enterprises into open joint-stock companies under conditions of share purchase which favour the acquisition of control by new external domestic or foreign investors. The gradual reformers, on the other hand, prefer to turn state enterprises into non-state companies owned and operated by their former managers, with a strong voice for workers.

The outsider-control model preferred by radical reformers has several possible variants, depending on the ultimate locus of effective control and the terms on which shares are made available to buyers. The simplest variant is for the government to sell shares of corporatized state enterprises in an open market, with the hope that a 'strategic investor' (domestic or foreign) will turn up and take over control, or in the expectation that an active stock market would discipline management even in a context where share ownership is widely dispersed among many small investors. A more complex variant involves the establishment of strong financial intermediary institutions (holding companies, mutual funds, etc.), which would be expected to buy controlling packets of shares in companies and proceed to restructure and monitor them. Either of these variants could be combined with a mass voucher programme, in which citizens are enabled to participate in the purchase of enterprise or investment fund shares through free privatization vouchers distributed by the government.

The insider-control model preferred by gradual reformers also comes in several variants, depending on the enterprise ownership structure and the terms on which shares are made available to buyers. Enterprises could be structured as open joint-stock companies in which managers and/or workers have acquired sufficient shares to exercise effective control, or they could be closely held firms. In the latter case, managers and/or workers could individually own separable shares (without making voting shares available to outsiders to any significant extent) or they could collectively own and control the firm. Most proponents of insider control have also argued for transfer of state assets on terms quite concessional to

enterprise insiders, on the grounds that it is these insiders who have contributed most to the formation of the assets of any given enterprise.

The 1992 government programme, as finally enacted in June 1992, represented something of a compromise between the radical and gradual reformers. The programme adopted a multi-track approach to privatization, distinguishing between small-scale, medium- to large-scale, and 'strategic' enterprises. The most relevant provisions are outlined in the following paragraphs.[11]

Small-scale enterprises — i.e. those with up to 200 employees and a book value of capital of less than 10 million rubles (at January 1992 prices) — were to be privatized primarily through competitive auctions (in which worker collectives as well as individual investors may bid for unconditional purchase), or through commercial tender competitions (where bids must include commitments to meet certain employment or investment conditions); there were also provisions for the buy-out of leased assets by leased enterprises. Thus market sale was clearly indicated rather than concessional transfer.

Virtually all small-scale enterprises in Russia (a total of more than 200,000) were targeted for privatization; it was hoped that more than half of them would be privatized by the end of 1992 and that the rest would follow in 1993. Most of these enterprises are involved in service, construction, and transportation activities; roughly half of them are engaged in retail trade (shops), public catering (restaurants) and other consumer services. Because most small-scale enterprises are owned by local and municipal authorities, their privatization was to be carried out by local property committees and funds (operating under the overall supervision of the GKI). In most arrangements for 'small privatization' certain benefits or discounts were made available to enterprise workers as opposed to citizens at large.

Medium- to large-scale enterprises — with from 1,000 to 10,000 employees or a book value of capital from 50 to 150 million rubles (at January 1992 prices) — were to be privatized through conversion into open joint-stock companies and subsequent sale of most of the shares initially held by government agencies. Enterprises falling between the small-scale and medium- to large-scale definitional limits could be privatized in the manner prescribed for either category. The 1992 government programme mandated the corporatization approach for roughly 6000 enterprises, representing more than two-thirds of Russia's productive capacity and including the bulk of the industrial sector.[12] Before the end of 1992 each of these enterprises was required to submit its own plan for privatization to one of 80 regional property committees set up by the GKI, and it was hoped that most of them would be privatized by the end of 1993. Enterprise employees, voting as members of their worker collective,[13] could choose from among the following three privatization options, all of which involve individual shareholder ownership of open joint-stock companies:

Option 1: a minority ownership share for insiders (workers and managers). Insiders receive 25 per cent of all shares free of charge, but these are non-voting (unless and until sold). Workers have the opportunity to buy another 10 per cent of (voting) shares, and administrative officers have the opportunity to buy another 5 per cent of (voting) shares, at highly concessional rates. The remaining shares — at least 60 per cent of the total and 80 per cent of voting shares — are to be sold through public auctions in which foreigners as well as domestic citizens can participate.

Option 2: a controlling ownership share for insiders. Insiders can buy voting shares up to 51 per cent of the total authorized capital, at a charge of 1.7 times the book value of the assets (a rate that is generally quite concessional); however, they are precluded from obtaining credit toward such share purchases from any state financial institution. The remaining shares are to be sold through public auctions.

Option 3: a contract with a subgroup of insiders. A group of administrative officers and/or workers enter into a one-year agreement to restructure the enterprise with a view to avoiding bankruptcy. If they are successful they gain, in exchange, the right to buy 20 per cent of the enterprise shares at the (highly concessional) book value of the assets. If this option is selected, all administrative officers and workers gain the right to purchase up to 20 per cent of enterprise shares at a highly concessional rate.

