

PRIVATISATION IN RUSSIA:

Hard Choice, First Results, New Targets

by

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Preface by Egor Gaidar

London:

Centre for Research into Communist Economies (CRCE),
New Series 12, June 1995

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ISBN 0 948027 24 X

For references: CRCE, 2 Lord Nord Street, London SW1P 3LB

Or British Library catalogues

ABOUT THE AUTHOR

Alexander Radygin was born on 17 September 1962 in Moscow. Having graduated (1984) from the Department of Economics of Moscow Lomonosov State University, he pursued his interest in issues of West European integration, structural and industrial policies, the public sector and privatisation in the countries of the West, and also taught political economy. He received his PhD in 1987 from Lomonosov University.

Since the foundation of the Institute for the Economy in Transition (IET) by Egor Gaider in Moscow in January 1991, Alexander Radygin has been working for the IET, where he is in charge of research on the problems of reforms in the field of ownership relations. He runs the Laboratory of Privatisation and Ownership Structure.

He was a member of the Working Group on drawing up a Russian Law on privatisation (1991), a member of the Working Group under the Government of the Russian Federation on Economic Reform (November 1991-December 1992) and an adviser to the First Deputy Chairman of the Government of the Russian Federation (September 1993-January 1994), as well as co-author of some government programmes on economic reforms, and a member of the Government Commission on working out a post-voucher privatisation model. From 1991 to the present he has been an adviser to the State Committee of the Russian Federation for the Management of State Property (GKI). In 1993 he worked as an independent expert for Russia on the UNCTAD Working Group on Privatisation.

He is the author of over 100 articles published in Russia and abroad.

PREFACE

Privatisation is a great historical development; it is a peaceful and civilised equivalent of a revolution. Previously in the history of Russia, as we know, it was not vouchers but Brownings that were used to bring about change.

The split that occurred in the state and corporate property and the destruction of the structure power within which the *nomenklatura* existed in principle implies an end to the *nomenklatura* itself as a stable and viable (and sometimes even hereditary) political and economic elite.

For bureaucracy the ideal formula is to add property to power! The idea is to achieve a restoration of property to private ownership in such a way that ultimately the production (production costs and risks) remains social but the appropriation private; to conduct privatisation - as was the case with Eastern despotic regimes - without creating a full-fledged market, so that power would be free, independent of the administrative machinery, and in effect private property.

It was not done immediately, but gradually; we reached that kind of situation somewhere in 1990. But the path thus travelled was a sweet one for bureaucrats. The landmarks are probably the law on cooperation and the election of directors and reduction of their responsibility to ministries (and the parallel total reduction of the so-called 'party discipline' which was the backbone of everything the state had), and the change in rules which made it possible for enterprises to 'whip up' the salaries as much as they wished and secretly jack up the prices of their products though on the official level prices were not 'freed'.

In my view, the period of the last days of Ryzhkov and Pavlov in 1989-1991 may be called the 'golden' period for the *nomenklatura*, when they knew no limits. The 1990-1991, system with no set rules and procedures on property rights, no responsibility for whatever one did, could be seen as if created (was it, indeed, so created?) specifically to make it possible to get rich, fearing nothing, ashamed of nothing. The *nomenklatura* found a 'neutral zone', 'no man's land'. One could do anything one wished in that land and only dream of staying there as long as possible.

It may be described as a certain 'irony of history'. If the way leading to the market had not been paved with honey, with dollars for the *nomenklatura* to grab (and there is no element of surprise there, they themselves 'controlled' the process), they would not have followed that path voluntarily and the nation would hardly have travelled the path peaceably, without blood shed. It was exactly the fact that capitalism was being built by the *nomenklatura* 'for themselves' that made it possible for the country to reach capitalism peacefully. But one has to pay for everything.

Well, the path travelled was without blood shed, but it was extremely ugly nevertheless. What we had by the end of 1991 was a hybrid of bureaucratic and economic market (the former prevailing) and an almost finished ('almost' because of a certain legal vagueness with regard to the formal property rights) structure of *nomenklatura* capitalism. The same hybrid of Soviet and presidential forms of government, a republic that was both post-communist and pre-democratic.

And while the ruling classes gained success after success in the

solution of their own private issues, the economy was in disarray.

That was the situation when 'fire-fighting reforms' started and a 'suicide team' of leaders was formed. We were called when a choice was made.

Prior to our coming to office, the so-called *nomenklatura* privatisation that had been in progress for as long as three years was following a classic scenario of privatisation under the 'asiatic mode of production'. The privatisation we had was reduced to the looting of satrapies by their satraps. Such privatisation, which guaranteed maximum gains and minimum risks for the oligarchy which retained full administrative power in its hands and, moreover, added unearned wealth to it, would always end up (at least in Eastern societies) in one and the same way : with an explosion and a new dictatorship. The general cycle of development these societies follow is this : dictatorship - disintegration (privatisation) - explosion - a new dictatorship. The first stage has split into two parts : a latent period (1953-1988) and an open period of disintegration in society (1988-1991). That period was coming to its end. One could see an explosion on the horizon. And the paradox is as follows : at the time when psychologically trust was in the democrats, and it was almost complete trust at that time, we came as close as possible to the dangerous edge of 'impending catastrophe' and the period of fighting it using the already tried methods.

Being aware of the acute and tense nature of that situation, we also realised that we could change track and go in a different direction. From the *nomenklatura* deadlock, where we were, there

are two ways out : an explosion (a new dictatorship) and the 'unstitching' of the social space, i.e. going to an open market, absorbing its mechanisms, moving away from the *nomenklatura*-type privatisation toward a democratic privatisation. And these were the things that were done at that time.

Without resorting to violent measures, without putting the economy into 'extreme circumstances', it became possible to change the catastrophic system of property relations that existed at the end of 1991. On the whole the course that was started at that time (and it was not possible to lead the government of the country astray, though there were quite a number of attempts of that kind), it seems to me, brought about vast changes and not only market-oriented changes, or changes toward capitalism but also changes toward a non-*nomenklatura* market, non-*nomenklatura* capitalism. Naturally, what we have today is an intermediate version that can develop in different directions but the general trend remains with all its inconsistencies, it is a non-*nomenklatura* trend. Today a non-bureaucratic market predominates. That kind of approach was made realistic (though not everything is done yet) in 1992-1993.

How did it become possible?

The main reason it became possible is that the political power of the *nomenklatura* was destroyed. Trying to achieve the privatisation they needed, the representatives of the party oligarchy went too far in the process of 'democratisation', that process became unruly, and democracy was already in place. And having lost their monopoly on power, the *nomenklatura* was no longer capable of keeping the process of privatisation under their complete control. The *nomenklatura*-type privatisation was

being replaced with a democratic, market privatisation.

Nomenklatura privatisation is not determined by questioning a new owner (for instance, by asking `what were you doing prior to 19 August 1991?'). For what it needs is not people but the system. If the system of state (semi-state) control is retained, i.e. bureaucratic-*nomenklatura* control over the economy, state capitalism, *nomenklatura* privatisation, is there to stay whoever is the owner.

Once the system is destroyed, the owners will bear financial responsibility on the market, which may spell bankruptcy, and that means that objectively it is an `anti-*nomenklatura*' privatisation that has been implemented.

And it is precisely for the destruction of the old system of government, the old property relations, that privatisation - with all its faults - have done an irreversible thing. It may not have created a middle class itself, but it did destroy the *nomenklatura*. In other words, there is an environment where the middle class may spring up.

So if the insolvency (bankruptcy) orders at the second stage of privatisation (when a considerable portion of state shares in enterprises are sold for money) are effective, then the market mechanism to change the owners (at least in general) may be thought to have been prepared. And only then one can evaluate the essence of privatisation.

Change in the forms of property, change in the roles and not just the performers acting on the stage - this is a real economic revolution, a social and economic revolution which has

occurred (which has been effected!) by means of evolution, but quite rapidly!

And now a few words about the author of the book. Alexander Radygin is my close colleague and collaborator who came to the Institute at the time of its creation. As is well known, the November 1991 government was formed to a certain extent on the basis of the Institute. It was my wish to have Alexander Radygin in the government but he was resolute in rejecting all kinds of administrative posts. The only post that he would agree on, by mutual consent, was that of adviser. And, maybe, it was all to the best for this way he could maintain an unbiased view on what was happening, and yet participate in the preparation of all decisions on privatisation. Without doubt he played a serious role in drawing up practical measures in the field of privatisation.

As to the book itself, in my view, it is the best we have today. It is practically the first systematic monograph devoted entirely to privatisation and reform of ownership relations in Russia.

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September 1994

INTRODUCTION

The privatisation wave that spread all over the world in the 1980s at last reached the shores of Russia in the 1990s /1/ and near the bastions of the administrative system it came to rest in a rather indecisive way. If in the 1980s the issue of privatisation was of real interest only for a narrow circle of academics, and again only as it was applicable to the nations of the West and the developing nations, the autumn of 1990 in Russia was a starting point for extremely vigorous deliberations over an acceptable model of privatisation for domestic needs.

The term privatisation itself becomes one of the most popular and necessary features of most economic programmes and discussions. Practically every economist, however little known, thought it was his duty to present his personal conception of privatisation or at least show his attitude towards the subject. Not only economists but also experts in some other fields, not always closely related, hastened to advance their own views and boasted of foreign experience.

If one can portray 1985-1989 as a period of cosmetic changes in the economic system when any alternative forms of property were considered only in the context of a 'diversified socialist economy', with the state sector remaining dominant, 1990-1991 already represents a period of more systematic reforms or, more accurately, a period of more systematic conceptions of pro-market transformation. A marked change can be observed in the ideological approach towards property as such and towards reforms of the corresponding relations in particular. The element of reforms could also be observed in the contents of the programmes considered, and in the laws that were passed during

that period. At the same time - against the background of continued debates on the possibility of alternative forms of ownership and methods of privatisation - one could clearly observe the development of a spontaneous privatisation process.

If 1992 enters the history of Russia as a year when a large-scale reform in the sphere of property relations on the basis of the privatisation legislation just developed began, 1993 was first of all a year of intensive build-up of 'critical mass' of the corresponding quantitative transformations, while 1994 must become a year of change-over towards a new privatisation model designed primarily to stimulate structural change and the investment component of the privatisation and post-privatisation process. It is clear that any drastic changes in the privatisation patterns and orientations must rest on the results of the path travelled, especially if such a highly politicised and populist path as that of voucher privatisation has been taken.