The second or third of the above options could be selected by enterprise employees only if supported by at least two thirds of the voting members of the worker collective, failing which the first option (clearly preferred by the authors of the privatization programme) was to go into effect.

Strategic enterprises — including those with more than 10,000 employees and a book value of capital of more than 150 million rubles (at January 1992 prices), as well as those in 'strategic industries' — were to be privatized, if at all, only with the approval of the GKI and/or other governmental authorities. Excluded from privatization (at least in the initial phase covered by the 1992 programme) were most natural resource-based enterprises, electricity generation stations as well as space and nuclear facilities. Some of these enterprises could be corporatized, but the state was to retain a controlling packet of shares — at least for the time being — in most enterprises in the energy, communications and military sectors, and foreign investors were excluded from some enterprises in these sectors.

A major feature of the whole 1992 government programme for privatization was the introduction of a mass voucher programme whereby 'privatization tokens' would be distributed to all citizens to enable them to participate in the acquisition of claims to state assets. Every one of Russia's 148 million citizens was to receive a free privatization voucher with a nominal value of 10,000 rubles. The total value of the vouchers represented roughly 35 per cent of the book value of the 6,000 medium- and large-scale enterprises due to be corporatized by the end of 1992 and privatized by the end of 1993. The intention was thus to transfer a significant share of state assets to the general public at a fully concessional rate. The privatization vouchers can be used to buy shares in joint-stock companies on the privatization list or to bid on enterprises at auctions; they can be deposited in investment funds; or they can be sold for cash to any buyer.

In structuring their preferred Option 1 for the privatization of medium- to large-scale enterprises, the radical reformers preparing privatization policy for the Yeltsin administration decided to encourage an outsider-control variant relying on strategic non-institutional investors rather than strong financial intermediary institutions. To meet worker claims on state assets they included the provision granting workers 25 per cent of the shares free of charge, but these shares were made non-voting in order to prevent workers from obtaining a controlling packet. To meet citizen claims on the nation's capital stock they undertook the mass voucher privatization scheme under which citizens on an equal basis could gain access to a substantial fraction of the assets of enterprises subject to privatization. Investment funds were permitted to be established, but limits were set on their ability to acquire citizen vouchers and they were not allowed to purchase more than 10 per cent of the shares of any single corporatized enterprise. The rejection of a major role in enterprise governance for strong financial intermediaries reflected the radical reformers' suspicions that such institutions could not be established or operated without coming under the excessively politicized influence of the state.

Some of the most outspoken opponents of radical reform pushed initially for an insider-control variant involving closely held collectively owned firms, with state enterprises to be transferred on concessional terms to their own managers and workers. This was the idea behind the kind of buy-out of initially leased enterprises that began to occur in 1990, and it also appeared to be the direction in which the Soviet Union was moving under Gorbachev;[14] even now it is still favoured by many leaders of worker collectives and their political allies. As the debate evolved both within and outside the Russian Parliament, however, most of the gradual reformers were increasingly ready to settle for the transformation of state enterprises into closely held individually owned firms under the control of managers and workers, with asset ownership to be transferred on terms favourable to the latter. In the face of the evident inequity of denying a claim to state property by the large numbers of people not working in the enterprise sector (and of benefiting employees in the enterprise sector very unequally, depending on the value of the assets in their own enterprise), many proponents of insider control agreed that insiders must ultimately pay for their acquisition of valuable assets at something approaching market prices, and that some of the revenues from the sale of state assets should be used for the benefit of citizens not in a position to acquire any such assets.

The end result of the struggle between radical and gradual reformers in parliament was a further compromise in the form of Option 2, which enables insiders to acquire a controlling packet of shares in the newly created joint-stock companies, but on terms that were only partly concessional to insiders, with no access to government credit, and only by at least a two-thirds majority vote of members of enterprise worker collectives.

Although the choice among options for privatization of medium- to large-scale enterprises was in several ways skewed in favour of the Option 1 preferred by the radical reformers, the results of voting by worker collectives in late 1992 and early 1993 were actually more often in favour of Option 2. Emboldened both by this display of worker commitment to insider control, and by the weakened political

position of the radical reformers after the December 1992 session of the Congress of People's Deputies (which led to the resignation of Acting Prime Minister Gaidar), a task force organized by prominent members of the Russian Parliament drafted a proposal for a fourth privatization option. As compared with Option 2, Option 4 would greatly facilitate and accelerate the transformation of state enterprises into insider-controlled companies; 90 per cent of the shares of an enterprise would be made available in a closed subscription for purchase by worker collectives at book value (thus on highly favourable terms), while only the remaining 10 per cent of enterprise shares would be made available for purchase by outsiders on the open capital market. Proponents claimed that the proceeds from this kind of privatization would still be great enough to provide substantial benefits for the fraction of the population not employed in the enterprise sector. This option represents an intermediate form of insider-oriented privatization, located between the establishment of enterprises owned collectively by insiders and the establishment of joint-stock companies in which insiders have limited advantages over outsiders in acquiring shares.