It is sufficient to imagine all the variety and the specific nature of the economic, legal, political, social, historical and national conditions in which reforms develop in Russia to lose any illusions about the degree of complexity of the issue. At the same time it should be stated that such illusions existed and still exist both in government circles and among MPs, as well as among various intellectual economists. The spread of positions on this issue is quite broad, reflecting practically the entire political range of Russian life.

It is absolutely clear that in this range of positions and opinions, hidden interests and open political ambitions, there is practically no room for any unanimous interpretations

(definitions) of the concept and the processes of privatisation in Russia /2/. The purpose of this book is to present, as far as possible, an integral picture of privatisation issues and processes in Russia by September 1994, both on the conceptual and legislative levels as well as reflecting the real economic progress, and to attempt to evaluate the results of the voucher model of privatisation and the prospects of reforms in the area of ownership.

I am grateful to Viktor Krupnov for his assistance in translation of this book into English.

Chapter 1. Purposes, Limitations and Special Features of Privatisation

As a fundamental element in the systemic reforms in the transition period the purpose of privatisation is to ensure the basic conditions for normal operation of a future market economy. It is the process of transformation of ownership relations on a nation-wide scale that brings the appearance of new motivations of economic subjects and the prerequisites for rational change in the structure of production as key factors to enhance the efficiency of production and increase the rate of growth of national income. Nor is there any doubt that privatisation is necessary to promote democracy within the political system, to form new social strata of people who have no interest in a communist return /3/. A very telling, if laconic, characterisation of the key goal of privatisation in transition economies is given by Shleifer: 'privatisation amounts to permanent reallocation of control from bureaucrats to firms' insiders and outside shareholders. Privatisation has very clear benefits for economic efficiency because it establishes genuine private property rights' [Shleifer, 1994, p.3].

In this sense such potential benefits of privatisation as 'universal' justice or adding to the revenues of the state budget are inevitably relegated to the background. Nevertheless, if the attainment of 'universal justice' in the course of privatisation is abstract and practically unrealistic, then the partial solution of the budget problem through privatisation is possible, depending on the models chosen. The privatisation process can only have a positive influence and purely privatisation issues can only be solved in the context of

a package of measures to provide for financial stabilisation, liberalisation of prices, demonopolisation of the economy, development of financial markets and pursuit of an active antimonopoly policy and opening of the economy for the import of goods and capital. In the conditions of the transition economy, privatisation proper does not automatically lead to the appearance of stable and viable enterprises; it serves only to create the necessary economic and legal prerequisites for this.

To a large extent the prospects of implementation of any privatisation programme also depend upon the level of development of the private sector of the economy and the state of financial markets, the degree of profitability the enterprises have, the presence of legal guarantees for foreign investors, the policies of trade unions, the general state of the economy, and the presence of a favourable institutional and legal environment. And it should be remembered that it is not only the nature of property but the market environment itself, the organisation of the operations of the firm and the ability of management that determine its performance, while economic efficiency depends to a much larger degree on competition and not just on the nature of property rights [Bizaguet, 1988, p.75]. Thus we see that the presence (absence) of proper economic environment to some extent determines how effective the privatisation becomes and how large or small its scale is /4/. In turn, privatisation serves as an inevitable prerequisite of transformation of the 'transition' economic environment into a market economy, primarily through the creation of a considerable sector of companies independent (at least formally at the initial stage) from the state and oriented to the market.

In a highly developed economy the main issue (within state

privatisation programmes) is the choice and preparation of the technical aspects of the transfer of property rights to individual companies (their assets) into private hands, this being done to ensure the economic efficiency of the further operations of these companies. In post-socialist countries the starting point of privatisation is the choice and theoretical foundation of conceptions and overall models of privatisation with a whole series of specific features.

In all these countries the following problems arise as special features of privatisation :

- linkage between privatisation and change in the power relations in society;
- scale of privatisation;
- absence of rational market competition environment;
- vast technological difficulties;
- necessity of ideological choice;
- lack of the required institutional structure at the initial stage.

Under the circumstances prevailing in Russia /5/ the development and implementation of privatisation policy became especially complex owing to the operation (more significant compared with other countries in transition) of the following factors :

- firstly, running parallel to the process of selection of overall (and legal) models, there has been a vast spontaneous transfer of state-owned enterprises and property into other forms of property (collective forms or private ones, or may be quasi-collective or quasi-private ones);

secondly, the high level of concentration, together with the state of backwardness characteristic of many sectors of Russian industry, prevent the conduct of an effective and socially 'soft' policy of structural change prior to and after the privatisation;

thirdly, and in our view most important, it is the policy of privatisation and the issues of change of ownership that are the area of economic reforms where the political and economic pressure is greatest.

The latter circumstance, in particular, directly magnifies the contradictory and unstable nature of the legislative base, which is manifested in the absence of an integral and uniform approach, simultaneous operation of contradictory regulations, frequent changes of tactics and tactical models, the adoption in some cases of regulations and acts which give exclusive rights, that go beyond the laws, to one or other party, and the possibility of repeal of decisions already taken.

Moreover, the high degree of politicisation of the privatisation process in Russia and therefore the forced conflict and compromise character of its development account for the objective necessity of abstracting - at least at the initial stage of implementation of the privatisation model - from the issues of 'genuine' privatisation in favour of a privatisation model used to attain a social compromise. In turn, this, as Malle rightly says, 'has a negative effect on the amount of transaction costs. They become higher than in the case when the transfer of the rights of ownership would rest only on economic criteria...' [Malle, 1994, p.55].

In other words, the elaboration of an overall macroeconomic model with regard for 'universal justice' and with an intensive spontaneous development running in parallel, leads us astray from the key goal of privatisation, which is consistent and gradual formation of a new economic environment and creation of the incentives for specific economic agents, an effectively functioning microlevel, the attraction and encouragement of 'strong' investors who are protected with unconditional legal guarantees and are interested not in 'eating up' the resources of an enterprise but in an effective long-term growth strategy.

In any case this is a long-term process whose major components are stability and non-contradictory legislation, taking into account the political atmosphere and feelings of the various strata of the population, providing for a carefully thought-out 'balance of participation' of all interested parties in the process of privatisation. The point is that if the official privatisation programme is not to a large extent a compromise in nature and does not stem from the principle of ensuring such 'balance of participation' along the entire chain of the implementation of property rights which existed *de facto* and were formed spontaneously, then the success of privatisation is more than doubtful.

I have already made some general observations on the goals and special features of privatisation in the countries in transition and in Russia, in particular. So what are the practical differences or, in other words, those already seen from experience between Russia and the East European countries? /6/

Despite the relative closeness of the countries of this region

to Russia, there were essential differences in their starting positions for market reforms in general and privatisation in particular. Throughout the entire period of operation of the planned economy the East European countries had, in one way or another, a private sector in the field of agriculture, commerce and the services sector (Poland, the former GDR and Yugoslavia) which considerably facilitated the creation of a market environment, thus making it possible for the state at once to lay greater emphasis upon large-scale privatisation, without concentrating so much on a small-scale privatisation process. Because of this, even before the reforms started these countries had some large strata of the population with a considerable share of resources and who wished to become owners of the former state property. In addition, one should not forget that in certain countries of Eastern Europe the state sector enterprises enjoyed larger economic freedoms for a much longer period, which all brought them closer to the market environment than the state-owned enterprises in the former USSR even in the period of the so-called cost-accounting (*Khozraschet*) if 1987-1991.

Outwardly the process of privatisation in Russia was quite similar to the analogous processes in Eastern Europe: rigid selection of enterprises for privatisation on the basis of adoption of a political decision, compiling formal lists and adoption of legal normative acts, the creation of a body responsible for the implementation of the programme, sale of the objects of small privatisation for real money, and issuing the people with certificates permitting them to get a part of the state property through the purchase of shares in small-size and medium-size enterprises. However, the exterior likeness hides some quite serious differences which determine to a great extent the place of privatisation in the general context of market

transformation and its further consequences in various countries.

As to the differences in the course of privatisation and the results of privatisation between Russia and the countries of Eastern Europe, we can mention the following :

- (1) From the quantitative point of view Russia is far ahead of East European countries in the rate of privatisation, and not only in absolute but also in relative figures (which should not come as a surprise if we take into account the scale of Russia).
- (2) In Eastern Europe the principle of distributing a certain part of state property to citizens has not become universal, nor has the idea of preventing a likely concentration of property in the hands of a limited circle of individuals without corresponding benefit for the rest of society and the state.
- (3) In the course of privatisation in Russia a formal act of restoration of property to private ownership has acquired an independent value and now the success of privatisation is measured in terms of the number of privatised enterprises, the amount of money thus earned, the correlation between the initial and actual selling price. As to the East European countries, they, not being in a hurry with privatisation, began (in 1992-1993) to include elements of industrial policy in the process.
- (4) The characteristic feature of the privatisation of many large enterprises in Eastern Europe is the lack of

excessive dispersion of shares, and one can observe this phenomenon at the initial stage of voucher privatisation in Russia.

- (5) The role of foreign investors in the East European countries was much greater, both quantitatively and qualitatively.
- (6) In Russia, under the conditions of slow differentiation of state property by areas of control and the continual struggle between the centre, subjects of the federation and local authorities, one of the main issues in 1992-1993 was the distribution of the rather small earnings (as compared with the total revenue of the budget) from privatisation between the budgets of various levels to find solutions for current problems. In Eastern Europe the pattern of distribution of privatisation earnings was quite different: in 1990 the share of the assets channelled into the budget and to pay off state debt comprised 85% of the total privatisation earnings; in 1992 it dropped up to 40%. The rest of the money was used to modernise the enterprises going through privatisation, the creation of guarantee funds for commercial banks which lend money to the enterprises being privatised, despite the risk that this will increase the rate of inflation.
- (7) In the course of privatisation Russia in fact did not consider the effectiveness of privatisation either from the point of view of the likely losses of revenue to the state (which was quite important, for example, for Poland because of the special payments of state enterprises into the Treasury (payments for capital, wage growth tax) which

were absent in Russia) or from the point of view of privatisation expenses (such as upkeep of the apparatus, advertising, issue of vouchers and so on). Nor was there any evaluation in Russia of privatisation of the enterprise from the financial position, the likely advantages to the state from keeping it in state ownership, or preparation of development scenarios after privatisation.

Beside these basically negative differences, Russia's privatisation was also characterised by some favourable factors compared with the privatisation in Eastern Europe. For example, in Russia there was no question of property restitution. (By the by, the only country in Eastern Europe where that issue was solved practically, without any losses to current production and without a polarisation of society, is the Czech republic. In Poland the adoption of a corresponding law became a very protracted process because of the continuous change in the political balance of forces in parliament. In other countries the process of restitution was either associated with large losses or to a great extent became a formality.)

Russia had only some sporadic signs of regional separatism in the course of privatisation (registered name privatisation deposits in Tatarstan in addition to the vouchers, the admission at certain auctions of privatisation vouchers that were issued in that region only, temporary suspension of privatisation, change in the schedule and procedure of privatisation of some types of enterprises). As to the Czech Republic, it was forced to reconsider the strategy of privatisation because of the disintegration of Czechoslovakia, leaving in the possession of the state the shares which were the objects of claims by the

citizens of Slovakia.

Thus in 1992-1994 Russia placed the emphasis on the formal restoration of property to private ownership, especially on the quantitative aspect, the rate of privatisation, which is very loosely linked with financial stabilisation, anti-monopoly policy, structural change and attraction of new investment (including foreign investment). Once most of the enterprises were privatised the possibilities of state influence on them were drastically lessened. However, the economy did not establish a base for the necessary future growth. Thus the countries of Eastern Europe, while partially sacrificing the rate of privatisation, solved the problems of support for macroeconomic stabilisation and created a potential for growth.

At the same time it would be an error to write off the negative differences of the Russian model, treating them as miscalculations (though of course there were miscalculations too). In the following pages I shall try to show that the model of the first stage of Russian privatisation (1992-1994) was formed objectively in the course of a very complex process of conflicts and compromises. Moreover, I believe that (and I shall try to provide the appropriate argumentation for this), despite the various and multiple losses, this stage may be characterised as a rather successful one.

However, we should start the analysis by providing some background information.

Chapter 2. First Approaches to a Reform of Ownership Relations

2.1. Some Cosmetic Measures of the Earlier Period of Perestroika (1985-1989)

During the earlier period of *perestroika* and in the period of follow-up measures the question whether it was possible to have other forms in addition to 'people's' ownership was one of the most vivid indicators of how far the reform had progressed and how deep it had become. Naturally, the emergence of some kind of legislative acts and, moreover, specifically new (quasi-new) forms of ownership was associated with a rather slow prior removal of the taboos and restrictions of communist ideology. And one should remember that the use of such notions (in the course of implementation of reform measures) as 'the right of private property' and 'privatisation' was not only unpopular but also potentially dangerous in 1985-1989.

And this is not surprising for, as many students of Soviet reforms in 1985-1989 point out, in the course of the first years of the policy of restructuring the attempts to reform the economy were geared to increase the efficiency of the centrally planned economy and in no way touched upon economic transformation. Actually a systematic market reform was planned only at the end of 1989, when discussions on the 'socialist market economy' actually reached deadlock and for the first time the planned nature of the system was questioned [CEC, 1991, p.12, 158].

Because of this the issues of the emergence and development of alternative forms of ownership were not debated in CPSU documents or mentioned in USSR normative regulations of the

first *perestroika* years which affected the question of the economic reform. The only exception was the USSR law 'On Individual Labour Activities'. Only after they were eventually made aware of the depth of the country's social and economic problems (and at the same time carrying out some cosmetic reforms in this field) did the then leaders of the CPSU and the USSR allow certain legislative acts to be passed that gave life to the first wave of legal reforms. It was practically the end of the 1980s before such legal forms as leasing and co-operation were looked at as an essential element of the 'radical economic reform' and the 'new model of economy'. And it was only in the autumn of 1990 that the term 'privatisation' came into use in programmes of economic reforms for the first time /7/.

The USSR Law 'On Individual Labour Activity' actually became the first normative act of the initial period of transformation, which gave legal power to the possibility of engaging in entrepreneurial activity and deriving income from the *de facto* use of private property. And this is not surprising, since some experts believe that in the middle of the 1980s some 19 million people in one way or another were involved in working in the paid non-state services sector - primarily in 'shadow' services. And it was assumed that that kind of activity was wholly based on the personal (family) labour of citizens. In other words such forms of work as small private business, family contract lease and some other such forms were legalised.

Naturally, there were many restrictions on the conduct of such business. These activities could be carried out only on the basis of what was actually a rigid list of 29 permitted 'socially useful' kinds of activities. One of the most difficult problems was that of getting a permit from local

authorities, who tried to block this kind of business on the basis of ideological or corruption considerations. Yet while at the time this law came into force (May 1987) there were only 82,000 'individual workers', in 1989 their number reached 672,000, half of them working in Russia [National economy..., 1990, p.275]. The overwhelming majority - almost 90% - of these were engaged in cottage crafts and in the services sector.

The co-operators who formed their businesses and operated in the second half of the 1980s and at the beginning of the 1990s were now much more prominent, compared with individual workers - they occupied the economic niche and partially ousted the individuals. The co-operators, however, did not become an alternative to the state sector.

Before a special law was passed the regulation of the activities of co-operatives, both in the USSR and in Russia, at the same time extremely detailed and fragmentary, was based on hundreds of different normative acts. The ideological distrust of 'private enterprise activities with the use of hired labour' required that - even after the adoption of the law on co-operation - there should be a rigid ban on participation in a co-operative as a member if one did not work in it. Even at the end of the 1980s and the beginning of the 1990s the normative acts of the 1920s were still in force. From the early 1960s, the cottage crafts were eliminated, only the consumer co-operatives continued in operation - and they cannot be considered as an alternative form to the state sector.

In 1987 there were already some 14,000 'new' industrial, trading and service co-operatives employing more 200,000 people. But it was only after the appearance of the USSR law 'On Co-operation

in the USSR' (on 26 May 1988) that one can speak of a brief co-operative sector boom (see table 1). In 1990 the USSR already had 245,000 co-operatives of this type, whose aggregate share in the gross national product (GNP) came to 6.1%. At the same time this figure, 245,000, made up only 59% of the total number of registered co-operatives.

No doubt the law gave a remarkable push to the development of the non-state sector of the economy and from the legal point of view, at least formally, it put co-operatives (or, in other words, group ownership) on a level with the state-owned enterprises and introduced the registration principle for their creation. And yet the expected social and economic effect - saturation of the market with commodities and services, saving of material resources, involvement of the personal resources of the population in production, development of the secondary employment that would stir competition with the state sector - was not produced either by the co-operatives or by the legalisation of individual labour activity.

Quite important here was an inconsistency in state policies toward co-operatives and 'individuals' which can be accounted for by a series of individual factors : there was the negative effect of the rather controversial legal regulation, primarily concerning the permissible spheres of business, taxation, access to materials and raw materials and the growing property differentiation between those engaged in the co-operative sector and those working for the state. There was also the negative public opinion based on this differentiation and the ideological dogmas that were still alive, and the restrictive policies of local authorities and many state-owned enterprises. In particular, in 1988-1989 price limits were set on the products

of co-operatives and restrictions were introduced on the use of bank accounts and on certain kinds of activities, and commercial and purchasing co-operatives were liquidated.

What happened was that, instead of an inflow of unskilled workers into the co-operative sector, a spill-over of qualified personnel from the state sector occurred, not to speak about co-operatives' competition with the state sector. The business activities of co-operatives (individuals) and the state sector in the production of goods and supply of services were in practice stopped. On the contrary, the co-operatives, because of their orientation to a very flexible structure of output, and especially goods that were in short supply, and because they filled 'free economic niches', as a rule, switched over to some other range of products as state enterprises familiarised themselves with the new types of commodities and services.

Furthermore, the vast majority of co-operatives actually strengthened the monopoly of the state sector. It was no accident that more than 80% of the co-operatives were formed at state structure, while the number employed in these co-operatives exceeded 90% of those employed in the total co-operative sector. Primarily this can be accounted for by the fact that there was strong administrative pressure (through the local authorities) from the state-owned enterprises in those cases when co-operatives actually undercut the monopoly of the state sector. Also, the latter had a monopoly of the supply of raw and other materials, and without the co-operation of the interested state enterprise it was not possible to lease premises or to include the work performed by the co-operatives as part of the plan of the founding state-owned enterprise. At the turn of the 1980s and 1990s the creation of co-operatives at

state enterprises - with the same management - became one of the key forms of 'spontaneous' privatisation (exploiting transfer prices, transferring property on the basis of the right of full business management, contributing to businesses in the form of shares and so on).

The years 1989-1990 therefore saw a clear trend towards a reduction in proportion of the population that consumed products of the co-operative sector in favour of state-owned enterprises. The greatest rate of development was of construction co-operatives, whose share in the total number of co-operatives was over 30% by 1990, and those co-operatives that turned out production equipment.

Within the framework of the co-operatives themselves, in addition to this modification of the branch structure of the co-operative sector, one can clearly see two distinct trends in the transformation of the informal relationships of power and property. What actually happened was that a major part of co-operatives operated as individual (family-type) private enterprises with a rigid system of control, with the meeting of the co-operative's members playing a nominal role and extensive employment of the hired labour in the form of those with two jobs. And that was quite a characteristic feature because on average the situation in the USSR was as follows: one co-operative had about 25 members plus those with two jobs. The larger co-operatives, despite their legal form, were inclined to adopt collective forms of business, forms close to a joint stock company or a partnership with limited liability.

Following the co-operatives boom of 1988-1989 these trends could account for the appearance of statutory regulations in the USSR

and Russia in 1990 on enterprises, joint stock companies and limited liability partnerships; the consequence for the co-operative sector was that it declined. Most of the co-operatives were turned into legal forms that were more suited to the *de facto* relationships between power and property.

If treated from a broader perspective, one can then say that, at a time when one could not even speak about a 'transition economy', the co-operatives became the first transitional form in the field of transformation of property relations in the USSR and Russia, irrespective of whether one has in mind the emergence of alternative forms of property or the first spontaneous steps towards privatisation of the economy.

In the USSR lease relations appeared only at the turn of the 1980s and 1990s. One can trace the dramatic development of leasing at the period of the collapse of the co-operative movement but one can hardly speak here about any strict succession of forms. Though to a certain extent the lease relations system did pressure the co-operatives from the point of view of spontaneous privatisation, yet one has to regard the attempt to introduce leasing from a broader perspective - first of all, it was a last 'safety valve' of reform of the state sector and the economic system as such without launching any new model whatsoever, a model of actual privatisation and formation of a private sector as an alternative to the state sector. This basic goal could not be attained for, taking into account the size of the state sector in the USSR, the absence of any competition, the surviving mechanisms of administrative control, and the mechanisms that controlled the business of enterprises whatever their property form, lease enterprises could become only a symbiosis of the state and collective forms of property,

combining the shortcomings of both forms.