Needless to say, the new proposal has led to further sharp debate between radical and gradual reformers since its presentation to the Russian Parliament in January 1993 as an alternative to the 1993 government programme for privatization prepared by radical reformers under the direction of GKI Chairman Chubais. Although there are strong differences of opinion on these and other economic policy issues within both the legislative and the executive branches, the approach to privatization reflected in the government programmes of 1992 and 1993 retains strong support among economic policy-makers in the Yeltsin administration, while the alternative Option 4 has a strong base of support in the Russian Parliament. The fate of Option 4 remains uncertain at the time of writing, but President Yeltsin's victory in the 25 April referendum has clearly strengthened the position of the radical reformers, and they appear likely to prevail on matters of privatization policy into the foreseeable future.

THE PROGRESS OF PRIVATIZATION TO DATE

To provide an overview of the evolution of patterns of ownership in Russia, we begin by presenting evidence on changes in enterprise form in the Russian Federation between 1990 and 1992 in Table 11.3, in the same format as in Table 11.2 for the Soviet Union. According to the figures in the table, the share of traditional forms of state enterprise dropped by about 7 percentage points from 1990 to 1991 and by another 8 per cent from 1991 to 1992. The change between 1990 and 1991 (the last year of the Soviet Russian Republic) was accounted for largely by an increase of almost 5 per cent in the proportion of employment in hybrid forms of enterprise; but these latter made a net contribution of only 3 per cent to the decline in traditional enterprise employment between 1991 and 1992 (the first year of the independent Russian nation). It is noteworthy, however, that the proportion of employment represented by joint-stock companies and corporate complexes actually increased by 4 percentage points between 1991 and 1992; we continue to list these as hybrid rather than (fully) private enterprises because up to

TABLE 11.4 Distribution of employment by enterprise organizational form in the Russian Federation: 1990–1992

	1990		1991		1992*	
Total	100%		100%		100%	
Traditional Forms	90.6		83.7		75.6	
State enterprises		83.2		76.2		68.8
Collective farms and consumer cooperatives		7.4		7.5		6.8
Hybrid Forms	7.7		12.6		15.3	
Producing cooperatives		3.5		3.4		2.9
Leased enterprises		3.8		7.6		6.6
Joint ventures		0.1		0.1		0.3
Joint-stock companies and corporate complexes		0.3		1.5		5.5
Private Enterprise	1.7		3.7		9.1	
Small businesses		0.1		1.1		4.3
Private farms, plots, etc.		1.6		2.6		4.8

Sources: IMF, Economic Review: Russian Federation (Washington, D.C., April 1992); unpublished data from the State Statistics Committee of the Russian Federation; and authors' calculations.
*The figures are for January–September 1992.

the end of 1992 their shares remained almost exclusively in the hands of government agencies and/or enterprise insiders.

According to Table 11.4 the growth in (full-fledged) private enterprise lifted the private employment proportion by 2 percentage points from 1990 to 1991 and by more than 5 percentage points from 1991 to 1992. This increase in private sector activity was accounted for both by new small businesses and by new private farms.[15]

As noted earlier, the privatization of small-scale enterprises had begun well before the 1992 government programme was finalized in June 1992. As of the end of April of that year, roughly 13 per cent of the state enterprises scheduled for privatization had submitted privatization applications, but only about 1.5 per cent had actually completed the privatization process. The total revenues received by government authorities from privatization sales by the end of April amounted only to about 3 billion rubles, as compared with the goal of 92 billion rubles set for 1992 in the December 1991 Yeltsin decree on Basic Provisions for privatization.[16]

Table 11.4 displays information on the pace of privatization of retail trade, public catering, and other consumer service establishments, which together account for roughly half of all of the small-scale enterprises in Russia. Figures are given separately for two different steps in the process of removing establishments from direct state control. First there is commercialization, the process whereby an establishment, which previously had no juridical or financial independence from the state enterprise or agency under whose auspices it was operated, gains the rights of an independent legal entity with its own economic accounts; typically such a commercialized enterprise is operated collectively by

TABLE 11.5 Commercialization and privatization of retail trade and service establishments in the Russian Federation

	1 Oct 1991	22 Jan 1992	1 May 1992	1 Oct 1992
Retail trade (shops)				
• commercialized	12,100	15,700	38,700	39,900
• privatized	66	n.a.	1180	10,814
Public catering (restaurants)				
• commercialized	3500	5200	9100	10,100
• privatized	28	n.a.	316	3174
Other consumer services (workplaces)				
• commercialized	2500	4900	17,500	21,900
• privatized	33	n.a.	906	6800

Sources: Data from the Russian State Statistics Committee.

its workers and continues to rent its premises and other assets from the local or municipal government, though it may eventually buy out some or all of these assets. Then there is full-fledged privatization, in which all ownership rights are transferred from the state to a non-state entity. The data for 1 October 1991, indicate that very few — only 127 — state service establishments had been fully privatized by the end of the *perestroika* period; most of these establishments are owned privately by individuals, but some are owned collectively by all their workers.