A legal impulse for a broad development of lease relations was given on 7 April 1989 when two regulatory provisions were issued - a Decree of the Presidium of the Supreme Soviet of the USSR 'On Leasing and Lease Relations in the USSR' and a Decree of the Council of Ministers of the USSR 'On Economic and Organisational Fundamentals of Lease Relations in the USSR'. November 1989 saw the adoption of a more fundamental decree: 'Fundamentals of the Legislation of the Union of SSR and of the Union Republics on Leasing'. What actually occurred was a recognition of the right of private persons and enterprises with a non-state form of property to lease state property and enterprises. If, in accordance with certain approaches, one treats a lease contract as a 'privatisation of management and finances', then such partial privatisation was legalised on the basis of the documents adopted.

As for the industrial sectors, the privatisation of lease relations began later there. Without doubt, the ban on leasing of enterprises in many branches of industry, the existing general administrative and legal restrictions and the resistance of the upper echelons all retarded progress in this field. And yet the wish of the managers of state-owned enterprises to get rid of the control of the upper managerial structures, as well as their preference for lease mechanisms (instead of co-operatives), which was attributable to the more stable legal regulation, and the managers' interest in the 'spill-over' effect of state property taken from the state sector, gave rise to a 'lease boom' in 1990-1991 which led to the appearance of 20,000 lease enterprises. An important factor that served as a great incentive for switching over to this form was the

possibility to include a right of buy-out of the enterprise in lease contracts. In Russia its most wide-spread form - a lease with the work collective having the right to buy out the enterprise - ceased to operate in July 1991, when a 'heritage' of some 15,000 enterprises with their contracts concluded was left.

These 'transitional forms', with all their excesses and negative features, nevertheless made a positive contribution, making the whole process of the subsequent reforms irreversible and facilitating the accumulation of capital for new social-pro-market strata of the population, partial legalisation of the shadow economy and partial transformation of the state-owned enterprises and their management in the direction of at least non-administrative system of relations among economic agents.

2.2. Legal Acts of 1990-1991 and the Reform of Ownership Relations as Such

First of all, the USSR Law of 6 March 1990 'On Property in the USSR' and the amendments to the Constitution of the USSR of 14 March 1990 (art. 10-13) actually recognised the right to private property, allowing the ownership by citizens and non-state legal entities of means of production, securities and other material and non-material objects and rights that earn income. At least at the level of formal declaration, all three legal forms of property, i.e. property of citizens, collective property (including the joint stock type) and state property, were all declared equal from the point of view of legal rights and protection. In addition to other things, the Union law on property was actually the first act that allowed incorporation

and privatisation: thus art. 10 provides for such methods of 'formation and increase of collective property' as leasing of state enterprises by the workers with a subsequent buy-out and transformation of state-owned enterprises into joint stock companies (incorporation). Yet because of the absence of any specific procedures such methods were in the nature of pilot schemes and were unique.

A whole battery of subsequent legislative acts served to secure and detail new norms, but because of the authorities' fear of launching a radical reform in the state sector, most of them remained only on paper.

According to the 'Fundamentals of Civil Legislation of the Union of SSR and Republics', adopted on 31 May 1990, the category of subjects of property rights includes citizens, legal entities and the state, which is in fact a confirmation of the legally acquired property rights. A separate chapter in the Fundamentals is on securities, by which is meant a 'document certifying a proprietary right that can be realised only if the original document is produced'. Falling into the category of securities are bonds, cheques, notes, shares, bills of lading, savings certificates and the like issued in accordance with the legislation on the quality of securities. though practically all the above-mentioned types of securities could already be seen in 1990-1991, at least occasionally, up to the start of genuine privatisation programmes in Russia and the former republics of the USSR state bonds and certain kinds of notes that are associated with trade and credit turnover practically dominated the scene. And yet the very appearance of this section should be regarded positively, especially so if one takes into account the fact that the last mention of shares was

withdrawn from USSR legislation in 1962, while joint stock companies of the 1989-1990 type were established primarily through special acts of the government.

The first act on companies that was based on the norms of the new law on property and on the provisions of the civil legislation was the USSR law of 4 June 1990 'On Enterprises in the USSR', which provided for the operation of enterprises based on the property of individuals (individual, family-type), on the property of work collectives (collective-type, production co-operatives, such as a joint stock company belonging to the co-operative or other business partnership, enterprises of public and religious organisations), and public and joint (mixed) enterprises. A similar Russian law was adopted in December 1990 and - for political and many other reasons - this law, though obsolete, is still in force.

The Decree of the Council of Ministers of the USSR No. 601 of 25 December 1990 on joint stock companies reproduced in detail (primarily in the spirit of the German legislation) the operating norms of joint stock companies and partnerships with limited liability. This gave a start to the vigorous formation of new legal forms - at the end of 1991 there were already over 150,000 newly established joint stock companies and other business partnerships on the territory of Russia (Table 2). As has already been pointed out above, the mass appearance of such forms led to the decline of the co-operative movement. And yet although there was a procedure - with its quite obvious contradictions and confusions - in the form of the Union act on the incorporation of public enterprises, this document has not prompted reforms of property relations at state-owned enterprises. Moreover, and this is the same story as with co-

operatives, many newly established joint stock companies and partnerships were instituted directly by state-owned enterprises, thus providing a convenient infrastructure for semi-legal operations by managements that took advantage of the 'right of full business responsibility'.

8 August 1990 saw the adoption of the Union legislation on the fundamentals of the operations of small businesses, which stipulated how the processes of creation and operation of small businesses should go on, without singling out a legal form and using as guidance only a criterion on the number of people employed.

In 1990-1991 the bulk of the small manufacturing businesses was created through a process of detachment and transformation of structural units (shops, departments) without changing the forms of property and retaining close linkage with the founder (for details see IEP, September, 1991). Among those enterprises that were registered a predominant role was played by enterprises with little or no capital, engaged in intermediary activities, which, in conditions of economic shortages, poor wholesale raw materials markets and absence of real state support for independent small business owners, remained (as with co-operatives) an easy and profitable sphere of business. It is essential to point out here that small business status gave quite a lot of legal and semi-legal opportunities and above all for the management of the 'parental' enterprise: a convenient means for transformation of property (both state and joint stock), transfer of non-cash means into cash, a considerable rise in salary for those employed, and use of a status that conferred privileged taxation treatment.

In other words, this process of small business development (in both the USSR and Russia) in this period should be understood not in the Western meaning of this term, where we associate it with a private enterprise form of business, but rather as a process of formation of rather flexible structures such as subsidiaries of state enterprises and joint stock companies that are used to serve the interests of the management of state-owned enterprises.

It was already at the 'declining' stage of the law-making process in the USSR that a USSR law was adopted 'On General Initial Principles of Enterprise for Citizens in the USSR'. The law was passed on 2 April 1991. This law, recognising the right of private and collective entrepreneurship as an activity that serves to earn profit or personal income, actually for the first time openly allowed the use of hired labour. And it is due to this factor that this law may be treated as the final act in the ideological evolution of the Union legislation of that period toward a market-oriented framework of law.

Thus in a most general sense and declaratory form it was only in spring 1991 that the formation of the institution of private property started in the USSR (naturally not the real final formation). This process vividly reflected the complex and contradictory evolution of approaches to the corresponding changes, the decisive point for which was the ever deepening crisis of the system. If in 1978-1989 granting economic independence to state-owned enterprises (including the dubious invention described as full cost accounting and management) and the emergence of co-operative and lease enterprises were treated as extreme radicalism, in 1990-1991 one can already speak about private ownership rights as such. At the turn of 1990-1991 it

gradually became clear that some type of privatisation model was inevitable in the USSR and Russia and that without that model - with the state sector still prevailing all around - it made no sense to speak about a private property right, or about the stock and the securities market or other features of economic and legal reform.

2.3. Privatisation in the Programmes of Economic Reforms

It is only since the autumn of 1989 that one can speak about attempts at a 'comprehensive' reform of the economy, implementing special economic programmes, each of which, to one degree or another, provided for the development of various forms of property /8/. The first programme of this kind - a three-stage project of 'moderate-radical transformation' suggested by L. Abalkin (November 1989) theoretically provided for the 'rights of owners' as a major condition of the operation of the market; however, practically the question of the private economic sector and large-scale privatisation was not raised.

The next two programmes are associated with the name of the ex-Chairman of the Council of Ministers of the USSR, N. Ryzhkov. In December 1989 the Congress of People's Deputies of the USSR approved a moderate version of reforms in accordance with which all large enterprises remain in the system of direct state control and only 20% were to become lease enterprises by 1995. However, the aggravation of the economic situation in the country required a rapid revision of this programme and so in May 1990 a second Ryzhkov programme was elaborated, which in essence was a redrafted Abalkin plan with the idea of speeding up reforms. This version directly tackled the question of

restoration of property to private ownership within the next 15 years.

The programme was rejected by the Supreme Soviet of the USSR but the main issue was not that; the point was that the rapid deepening of the crisis in the economy made the stabilisation projects obsolete already at the stage of discussion. And what we saw after September 1990 was a 'race' between alternative programmes of reform of the economic system of the USSR and the republics. As people became more and more aware of the depth of the economic problems more and more attention was paid to the issues of privatisation as an inevitable condition for creating a competitive market environment and an efficient economy. As Shatalin put it, 'the risk of change-over to the market is less than the punishment you get in case of shifting from one foot to the other' [Shatalin, 1991].

Among the three alternative programmes that were submitted for consideration by the Supreme Soviet in September 1990 - a governmental programme, Shatalin's programme ('500 days') and a 'synthesis' produced by Aganbegyan - the second should be regarded as the most radical.. As conceived by the authors of the '500 days' programme, the process of real privatisation (i.e. using incorporation, tenders, auctions and other forms) would have taken some 15-20 years. By the end of this period the situation in industry as far as the relative shares of different forms of property were concerned would have been: 25% state-owned enterprises (including 3-4% lease enterprises), 45% corporations, 15% partnerships and co-operatives, 10% collective enterprises and 5% private enterprises [transition..., P.73]. An indisputable advantage of the privatisation measures of this programme was the fact that it was well furnished with a package

of the necessary normative acts and that it offered a rather elaborate pattern of long-term and short-term measures in this area.

As far as privatisation was concerned, the September programme of Ryzhkov and Abalkin was much more modest: most probably, this programme was considered not so much as a means of change-over to a multi-type property system, but rather as a way of removal of 'excessive funds' from the population. In practice it meant that the government continued to adhere to basically lease-type enterprises, while the sphere of privatisation as such was to be limited to small and medium-size enterprises in a series of non-strategic branches of industry.