The data in Table 11.5 suggest that the commercialization of retail trade and service establishments did not begin to lead to much privatization of such establishments until the second half of 1992. By 1 October 1992, over 20,000 such

TABLE 11.6 Privatization of state enterprises in the Russian Federation as of 1 January 1993

	Enterprises subject to Privatization	Enterprises Privatized	Percentage of Enterprises Privatized	Proceeds* from Privatization
All sectors	217,694	46,815	21.5	157,152
Industry	78,714	10,208	13.0	42,436
Light industry	2284	752	32.9	7146
Food processing	4991	1507	30.2	6464
Construction	14,555	2178	15.0	6955
Agriculture	13,817	1457	10.5	2565
Others	43,067	4314	10.0	19,295
Services	138,980	36,607	26.3	114,716
Retail trade	53,500	18,387	34.4	72,721
Public catering	20,537	4373	21.3	10,220
Consumer service	27,676	10,660	38.5	16,493
Others	37,267	3187	8.6	15,282

Sources: Data from the Russian State Property Committee, and authors' calculations.
*In millions of rubles at current prices.

establishments had been fully privatized in independent Russia, and the figure surpassed 33,000 by the end of the year, representing roughly one third of all such establishments scheduled for privatization (see Table 11.6). There has been very substantial geographic variation in the extent of commercialization and privatization of retail trade and service establishments, with the most rapid rate of change generally being registered in the large cities of Western Russia (Bim *et al.* 1993b, Tables 7 and 8). The most common method of privatization of small retail trade and service establishments in Russia has been through commercial tender competitions; but the buy-out of leased assets and competitive auctions has also been relatively common (Bim *et al.* 1993b, Table 9). In the majority of cases the newly privatized enterprises are owned by their own workers.[17]

In Table 11.6 presents the latest comprehensive GKI data available to us on the privatization of state enterprises in Russia, broken down by sector of the economy. Out of 218,000 state enterprises to be privatized, some 47,000 — a little over 20 per cent — had been privatized by 1 January 1993.[18] Unofficial estimates reported in the financial press suggest that this number surpassed 60,000 by the end of the first quarter of 1993; and at the rate of privatization established in early 1993 about half of all Russia's small-scale enterprises would be privatized by midsummer of 1993.[19] The pace of privatization has clearly been more rapid in service than in industrial activities, which is not surprising given the typically smaller size and value of service establishments. According to Table 11.5 a total of 157 billion rubles was realized by government authorities for the sale of privatized enterprise assets during the year 1992; this represents very roughly 15 billion rubles at January 1992 prices, or little more than 15 per cent of the 92 billion ruble target for privatization proceeds in 1992.[20]

Aside from small-scale enterprises, the second main arena of privatization in Russia up to the end of 1992 was the agricultural sector. Although state and collective farms have remained dominant in Russian agriculture, there has been significant growth in the number of new private commercial farms — typically based on lifetime or long-term leasing of land from collective farms and/or municipal and local authorities. The growth of private farms in 1991 and 1992 is tracked in Table 11.7. At the beginning of the year 1991 only 4400 private farms

TABLE 11.7 Growth of private farms in the Russian Federation

Date	Number of Farms	Total Area (thousand hectares)	Average Area (hectares)
1 Jan 1991	4432	199	45
1 Mar 1991	8931	395	44
1 July 1991	25,159	1094	44
1 Oct 1991	na	na	na
1 Jan 1992	49,006	2058	42
1 Apr 1992	94,132	3859	41
1 July 1992	127,233	5344	42
1 Oct 1992	148,681	6245	42
1 Jan 1993	183,663	7840	43

Sources: Data from the Russian State Statistics Committee, and authors' calculations

had been registered across Russia; but the number of private farms rose by 45,000 during the year 1991 and by more than 130,000 during the year 1992. By 1 December 1992, a total of 184,000 private farms occupied a total area of 7.8 million hectares, at an average area of 43 hectares per farm. Yet these new farms accounted overall for only about 2 per cent of the cultivated land in Russia; by comparison, the traditional farm sector of small family plots accounts for about 3 per cent of all agricultural land (World Bank 1992: 200). Moreover, the new farms accounted for no more than 1 2 per cent of total agricultural production in Russia in 1992.[21]

Turning to the privatization of medium- to large-scale enterprises, it has already been mentioned that the 1992 government programme mandated the corporatization of roughly 6,000 enterprises by the end of 1992, based on the particular privatization option to be selected (from among three alternatives) by each enterprise worker collective. It was hoped that most of the designated enterprises would be privatized by the end of 1993. By the end of 1992 each adult Russian citizen was to receive a privatization voucher with a nominal value of 10,000 rubles, which could be used *inter alia* to bid for shares in the corporatized enterprises.

Given the ambitious nature of these mass privatization plans, it is hardly surprising that the original timetable has not been met.[22] The designated enterprises began to hold votes by their worker collectives and to submit privatization plans in late 1992, but only about 600 were transformed into joint-stock companies by the end of 1992; it was estimated that almost 2000 of these enterprises had completed their corporatization by the end of June 1993 and that another 3000 would be completed by the end of 1993. Thus far the worker collectives of enterprises being corporatized have most often chosen the second privatization option, which enables workers and managers to buy up to 51 per cent of the shares and maintain insider control of the enterprise.[23]

The distribution of privatization vouchers was begun in October 1992 and virtually completed by January 1993; during this time they were fetching between 4,000 and 6,000 rubles in the secondary market (roughly half their face value), though apparently most people were not selling them immediately for cash. The first auction of shares under the voucher programme took place on 9 December 1992, at the Bolshevik Biscuit Company in Moscow. Bolshevik workers and managers had already purchased 51 per cent of the company's equity in a closed subscription at 1.7 times its early 1992 book value (following privatization Option 2), and on 9 December a two-week period of public voucher bidding on another 44 per cent of the equity was initiated.[24] Most of the publicly auctioned Bolshevik shares were purchased by enterprise workers, managers, pensioners and their families, thus reinforcing insider control of the enterprise.

Such public auctions of shares for privatization tokens under the voucher programme continued apace in the following months, involving enterprises of all sizes. Auctions were held for just 18 enterprises in December 1992, but the monthly rate increased rapidly and by June 1993 shares in 2,418 enterprises had been sold in voucher-based auctions, of which roughly 700 were in the medium- to large-scale category (Boycko *et al.* 1993, Tables 2 and 3). These latter included a few of the very biggest of Russia's industrial enterprises; for example, the giant

ZIL Company — with 15 plants and over 100,000 employees across the country — began in March a nationwide sale of 35 per cent of its assets for vouchers.

Several hundred investment funds had been registered in Russia by mid-1993, and this number was expected to continue to grow. These funds can accumulate citizen vouchers in exchange for shares of their own equity, and use the vouchers to bid for enterprise shares; but current legislation prohibits any such fund from holding more than 10 per cent of the shares — or investing more than 5 per cent of its own assets — in any one enterprise. It was estimated in April 1993 that some 15 per cent to 20 per cent of all privatization vouchers had been invested either in enterprises or in investment funds.

The overall results of the privatization process in Russia through May 1993 have been mixed. Clearly the privatization of small-scale enterprises is well on its way to completion, if not by the end of 1993 then surely within the following year. The privatization of medium- to large-scale enterprises, however, has been somewhat slower and remains quite incomplete. By mid-1993 about a third of the 6000 enterprises scheduled for corporatization and privatization in the 1992 government programme had been transformed into joint-stock companies; less than half of the latter had offered shares in public voucher-based auctions. Many important state enterprises — especially in the military-industrial complex — were not even mandated for privatization under the 1992 programme, and their future remained uncertain in mid-1993.

4. Conclusion

From the launching of Mikhail Gorbachev's economic reform policies of *perestroika* in 1987 until the demise of the Soviet Union in late 1991, privatization in the Soviet Union developed in two stages. In the first stage, until 1990, the main thrust of privatization policy was to decentralize control of state enterprises within the continuing context of a centrally administered socialist economy; some new forms of non-state enterprise were encouraged (e.g. cooperatives), but these were limited in scope and scale. In the second stage economic policy-makers began to articulate plans for the divestment of state assets and the development of independent private enterprise on a substantial scale. By the end of 1991, however, privatization had not proceeded very far, and it mainly took the form of leased enterprises (whose assets were still owned by state authorities) or *nomenklatura* privatization (the conversion of state enterprises into joint-stock companies whose controlling shareholders are present or former government officials). It was only with the demise of the Soviet Union and the rise of independent Russia, under President Boris Yeltsin, that the era of widespread privatization really began.