In his programme of stabilisation of the economy and transition to the market Aganbegyan attempted to synthesize both projects; however on 19 October 1990 the Supreme Soviet of the USSR adopted the USSR President's version, 'Main Trends of Stabilisation of the National Economy and transition Towards a Market Economy'. This attempted to combine the advantages of all three alternative projects. Rather general ideas of the 'main trends' relating to privatisation were strengthened by the decisions of the 4th Congress of the People's Deputies of the USSR, one of the provisions of which ran as follows: 'conditions should be provided for incorporation of state enterprises into market structures, transfer of property to a lease system, establishment of joint stock companies, support of small businesses, distribution of some state assets among the working people, giving priority to the workers of work collectives and to veterans of labour' [IV Congress, 1990]. In line with the decisions of the Congress, work in the field of a Union law on privatisation was intensified.

However, it was only in April 1991 that the Council of Ministers of the USSR presented a Draft Programme of Action designed to get the economy out of the crisis. This document, which detailed the October 'Main trends' of the President and which, therefore, was not an independent draft, could well be treated as a positive contribution at the level of declarations but it was eclectic from the point of view of taking some specific steps. This is quite evident as far as the privatisation sphere is concerned, for the programme (a) lacked distinct treatment of the concepts of 'privatisation' and 'restoration of property to private ownership', (b) was not clear where the line of demarcation indicating the sphere of power of the Centre and the republics would be, (c) was not clear what the rate of privatisation would be or how realistic the whole thing was, (d) did not indicate the scale of the privatisation effort with reference to medium-size and large enterprises (which is not surprising if one takes into account the scale of operations of the then Military Industrial Complex (MIC)). What the architects of the Programme insisted on was the basically 'for payment' nature of privatisation, rejecting the ideas of a free 'hand-out' of state property among work collectives or the entire population of the nation. At the same time, and specifically ignoring the experience of Yugoslavia, they acted as consistent adherents of the so-called 'collective (people's) enterprises', priority for which was set out in the programme.

It is approximately at that time that we could see an intensive effort in developing anti-crisis programmes. For instance, on 17 April 1991 the Presidium of the Council of Ministers of the RSFSR approved a USSR Government Programme on stabilising the economy and transition to market relations which also affected

the issue of privatisation. In particular, the plans of the government of Russia in 1991 included ensuring incorporation of some 100 large enterprises, keeping in mind their forthcoming privatisation (this limitation on the number of enterprises could be explained by the large share of the Union MIC in Russia's industry - up to 60%), the privatisation of up to 46,000 small business enterprises in commerce, the services sphere and housing and utilities. Yet it should be emphasized that the `Silaev's programme', as well as that of the Union, was basically eclectic regarding the forms of privatisation (`going from various versions of free distribution of state property ... up to its forceful sell-out') and it was somewhat declaratory in nature.

An outcome of the vigorous work of the Union and republican governments in working out anti-crisis measures was the signing (in July 1991) of a Programme of joint action by the Cabinet of Ministers of the USSR and the governments of the sovereign republics designed to extract the economy of the country from crisis in conditions of transition to the market. As far as privatisation was concerned, the programme provided for the following:

- from the third quarter of 1991 - implementation of special Union and republican programmes,
- priority privatisation of enterprises which service the population and which turn out goods of mass consumption or produce foodstuffs, then small industrial businesses, and construction and transport businesses,
- a consistent reduction of the share rate,

- priority to the establishment of joint stock companies, partnerships, collective (people's) and lease enterprises with a but-out right,
- preferential terms for members of work collectives.

The Programme laid strong emphasis on priority for the development of collective property but the accent changed compared with April: now the talk was not so much about an abstract 'people's enterprise' but deposits, shares and interests of citizens, which represented a step forward within this concept. To speed up privatisation, the programme also provided for the sale of property by an instalment system, some tax privileges and credit assistance.

In summer 1991, as in September 199, the governmental programme faced an alternative: this was a project with the title 'Accord for a Chance', worked out by Yavlinsky and his group and Allison. In the field of privatisation this programme envisaged two stages (1991-1993, 1994-1997), provided for an immediate speed-up of the rate of small privatisation with a gradual addition (as incorporation proceeded) of large enterprises the first stage was followed by the second. In essence, at least as far as privatisation is concerned, this meant a speed-up in the implementation of the '500 days' programme, geared to co-operation with the West.

Actually, none of the programmes were translated into reality - be it full or partial. The problem was not only the popularity orientation of most of these programmes but the objective conditions of a growing crisis, a crisis that was running ahead

of any recommendations or stages of development, and the fact of collapse of the USSR. As it turned out it was more realistic to implement some anti-crisis and privatisation measures within the framework of Russia on the basis of the operational adjustment of the economic situation.

What happened in August 1991 only contributed to the vigorous strengthening of the process of separation of the implementation of the economic reforms in individual republics. The experience gained in the course of implementation of the 1989-1991 programmes was not in vain; however, what really happened was a switch-over to the republican level as far as the process of reform was concerned. In conditions of a real shift of all conditions of the announced policy of radical economic reforms (remember the agreement between Gorbachev and Eltsin) and the declaration of the 'full recognition of the right of private property' (as stated at the extraordinary session of the Supreme Soviet of the USSR on 26 August 1991) it became quite possible to go ahead with a full-scale programme of privatisation. By that time Russia already had some fundamental legislation on privatisation but the problem was of a different kind, namely, how to operate the necessary mechanisms in practice in a situation where the process of spontaneous privatisation was so intensive.

Chapter 3. The 1990-1991 Debate on Privatisation

Since the middle of 1990, simultaneously with the development of the governmental programme and alternative programmes of the transition to a market economy, the privatisation debate became more practical: the object of debate was not the legality of this process itself but the more effective and socially acceptable methods of privatisation. In practice from the middle of 1990 the pivotal issue of privatisation was whose interests would the privatisation serve.

What the debate of 1990 showed was the existence of a range of approaches: the politicians and economists of the Soviet school were in favour of giving away the state property, thinking that that was the way to solve the issues of privatisation democratically, while those who looked to Western practice stood firmly for a rapid corporatisation approach (see Grigoriev & Yasin, 1991) /9/. Rather influential, though keeping somewhere in the background, was the most conservative wing of the Soviet school, advancing the ideals of the 'socialist choice'.

The elaboration of the legislation on privatisation at the all-Union and republican levels which had been going on since the beginning of 1991 now received a new impetus to boost the theoretical debates. The peak of these debates was the spring and early summer of 1991 - i.e. the period that directly preceded the adoption of privatisation laws by the Union and Russian parliaments. It is at that period, if we leave aside the views of those who categorically denied any necessity for the transformation of state property, that one can clearly distinguish three basic approaches toward privatisation /10/:

- the creation of collective (people's enterprises both with non-divisible and collective-divisible (individualised) property;
- the incorporation of enterprises and open sale of the shares of state enterprises on the securities market;
- distribution of state property among the entire population through the implementation of various versions of the voucher system in line with the East European concepts.

I intend to deal with the issues in greater detail since at the time of writing (autumn 1994) such divisions remain, though to a great extent this is at the level of irrational political pronouncements by one party of politicians or another.

3.1. Creation of Collective People's Enterprises

Adherents of this approach (and we can mention here V. Cherkovets, A. Boiko, V. Tarasov, E. Yasin, T. Popova and many others) suggested that state enterprises should be turned over to the ownership (or at least control) of work collectives free of charge or on the basis of a privileged buy-out. In their opinion, that was the simplest and most painless way of transition toward market relations, when work collectives of self-run enterprises will be acting as economic subjects. Among the advantages of such an approach, the things that were named first were the ideological acceptability and attractiveness for broad strata of the population, as well as a possibility to enhance the efficiency of production, since workers who are at the same time owners of property have an interest in improvement

of the results of their activities at their own enterprise /11/.

These, however, were the very features that were so violently attacked by the opponents of collective ownership (P. Bunich, S. Glaziev, A. Zaichenko and others). Transfer of the means of production into the ownership of work collectives when these enterprises are profitable, well-equipped businesses would indeed be attractive for their workforce. But for the workers of unprofitable enterprises or enterprises where the fixed assets are already heavily depreciated, not speaking about doctors, teachers, pensioners and some unemployed young people, this kind of approach is certainly discriminatory /12/.

Quite as doubtful is the thesis on its economic effectiveness, resting on the assumption that a worker who is at the same time an owner is interested in the results of his enterprise. Actually what such a worker-owner is most interested in is how to maximize his current earnings. Therefore, there is a real danger that collectively owned enterprises will try to direct the lion's share of their earnings to wages and salaries, thus undercutting the interests of long-term progress. In other words, they can hardly take effective decisions in the area of investment policy or take the necessary risks in business, or make intensive use of labour resources or eliminate the existing redundancy. Moreover, the process of decision making in large collectives in principle involves enormous difficulties. Very often, in spite of the formal equality, the decisions are made by a handful of people, or the work collective may easily fall under pressure from outside.

These dangers are not only fully exemplified by the experience of Yugoslav 'people's enterprises' but also supported by data on

the comparative effectiveness of private and collective autonomous (self-managing) firms in developed market economies. On average, collective firms in these economies register poor performance indicators and play an insignificant role in the development of the economy and should be treated rather as a means to fight unemployment, as a social stabilising factor rather than a means of enhancement of production efficiency (for details also see Sirc, 1994).

It should be noted that the adherents of this approach were quite heterogeneous. It is enough to say that the group included deputies of 'Communists of Russia' and one of the authors of the '500 days' programme, E. Yasin. In other words, the concept was shared by 'fundamentalists' adhering to their communist values or the society of 'people's rule' who tried to prevent any cardinal transformation in property relations, and modest reformers who advocated their painless and socially acceptable transition to the market.

A watershed between these two groups lies in the question of the nature of collective property. In principle, one can distinguish two versions of giving enterprises to work collectives: in non-divisible and collective-share types of property. The first version, backed by the 'fundamentalists' in both party and business structures, actually implies the institution of *kolkhozy* in industry, which would give bureaucrats quite real powers to retain their privileged status. Modest reformers suggested that collective enterprises should be set up with share-type personalised property as an inescapable and legal process, since it rests upon the initiative of work collectives and makes it possible to get enterprises out of the control of the state rapidly.

3.2. Incorporation and Sale of State-Owned Enterprises

Some economists who did not agree with the arguments of the adherents of collective forms of ownership for enterprises suggested that a generally accepted world path be taken and the state property right sold off into private hands. Small enterprises would be sold on the basis of tenders and auctions and the large and medium-size enterprises would be incorporated as joint stock companies and then, as the secondary market in securities shares became more mature, offered for sale to institutional and private investors.

One of the major advantages of the sale of state property was, its adherents believed, the possibility of tying up 'hot money', stabilising the financial position of the nation, as well as channelling the financial resources obtained to set up a system of social protection for needy people. The necessity of sale was also supported by the claim that only property that was bought and not given free would be put to effective use.

The idea of selling the state property was shared by both the radical market-oriented elements (for example, this method was supported by the Democratic Party of Russia) and the pragmatic elements and sometimes even by rather conservative elements close to governmental circles. While the former stressed the fact that the sale of state property into private hands was the most direct way to get to a full-fledged market, the latter elements put more emphasis upon getting some additional money for the budget that later on could be utilized not so much for social programmes and maintaining healthier finances as for

propping up unprofitable enterprises and the military industrial complex.

There were also quite substantial differences regarding the incorporation of enterprises. Such economists as V. Selyunin, B. Alekhin and S. Glaziev were in favour of obligatory sale of all or a considerable portion of shares to private persons and to institutional investors that were independent of the state. Yavlinsky and Grigoriev, on the other hand, wanted a full-fledged, though somewhat gradual, incorporation of enterprises. These ideas can be seen in the '500 days' Programme /13/. And as to the recommendations and advice of the government experts, and here we can mention first of all T. Popova, G. Melikyan and S. Assekritov, they were for incorporation that was to a large extent formal, for what they suggested was to establish largely closed joint stock companies, selling only a small portion of shares (about 10%) to the work collectives of the enterprises /14/. The last method actually meant a kind of mimicry of the dominating bureaucratic structures.

3.3. Free Distribution of Property Among the Entire Population

The adherents of free distribution of state property among the entire population (L. Piyasheva, P. Bunich, G. Popov, O. Bogomolov, V. Rutgaizer, P. Filipov, M. Malei) believed that both the above-mentioned methods of privatisation were unsatisfactory, first of all because they did not meet the criteria of social justice /15/. Once the Soviet Union proclaimed people's property, its division must be among the entire population. In this case reference is often made to the

authority of Milton Freedman who even at the beginning of the 1980s suggested that privatisation of state corporations should be through handing shares out to the entire population of the country. A major influence on the Soviet economist here was the vigorous debate and then the adoption in legislation of the principle of free apportionment of state property in Czechoslovakia, Poland and Romania.

In practice it was suggested that a free property distribution be made by providing each member of society with special means of payment that could later be used to buy shares of the privatised enterprises and other state property. The functions of the special means of payment would be carried out by investment of privatisation vouchers (L. Piyasheva, P. Filipov), bonds (V. Rutgaizer), certificates (O. Bogomolov) etc.

Some other economists advanced the idea that it was advisable to open special investment accounts (privatisation accounts). However, actually the difference here is one of name. The mechanism to be applied for property apportionment is the same in principle. The amount of means to be issued to one person was calculated on the basis of a simple division of the cost of the state property subject to apportionment (distribution) into the total number of the population (or only adults).

To prevent inflation and rapid disintegration of society, most of the economists advocating free distribution were in favour of complete prohibition of the sale of investment vouchers (make them registered vouchers for this purpose) and a period of limitations on disposal of the shares of the privatised enterprises. To reduce the level of risk and promote equal start-up opportunities, some economists suggested that citizens

should be issued not with shares of individual enterprises in exchange for their vouchers but rather shares of specially established holding companies that would hold shares of a number of joint stock companies.

None of the theoretical approaches advanced provoked such bitter controversy as that of a free distribution of property. The most radical rejection of the idea came from E. Yasin, L. Grigoriev, S. Alekseev, T. Popova and some others, asserting that the principle of property distribution was to carry out privatisation for the sake of privatisation, or to effect a reverse collectivisation /16/. As the critics put it, having focused their attention on populist principles of social justice and technical details, the advocates of free distribution of property paid little (if any) attention to the primary goal of privatisation - enhancement of production efficiency. There was acute criticism of the arguments about providing equal start-up opportunities and solving the problem of the population's shortage of financial means, and the counterarguments maintained that the colossal technical difficulties were underestimated and that the distribution of property among regions would be unequal.

Now, when the first stage of privatisation in Russia is practically over (including voucher privatisation), the whole debate seems naive. The important issue lies elsewhere - in one or another way, practically all these approaches were represented in official documents on privatisation in 1991-1992, thus embodying all these principles, in some way or other, in practice. Chapters 5 and 7 of this book deal with these issues.

It should also be noted that most 'stable' and viable ideas seem

to be those of the advocates of the interests of work collectives. For instance, in February-April 1992 the press carried some reports of Russian economist and publicists pressing for free apportionment of the bulk of the property to the work collectives as economic entities, primarily in the form of closed joint stock companies /17/. The paradox is that the advocates of giving the property to work collectives include theorists of the communist type and quite a number of assorted national ultra-liberals, while among those who rejected the idea were Russian democrats and the former and present bureaucracy.

As to the practical 'implementation' of this idea, the demands of leaders of the councils of work collectives of various industries and regions were much more pragmatic: a ban on privatisation through auctions, a right of complete business management and contractual employment of the administration by the councils, exclusion of any benefits for the administration in the course of privatisation and so on. A characteristic example, though, was the port of St. Petersburg, where immediately after the receipt of the right to transfer the controlling block of shares in the port to its work collective (with the consent of the President of the Russian Federation) the trade union leaders of the dock workers notified the Government of Russia of their refusal to agree. The argument was very simple: the work collective, as the key investor, was insolvent, while the port needed tremendous investment to modernise its facilities.

Starting from 1992 (when the official privatisation campaign began) theoretical arguments in favour of this approach were confined to professional politicians and became an instrument of their ambitions, though one quite detached from the real

privatisation and policy law. Many schemes in 1992-1993, which in one way or another affected the interests of the work collectives, were not put forward by the collectives themselves and pursued purely political goals. One example is the 'fourth version of incorporation' /18/, as well as a battery of draft laws proposed by the communist factions of the former Supreme Soviet on the dominant role of work collectives in the process of privatisation.

As to debates on incorporation, they automatically melted away as a process of forceful corporatisation of medium-size and large enterprises started at the beginning of 1992. So we can say that the issues discussed in 1992-1994 primarily touched upon the technical and legal rights that come from the specific practice of incorporation.

As to the fate of the approach associated with free distribution (apportionment) of property, it is more interesting. Initially the law (July 1991) was approved and backed by the communist factions, and by the higher echelon (part of the *nomenklatura*) and by some radical democrats. However, in 1992-1994, when the voucher model of privatisation was already in progress, most of the advocates of this idea (when dealing with it at the conceptual stage) crossed the line and went to the critics' camp when it came to practical implementation. The seeming absurdity was that this model of privatisation was translated into reality by its initial opponents, while many authors and advocates grew into uncompromising opponents (see Chapter 7, where we describe this in more detail). It is also interesting that the 'struggle with the voucher' in 1992-1994 also turned into a kind of political campaign, a campaign that was far away from good sense and practice and primarily geared to the attainment of some

political goals. The last outburst of this struggle was a campaign launched to criticise the results of voucher privatisation in the State Duma in May-June 1994 by the communist factions and the Liberal-Democratic Party.

It is unlikely now that there will be any further protracted debates of sharp conflicts connected directly with the course of privatisation which go beyond political manoeuvring. Today it would be difficult (not to say suicide) even for the most 'irreconcilable' to scrutinise everything that has already been done in this field. In Chapter 9 I shall try to show that in future the debate will be on topics that are close to privatisation, rather than privatisation itself.

Chapter 4. Spontaneous Privatisation in 1987-1992: Forms and Stages

It is well known that the USSR law 'On the State Enterprise (Association)' became a corner stone in the reforms of 1987-1989 /19/. What most concerns us here is the role played by that law in the process of spontaneous privatisation and, consequently, in emergence of alternative forms of property. Thus, in Kochevrin's view the transfer of enterprises (from 1 January 1988) to the economic mode of operation, as provided for in the law on the state enterprise, opened a breach in the distinction between cash in hand and money on account and became 'partially a privatisation on the scale of the entire economy...' [Kochevrin, 1991]. In other words, the possibility of pumping state resources - both financial and material - into the non-state sector became one of the most powerful incentives for the development of the corresponding forms of ownership in the period under review.

So the co-operative and lease legislation of the USSR, as well as other business regulations of the USSR and Russia of this period, relating both to one or other type of procedure for the transfer of property rights, became a powerful incentive for the development of the spontaneous process. All this resulted, especially in conditions of growing threat to the state authorities' control over enterprises, in the emergence of some kind of symbiosis of quasi-private and quasi-state structures engaged not in competition with each other but rather in pulling apart the property of the state.

The attempts of the centre to retain control over property on the territory of some former Union republics only led to the

birth of specific forms of transformation of property relations. To a large extent, under the circumstances, the directors of state-owned enterprises tried to retain control over the property for their future interests and to extract the maximum profit out of the spontaneous appropriation of some state-owned assets /20/.

It should be borne in mind that any attempt at categorising the forms of spontaneous privatisation will be rather conventional. And yet the following fundamental forms may be chosen as characteristic of 1990-1991:

- *nomenklatura*-bureaucratic privatisation;
- *nomenklatura*-territorial privatisation;
- tenders and auctions conducted by local authorities;
- people's (collective) enterprises;
- managerial privatisation.

Nomenklatura-bureaucratic privatisation boils down to an officially sanctioned (by the government) change in the legal forms of ownership with certain managerial innovations being added (turning ministries and departments into concerns, associations and so on), or it meant creation (on the basis of state-owned enterprises of some branch of industry) of joint stock companies with the controlling interest going to the state. In essence what happens is that either one has an elementary decentralisation of the rights relating to management or a reallocation of property rights within the state-owned sector itself (see also Gaidar, 1990).

The basic forms found in this type of privatisation are as follows:

- a) 'incorporation' of the branch of industry with the controlling block of shares of enterprises being in the hands of the ministry;
- b) 'concernisation' of the branch of industry: what happens in this case is that the ministry is transformed into a concern with the delegation of rights to it in the area of the management of the state property;
- c) creation of a sectoral association (which is similar to a concern);
- d) delegation of rights to manage state property, including the rights of managing state-controlled blocks of shares;
- e) incorporation of large enterprises, retaining the controlling block of shares in the hands of the ministry and some other such measures.

As far as the territory of the USSR is concerned, the spontaneous privatisation process became especially intensive in January-June 1991, immediately before the adoption of the official privatisation legislation, when practically all the ministries and departments at all levels in one way or another tried to secure the maximum number of 'their own' enterprises under their jurisdiction and management. That period alone saw the creation of 126 concerns, 54 associations and about 1500 amalgamations and associations, many of which were given a right to manage the property and to acquire the functions of a holder of the state shares of those enterprises that could be formed into a legal corporation.