The approach to privatization favoured by the radical reformers who gained the upper hand in the Yeltsin administration once Russia became independent calls for outsider control of individually owned open joint-stock companies: this is reflected in their preferred privatization Option 1 for medium- to large-scale enterprises under the 1992 government programme for privatization. Many gradual reformers favoured instead a very different approach to the transformation

of such state enterprises, aiming at insider control of closely held collectively owned firms. This approach has been resisted by economic decision-makers in the Yeltsin Administration, but an alternative and more moderate version — involving insider control of individually owned joint-stock companies — was incorporated as Option 2 into the 1992 government programme.

The approach of the radical reformers clearly stresses the goals of economic efficiency and dynamism over the goals of economic stability and security. The idea is to promote restructuring and rationalization at the enterprise level, even though this is likely to generate — at least in the short run — a great deal of dislocation and unemployment. The approach of the gradual reformers, by contrast, puts considerably more weight on stability and security. In spite of the efforts by the radical reformers to elicit the choice of Option 1 in voting by worker collectives in medium- to large-scale enterprises, votes up to mid-1993 have gone heavily in favour of Option 2. This outcome clearly reflects a very strong commitment by workers to maintaining a degree of stability and security through insider control.

The economic merits of outsider *versus* insider control depend on the relative importance of the potential efficiency gains and losses associated with each form of control, for example the gains from radical firm restructuring *versus* the gains from preserving enterprise stability and long-term employment relations (see section 1). These relative gains will surely differ from one enterprise to another, depending on the particular circumstances; so one cannot make a universally applicable case for one form of control over another. It has become clear, however, that insider control — whatever its merits or demerits — is likely to be a fact of life in most medium to large-scale enterprises in Russia for a long time to come. The radical reformers' effort to attract strategic external investors appears unlikely to succeed, not only because of the preferences of voting workers for insider control, but also because there are few potential outside investors ready and able to take on responsibility for management of transformed state enterprises. The bulk of the domestic population lost all of its savings in the inflationary spiral of the past few years, and even with vouchers does not have enough resources to purchase any more than a few shares in large joint-stock companies. Those Russians who possess large amounts of investible funds (mostly traders and speculators who have benefited from the opening up of markets in a highly volatile and inflationary economic environment) generally find it much more profitable to continue their lucrative short-horizon trading activities than to invest their money in long-term restructuring of failing enterprises. Potential foreign investors are scared away by the enormous political and economic uncertainty that continues to characterize contemporary Russia; such foreign investments as there are tend to flow into the primary product extraction and service sectors (where there are prospects for quicker profits and where success is less dependent on the whole economic environment) rather than into manufacturing industry.

The situation, however, has slightly changed in the summer of 1993. Some private companies, including newly created commercial banks, have expressed interest in the privatization of former state enterprises. There are already cases where large packages of shares have been bought through auctions and tenders by

purely private outside investors who have managed to accumulate their capital through trading and speculation. This is important in that it opens up new possibilities for outside control over privatized enterprises in Russia as a significant form of property structure and enterprise governance. Thus 'free' potential capital now already exists and is showing interest in the process of privatization. Of course the prospects of channelling financial capital into the productive sphere will depend on many different factors, of which two are especially important. First — whether privatization procedures will be developed so as to stimulate outsider access to a controlling block of enterprise shares; otherwise it is very unlikely that outsiders will be interested in investing their money. Second whether the current managers of the enterprises will be interested enough in new capital investment so as to accept a redistribution of shares to outsiders; this requires that the government cease providing preferential credits to enterprises.

External control of state enterprises on a large scale would appear to be impossible without a major government-led effort to create and support outside investors on an institutional basis. In order to take control out of the hands of insiders, the Russian government would have to encourage private holding companies and/or mutual funds to take over control of large numbers of transformed state enterprises. Far from encouraging the development of large external institutional investors, however, the policy actually followed by the Yeltsin administrations has very much restricted the role of institutional investors like voucher investment funds. This has made it all the more likely that government agencies will continue to hold a substantial fraction of the shares of corporatized state enterprises in which insider managers are exercising control. Such a pattern of ownership and control makes it especially difficult to overcome the well-known problems associated with soft budget constraints.

Contributing to the problems besetting the government programme of privatization has been an overall erosion of the authority of the federal government. This has made it all the more difficult to ensure reasonably fair access to shares on the part of outsiders; the rank and file of the *nomenklatura* are often able to arrange privatization deals in ways that benefit themselves at the expense of the public interest in higher privatization proceeds, if not outsider control. The under-developed state of of capital markets has also seriously hampered the operation of the government programme of mass privatization. To succeed as intended this approach requires good information-gathering, accounting and regulatory institutions which are only very slowly developing in the Russian economic environment.

The predominance of insider control of privatized enterprises in Russia at the present time reflects not only problems in the tactics of the radical reformers. It reflects also an underlying reality confronting their basic strategy, namely the strong desire of a large proportion of the Russian people for stability and security. Even where and when it makes good economic sense to promote efficiency and dynamism through outsider control, the goals of stability and security cannot be ignored or given only secondary consideration. Popular demands for these latter goals will surely surface in one way or another, as they have in the struggle over privatization options in Russia. It follows that any effort to dislodge insiders from control of transformed state enterprises would have to be accompanied by

an effective society-wide programme for dealing with the dislocation and unemployment that results from external control. Although the radical reformers in the Yeltsin administration do pay at least lip service to the importance of dealing with problems of unemployment, their overall economic strategy (including sharp cuts in government spending) raises real doubts about their desire and/or ability to compensate dismissed employees for their loss of employment and enterprise-based social services. Thus it does little or nothing to relieve enterprise managers of the implicit obligation to keep on providing employment and social services to their workers.

Turning from the question of control to the terms of transfer of state property, we confront issues of social justice: who deserves to inherit the property accumulated by the state on the (nominal) behalf of the people? Proponents of mass voucher programmes argue persuasively that such a concessional transfer is more than just either concessional transfer to insiders or market sale of state assets, for a voucher system allows all segments of the population equal access to the nation's capital stock, whether or not they have an inside status and whether or not they have somehow accumulated investible funds. The authors of the 1992 government programme for privatization in Russia did indeed undertake a mass voucher privatization scheme, in order both to enlist citizen interest in the privatization process and to assure the public of its fairness. While the Russian voucher programme is consistent in principle with these objectives, the degree of distributive justice it brings about in practice is limited in two important respects. First, the privatization vouchers enable citizens to participate in acquiring only a fraction of the nation's assets; the rest go on somewhat preferential terms to enterprise insiders, are subject to market sale, or remain in state hands. Second, the underdeveloped condition of capital markets, as well as the scarcity of reliable information about investment opportunities, serve to erode the real value of the vouchers for the average citizen investor

Given the strong pressures for continued insider control of transformed Russian state enterprises, what will be critical is the economic environment in which insider managers control their enterprises, for example how much competition they will face in product markets, what kind of access they will have to investible funds, and how well they and their workforce will be motivated to improve enterprise performance. The single most critical issue may well be where to find the funds to undertake new capital formation, for without such investment no programme for restructuring can succeed. The Yeltsin administration reformers had hoped that external investors would supply the needed capital in the process of acquiring control over enterprises. Major changes in the structure of ownership rights in these enterprises were expected, through resultant changes in incentives to save and invest, to lead to significant increases in real saving and real investment.[25] But the paucity of external investors casts great doubt on the success of such an approach. Moreover, the very low level of proceeds realized by governmental agencies from the privatization process has weakened the capacity of the state to play a major role in making ingestible funds to the non-state sector (or to undertake public infra-structural investment).[26]

In the last analysis, the success of the privatization process in Russia will not be measured — as it so often is now — in terms of the percentage of former state

enterprises that have been transferred into non-state hands. Instead, it will be measured in terms of the success of such enterprises in restructuring and improving their economic performance, in producing needed goods and services, and in providing the basis for economic and social stability. In order to achieve these goals, privatization policies and procedures will need to be developed in such a way as to attract outside capital inflows, to stimulate effective competition, to improve the motivation of enterprise workers and managers, and to facilitate the utilization of existing productive assets as well as the formation of new labour skills and physical capital.