At the end of 1990 and the beginning of 1991 one could see vigorous activities on the part of union authorities, ministries and departments in the field of formation of various quasi-stock companies, associations and so on. That kind of activity related to the territory of a number of the former union republics (especially Latvia, Lithuania and Estonia) so that the centre could retain some control over the union property it had there (*nomenklatura*-territorial privatisation). What it actually amounted to was formation (in one republic or other) of some kind of ministry or state holding company to manage the all-union property on its territory (the Lithuanian Association of Free Entrepreneurs, the State Intersectoral Joint Stock Association in Latvia, the State Intersectoral Association 'Integral' in Estonia, set up in 1990 with the permission of the Council of Ministers of the USSR). It goes without saying that that kind of activity met strong resistance from the local authorities and thus led to more serious confrontation.

As to Russia, a typical example of the establishment of the so-called 'rubber Wall Street' (as Kornai put it) may be the transformation of the RSFSR Minlegprom (on 18 March, 1992) into Roslegprom, combining some 378 enterprises and organisations on the basis of an association that controlled the stock of its constituent 'people's' companies. Falling into the same category is the establishment of the Avtokron Holding Company, combining some two dozen state-owned enterprises and organisations dealing with the manufacture of buses and trolley-buses. That action was backed by the Council of Ministers of the RSFSR in the second half of 1991. The Moscow's Mayor's office was quite active in 'pushing' projects to create holding companies and associations, for example in the field of

construction and the construction materials industry, on the basis of the corresponding trusts and administrative offices.

All together, in the second half of 1991 alone the number of associations and unions in Russia increased twofold (see Table 2), and of the total number of concerns, consortia and associations, 400 (or 10%) were instituted on the basis of the former sectoral management bodies [*The Economic State...*, 1992, P.169].

It should be stressed that the process of *nomenklatura*-bureaucratic privatisation is controversial and can be appraised in more than one way. On the one hand, it is a clear trend toward strengthening *nomenklatura* monopolies under the guise of market terminology. On the other hand, it is a *de facto* and *de jure* step forward toward more real privatisation and toward the formation of a 'stock management' environment for it, and in many cases, it may be treated as a rather willing association of enterprises to protect themselves against unstable external business conditions.

The attempts by Russia's government (in autumn 1990) to suspend deals that implied a change of ownership (at least there was a verbal promise) and make an 'inventory' of all privatised property and property which should be subject to privatisation proved to be fruitless and actually stimulated a search for new by-passes and semi-legal ways of privatisation.

The form 'people's (collective) enterprise' was very often used by enterprises in light and local industries, in the area of retail trade, the public catering sector and the consumer servicing sector. Commonly, enterprises were first leased, with

a subsequent buy-out right, by work collectives. Because of the lack of firm legislative provisions the forms of ownership of these enterprises were quite loose. Once the provisions in the Fundamental Regulations of the state programme of privatisation for 1992 were out of use, such forms of privatisation as lease with a buy-out right, and the fact that there are enterprises which are still 'on lease' and have not yet been bought out, all gave birth to many legal collisions, although their transformation into full-fledged joint stock companies operating on the principle of private share ownership seems to be inevitable.

During 1991 some 60 rather large industrial enterprises were turned into the collective form of ownership. Table 3 gives some general statistics on how this process has proceeded.

This form of privatisation is associated with direct violations of the legislation, when lease contracts with a buy-out right were signed after the date on which the ban on this was proclaimed. This kind of falsification went on even in 1992. The 'official' privatisation that started in January 1992, mostly (in the first half of 1992) followed the buy-out line via lease agreements that were initiated prior to the adoption of the Fundamental provisions that put an end to the conclusion of new contracts with a buy-out provision. Out of more than 2,500 applications put into effect by the beginning of April, some 900 related directly to this type of privatisation [*Privatisation...*, 1992]. Moreover, experts believe that up to 50% of these contracts were falsified, i.e. were drawn up after the official ban with antedating of the contracts.

Starting from 1991, such forms as tenders and auctions conducted

by the local and city authorities at their own risk were used rather actively, it was only in 1992 that the appropriate federal legislation came out. Various small commercial and consumer services businesses, housing and real estate were offered for sale. Both legal entities and natural persons could act as buyers.

One more trend in spontaneous privatisation is conventionally called managerial privatisation. By this we mean a package of measures (sometimes almost on the border of legality) designed to transfer ownership from state-owned enterprises to private hands without accompanying special permission from the central or local authorities. In this case the initiative rests with top executives of the state enterprises themselves, or it may come from the representatives of market commercial structures interested in buying some piece of state property (share of property), as a rule 'sharing' it with the managers. At this level all the deals are made, as a rule, on the basis of personal arrangements. When this kind of privatisation is carried out, the following methods may be employed: accumulation of the assets to buy out the enterprise through a co-operative (or a chain of co-operatives), use of state equipment and materials for the manufacture of goods or supply of services within a private enterprise, contribution of a state share to a mixed enterprise, creation of various types of private holding companies, repurchase of unprofitable enterprises and false bankruptcy, registration of a state enterprise with subsequent withdrawal of the state founder, purchase of state property at reduced prices for private use (e.g. bungalows, dachas, etc).

It is also possible to identify certain stages of development of

spontaneous privatisation in Russia. The characteristic of the first stage (prior to July 1991, when a law on privatisation was adopted) was use of virtually any forms, including some 'wild' or legally dubious steps; now it seems unrealistic to attempt to remedy the situation.

The second stage is the period from July to December 1991 when the law on privatisation was practically in effect but the official process of privatisation had not yet started because there was no state programme and no statutory documents (though formally each enterprise could be privatised following the patterns spelled out in the law).

Within the second stage this process not only did not become more orderly, in spite of the presence of the more formal legislative base, but, on the contrary, became even less controlled and in a series of cases turned out to be corrupt. Because the official privatisation line was suspended, the real process went on like this:

- privatisation was carried out with a permit from the local authorities, but to do this it was necessary to prove that the enterprise concerned belonged to the jurisdiction of the municipal authorities;
- use of the 'untested' multiple channels of acquisition of a state enterprise by natural persons; as a result what the legal entity has is only a legal shroud, and the term privatisation does not show up in the corresponding documents;
- redemption of the lease for enterprises in those cases

where this possibility was included in the lease contracts.

From the end of 1991 and beginning of 1992 one can speak about a third stage of spontaneous privatisation in Russia, when in principle the fundamental privatisation documents had already been prepared and large numbers of privatisation applications had already begun to build up in the corresponding committees. In this situation, when direct methods of privatisation became more difficult, it was inevitable that enterprise managers would use sophisticated forms of spontaneous privatisation (the manipulation of the fight of 'full business operation', the creation of shell companies to purchase enterprises at an auction, etc), exploit the contradictions in the current legislation and find various methods of buy-out of lease enterprises. There was large-scale registration of various enterprises with a mixed form of property, with state enterprises and agencies and natural persons who contributed mainly their 'intellectual property' acting as founders. A more marked trend among state enterprises was to invest (in various forms of contribution) in stock companies and other businesses (and this in conditions of growing current insolvency). Under the circumstances, as statistics from Goskomstat RF show, it was state enterprises that became the key holders of shares and interests at that time, making, as founders, 82% of the contributions to joint stock companies and 55% in partnerships with limited liability, while 11% of the joint stock companies examined were not newly established [*The Economic State...*, 1992, p.169].

The real volume of spontaneous privatisation on the national scale cannot be measured quantitatively, especially keeping in

mind that the battery of specific methods used is changed regularly, including in response to each new legislative act (see also Chapters 7-8). What is essential to point out is the sharp intensification of this process in 1991 that served as one of the key arguments for the fastest possible launch of the official privatisation model on the basis of legislation.

Chapter 5. 'Programming' the Privatisation Process

5.1. Creating Conditions for Privatisation in 1991

Irrespective of the marked ideological shifts in approach in favour of a radical reform in property relations at the turn of 1990-1991, practical steps in this direction seemed to be a matter for the remote future. At this time both the Union and Russia's authorities were only making their first experiments with conception of privatisation. naturally, elaboration and adoption of a fundamental law on privatisation seemed to be the first goal. In addition to the general incentives (a deepening of the economic crisis, available legal and ideological base, and to some extent an intensification of the spontaneous process), it was extremely important for Russia to work out a republic law before the Union parliament could pass all-Union norms on this issue. this last factor seems to have been decisive in spurring on the law-making effort in the first half of 1991.

On the basis of the package of documents prepared by the Yavlinsky - Mashits - Grigoriev group in November-December 1990, two working groups were actively elaborating privatisation programmes: the Group of the Supreme Soviet of the RSFSR (P. Filipov) and the Group of the Council of Ministers of the RSFSR (M. Malei). In contrast with the Yavlinsky package, the programmes of these groups provided for some free distribution of state property in the form of investment vouchers (deposits). While Filipov's package was geared to the combination of various forms of privatisation, (e.g. it provided for investment deposits, sale of shares of state-owned enterprises, tenders, auctions, partial buy-outs and so on), for a term of 5-6 years,

Malei's package was much more rigid and in it the priority was definitely given to a 'collective form of privatisation', through the so-called 'people's enterprises', and it was to be implemented at once.

The RSFSR law 'On Privatisation of State and Municipal Enterprises in the RSFSR', which was introduced for a second reading in the form presented by the Filipov group, was adopted on 3 July 1991. The most acute debates concerned the so-called forced privatisation of enterprises, the priority rights of work collectives to a buy-out and privileges for the employees in privatisation. So 3 July also saw the adoption of the RSFSR law 'On Registered Privatisation Accounts and Deposits in the RSFSR' and a decree of the Supreme Soviet on 'Adoption of the Regulations on the Russian Federal Property Fund'. /21/

Article 1 of the RSFSR law 'On Privatisation of State and Municipal Enterprises in the RSFSR' spells out that privatisation 'is the acquisition by citizens, joint stock companies (partnerships) of various forms of property (as provided by the law) from the state and local soviets of the people's deputies as private property. The share of the state, a local soviet, public organisation or charitable fund was limited to 25% in the authorised capital of the buying legal entity. The law provided for a sale of shares of the enterprise being privatised, by auction or tender, and certain benefits for the workers, and in general a very wide range of methods of privatisation - as well as broad possibilities for their interpretation.