Notes

1. The process of privatization in contemporary Russia is of course ongoing and continuously evolving; our survey in this chapter necessarily takes account of developments only up to the time of the paper's completion in the summer of 1993.
2. We recognize that the term 'privatization' is often defined more narrowly to connote the transfer of enterprise ownership from the public to the private sector, but our broader definition allows us to encompass the whole evolution of Soviet and Russian policy in this area.
3. See Leijonhufvud (1993) for an insightful analysis of these issues.
4. See Desai (1992) for a review of the evolution of *perestroika* economic reform policies and Bim *et al.* (1992) for further details on legislation relevant to privatization.
5. See Bim *et al.* (1993a) for an analysis of 'hybrid' forms of enterprise organization in the Soviet and Russian context.
6. We draw in this paragraph on the detailed survey of new cooperatives and leased enterprise provided by Bim *et al.* (1993a).
7. It should be stressed that the figures in Table 11.2 do not provide a precise measure of the overall significance of non-state economic activity, because they ignore the widespread semi-legal 'second economy' which engaged at least the part-time efforts of a large fraction of the Soviet population. One can, however, give credence to the trends displayed in the table.
8. As in the case of Table 11.2, the figures in Table 11.3 ignore the 'second economy'. There are also some inconsistencies between Tables 11.2 and 11.3, which reflect the different sources of data. Thus the figures in Table 11.3 do not provide an accurate measure of the existing employment structure, but they should provide a reasonably good indication of trends in employment over time.
9. Viktor Chernomyrdin succeeded Yegor Gaidar as Prime Minister of Russia in December 1992.
10. See Wegren (1993) for an account of the evolution of Russian agrarian reform legislation.
11. For a more detailed summary and discussion of this and other documents relating to the Russian privatization programme, see World Bank (1992: 85-92), Bush (1992, 1993); and *Transition*, Vol. 3, No. 10 (November 1992), pp. 6-7.
12. An additional 18,000 enterprises were estimated by the GKI to fall into the intermediate range (book value of fixed capital from 1 to 50 million roubles, or of less than 1 million roubles but with more than 200 employees) where corporatization is possible but not mandatory. See Bim *et al.* (1992, Table 3.3.1).
13. The legislation actually defines somewhat more broadly the members of a worker collective eligible to vote (and to receive employee benefits and discounts): employees holding their principal job at the enterprise; persons who are entitled to be re-employed at the enterprise, according to the laws of the Russian Federation; pensioners who have retired from the enterprise, or former workers of the enterprise who have worked there not less than 10 years in the case of men and 7.5 years in the case of women, and who retired voluntarily or as a result of staff cuts; and persons discharged from the enterprise as a result of staff cuts after 1 January 1992.
14. Transformation of leased state enterprises into non-state collectively owned firms through the buy-out of assets on favourable terms was first allowed under the 1990 Soviet Law on Ownership, and it remained one of several permissible privatization mechanisms in the 1991 Russian Law on Privatization.
15. As in the case of Tables 11.2 and 11.3, the figures in Table 11.4 do not reflect activity in the 'second economy'. In the transition from the Russian Republic to independent Russia, much of the restrictive legislation that drove private business into the semi-legal and illegal realms of the second economy lost its force. Although a good deal of such activity remains unrecorded, if not illegal, some of it has been channelled into legitimate private business. Thus the figures in Table 11.4 probably overstate the rate of growth of private business activity in Russia between 1991 and 1992, while continuing to understate the level in all years.
16. The figures cited in this paragraph are GKI data presented in Bim *et al.* (1992, Table 2.1.5).
17. According to *Russian Economic Trends*, (1993) 2(1), 'at the end of 1992 worker collectives owned 60 per cent of the shares in privatized small-scale enterprises, other firms owned 27 per cent and individuals owned 13 per cent' (p. 51).
18. These GKI data refer to state enterprises of all sizes, but the vast majority – and virtually all of those already privatized by January 1993 – are small-scale enterprises.
19. A report in *Ekonomika i Zhizn'* #17 (April 1993), p. 4, indicated that 11,000 small-scale enterprises were privatized in January and February 1993. GKI Chairman Chubais is quoted in *Transition*, Vol. 4, No. 2 (March 1993) as declaring in Washington on 19 March that almost 50 per cent of Russian small businesses were already privately owned at that time; but elsewhere the number of private small enterprises has been estimated at about 60,000 in March, a figure quite consistent with earlier data but amounting to less than 30 per cent of the small establishments scheduled for privatization.
20. Since most of the enterprises were privatized in the second half of the year, and since price inflation for small enterprise assets is estimated by GKI at roughly 1000 per cent through the first three quarters of the year, it is reasonable to divide the value of assets sold throughout the year by about 10 to arrive at an estimate of the real value of assets sold in January 1992 prices.
21. Wegren (1993), p. 53, footnote 53, cites estimates that in 1992 new private farms produced about 2 per cent of all the grain purchased by the state and less than 1 per cent of the potatoes, vegetables, meat, poultry and milk produced in the country.
22. The information on the progress of privatization in medium- to large-scale enterprises, provided in this and the following paragraphs, is drawn primarily from reports in *Transition*, Vol. 4, No. 2 (March 1993), pp. 1–4, and from Bush (1993); more recent information was obtained from Boycko *et al.* (1993) and from periodic reports from the financial press in Russia and abroad.
23. According to *Russian Economic Trends*, (1993) 2(1), by the end of 1992 64 per cent of workers' collectives in medium- to large-scale firms had chosen Option 2, 34 per cent had chosen Option 1 and 2 per cent Option 3 (p. 51). Boycko *et al.* (1993) report that as of July 1993 the corresponding figures were 68 per cent for Option 2, 31 per cent for Option 1 and 1 per cent for Option 3 (Table 2).

24. The proportion of enterprise equity that could be sold for privatization checks was increased from 35 per cent to 80 per cent in October 1992 in order to increase interest in (and the value of) vouchers.
25. This approach clearly reflects the supply-side notion that the best way to revitalize an economy is to let the market take care of things under clearly defined property rights, rather than to enlist government in an effort to mobilize real resources and channel them into desired activities.
26. The low level of government proceeds from privatization is due both to the large amount of state property turned over simply in exchange for vouchers and to the concessional prices at which much of the remaining state property is sold. As noted in section 3, privatization proceeds for 1992 amounts to only about 15 per cent of the original target.

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