The administrative and bureaucratic aspect of privatisation were entrusted to the State Committee of the RSFSR for the Management

of State Property (GKI), a part of the government, while the actual selling or 'holding' of property was a function of the Russian Federal property Fund, which operated under the aegis of the Supreme Soviet /22/. Thus the element of dualism inserted into the diagram of control over the privatisation process became one of the key elements that was a brake on the path of privatisation and reinforced the confrontation at all levels of authority between the legislative and executive organs in 1991-1993.

In general, the law 'On Privatisation of State and Municipal Enterprises in the RSFSR' was not in contradiction with the Union law 'On the Foundations of Restoration of Property to Private Ownership in the USSR' of 1 July 1991, at least because the latter had no direct legal force and had to be implemented through republican legislation. And yet there were also some differences between them. For instance, while Russia provided for a mechanism of free handout of some state property (opening registered investment funds for private citizens), the USSR law was primarily geared to sales. In the Union law a work collective enjoyed a priority right to purchase an enterprise, while the Russian law gave no clear-cut norms of priority for enterprises' workers. And finally, as far as the USSR was concerned, a uniform privatisation body was provided - the Fund of the State Property of the USSR - while Russia actually adopted some dualism in monitoring the process of privatisation.

The political situation in Russia after August 1991 was conducive to the radicalisation of the economic reforms in general and to the implementation of the privatisation programme in particular. At the same time, the instability and anarchy characteristic of the current economic process, the state of

permanent confrontation between the legislative and executive powers, the ambitions of the regions, and the lack of control and corruption of the officials at various levels of power were undermining the success not only of the implementation but even of the launching of the programme.

Now, because of the general political instability and lack of coherence in the division of powers between various levels and branches of power, the whole schedule of privatisation was in disarray (the elaboration of the privatisation programme had been planned for 1 September 1991) and the necessary regulations that would fill in the detail of the law on privatisation (planned for 1 August 1991) did not exist. So what happened was that, up to the end of 1991 (with the law on privatisation in force), there were no specific privatisation instruments or a privatisation conception as a whole, and as a result what one could observe were spontaneous processes of all kinds.

From November 1991, after the changes in the composition of the Russian Government, one can speak about a new stage in the ideology of privatisation first of all, and an abrupt intensification of efforts to ensure practical implementation of the privatisation mechanism. From the very outset, having stated that privatisation was one of the key elements of the economic reform, the Eltsin and Gaidar government stepped up its efforts in the area of development of the legislation on privatisation, but at the same time it had no real opportunity of operational monitoring of the process of privatisation. That is why one of the specific features of the economic reform of that government was liberalisation of prices before a period of wide-scale privatisation which went beyond the dominating theoretical orthodoxy in the field of transition to the market

and was in contradiction with the experience of some foreign countries. And there were quite sound reasons for this /23/:

- it was impossible to wait for the end of the 'large-scale privatisation' conducted in a classical way (i.e. over a number of years), because of the extreme shortage of goods prevailing in 1991;
- if prices were not liberalised, any state-owned enterprise actually became a state entity, so as to ensure administrative distribution of goods in short supply, which could ultimately grow (even without free prices) into a serious conflict;
- intensive spontaneous privatisation.

On 29 December 1991 the President of the Russian Federation signed a decree 'On Speeding Up the Privatisation of State and Municipal Enterprises', in accordance with which approval was given to the 'Fundamental Provisions of the Privatisation Programme of State and Municipal Enterprises in the RF for 1992', these provisions being elaborated on the basis of the 'Draft of the State Programme of Privatisation for 1991'. The implementation of these provisions was begun on 1 January 1992. So the Fundamental Provisions actually became the first document that provided practical regulation for the privatisation process and gave a push to programmed privatisation (as opposed to spontaneous privatisation) in Russia.

On 29 January 1992 a Decree of the President of the RF 'On Speeding Up the Privatisation of State and Municipal Enterprises' contained some 7 normative departmental regulations

that gave details on how to go about implementing the Law on Privatisation and the Fundamental Provisions and set certain rules for the privatisation procedure (a procedure on application for privatisation, on the valuation of the property of an enterprise, on turning state enterprises into open joint stock companies, on auctions, on tenders, on the use of economic incentive funds and profit in the privatisation process, as well as on the operation of commissions dealing with privatisation). However, the experience of the first months of practical implementation of the package showed that all these regulations faced many problems. Delay was caused by poor operation (and poor coordination) of the privatisation bodies at various levels, poor professional training of the personnel, local red tape, the dominance of political methods over democratic ones (in other words, bureaucrats tried to find out who was behind a privatisation effort in each particular case and regarded that as decisive in taking a decision), as well as the complex nature of the technical details provided by the package and certain defects in the documentation itself.

In the following sections of this chapter I shall deal with the fundamental provisions and procedures of the state programmes of privatisation which became core programmes for the Russian privatisation process in 1992-1994. The statistical results of these programmes, as well as the analysis of the model of mass privatisation, will be treated in subsequent chapters.

5.2. First State Programme of Privatisation (June 1992)

The contradictory nature of the privatisation process in Russia is evident in the debates and in the process of adoption of the

draft privatisation programme for 1992 in the Supreme Soviet, during which some of its provisions underwent gradual modification. While in November 1991-March 1992 the new top officials of the GKI managed to defend the principles of privatisation drawn up without compromise, in April-June 1992, under the pressure of multiple lobbies, they had to withdraw from some positions at least partially.

As one could expect, criticism both from the right and the left was as controversial, multifaceted and politicised as the process of economic reform itself and the process of privatisation in particular. The criticism led to both dilution of work collectives' management role and over-emphasis on their role in the process of privatisation. At the same time as the purely private nature of future property ownership was stressed, no mechanisms were established for creation of a private owner, no system of incentives to speed up the privatisation and encourage work collectives and managers to set up open stock companies. Other controversies concerned the forced or bureaucratic nature of privatisation based on the old institutional structures, the restraint of the role of the state, balancing the state budget and promoting a wide layer of owners at the same time, banning closed joint stock companies, putting off or speeding up the system of vouchers, the contradictions between the law and the programme, and the permissive attitude toward investors which did not take into account the corruption among the officials, and many other things.

A final version of the first State Programme of Privatisation of State-owned and municipal Enterprises in the Russian Federation for the year 1992 was not adopted by a decree of the Supreme

Soviet of the RF until 11 June 1992. This programme, adopted after a series of delays, was actually a compromise, on the one hand between 'paid' (for the active part of the population) and free (with vouchers given to the entire population and benefits given to work collectives) privatisation and, on the other hand, between a model of privatisation for all (GKI) and the division of property among the workers of enterprises (communists and workers' unions). All the previous documents were thus taken into account and the resultant compromise - which was inevitable to launch the model - finally turned into defeat of the pro-communist forces of the Parliament /24/. It should also be stressed that it was that very document which became a basic document for the subsequent large-scale privatisation in 1992-1994.

5.2.1. Primary goals and Methods Envisaged by the Programme

According to the programme the privatisation objectives were as follows: (a) emergence of a socially oriented market economy on the basis of formation of the category of private owners; (b) enhancing the efficiency of enterprises; (c) social infrastructure development using the revenue from privatisation; (d) contribution to financial stabilisation; (e) contribution to a competitive economy and demonopolisation; (f) attraction of foreign investors. However, in autumn and winter 1992 the implementation of Russia's model of mass privatisation became the primary goal of the privatisation policy, on which both the President and the Russian government counted (see Chapter 7).

For 1992-1993, according to the programme, the following

privatisation methods were envisaged:

- sale of ownership interests (shares) in the capital of corporatised state-owned enterprises, including private offering for the management and employees (see Appendix 1) and going public through voucher and money auctions;
- sale of enterprises at auctions;
- sale of enterprises through commercial tenders (including those with a limited number of bidders);
- sale of enterprises through non-commercial investment tenders (investment bidding);
- sale of property (assets) of enterprises being liquidated and already liquidated;
- buy-out of rented assets (redemption of the property of enterprises leased out fully or partially).

At the same time direct bargaining was rejected in favour of auctions and tenders (although it is in conflict with world practice, according to which direct sales in 1991 covered 50% of all privatisation transactions, amounting to \$50 billion). The top GKI officials thought that: (1) competition facilitated fair prices and simplified the valuation of enterprises, as the market value of enterprises was determined by the buyers. In the absence of competition, complex and contradictory methods of valuation had to be employed, which contributed to delays, arguments and corruption; (2) the highest bidders guaranteed the highest budget revenue to the seller.

All state-owned enterprises were divided into three categories depending on the method of privatisation used:

- small businesses (with an average workforce of up to 200 employees and book value of fixed capital less than 1 million rubles on 1 January 1992) would be sold at auctions and tenders;
- large enterprises (with an average workforce of more than 1000 employees or a book value of fixed capital of more than 50 million rubles on 1 January 1992) would be privatised by being transformed into open joint stock companies;
- the remaining enterprises could be privatised by any method laid down in the programme.

To understand correctly the adoption of the mass privatisation course it is essential to take into account not only the above classification of enterprises from the point of view of the permissible methods of privatisation but also the total number of enterprises that Russia had prior to the 'programmed' privatisation process. Because of the poor quality of statistics the spread of estimates is rather wide (table 4), but the total number of enterprises of all sizes before the process of privatisation was not less than 240,000 according to GKI data. That placed great demands on the procedures for privatisation (for greater detail see Chapter 7). It is quite clear that the scale of the operations to be performed influenced the choice of methods of property valuation in the process of privatisation.

5.2.2. *Valuation of Assets*

Hinds indicated that there were 'three serious problems that would hinder the sale of enterprises. first, since capital markets do not exist the value of the enterprises and therefore the price of their shares is not known. Secondly, the sale of enterprises will have to wait for completion of liberalisation... And a third problem is the perception that population has not enough purchasing power to buy the enterprises...' [Hinds, 1990].

In this context valuation of assets is a crucial problem, at least theoretically. On the one hand, valuation could be based on the depreciated book value conditioned by the primitive stage of the Russian capital market, modest demand of the population and widespread corruption. On the other hand, the real needs of the federal and local budgets stipulated that valuation principles be adopted that could provide relatively high revenue from the process. It should be also noted that one can find almost anything on the balance sheets of Russian enterprises (housing, kindergartens, municipal services, etc) and it is quite difficult to force anybody to take these privatisation assets, within or outside the privatisation process (for details see Aleksashenko & Grigoriev, 1991, p.551).

The compromise was that the initial price of an enterprise for sale by tender (or auction) or the amount of the authorised capital of a joint stock company may be determined on the basis of a full inventory of its assets. The property to be valued includes fixed assets and investments, reserves and inputs,

money and other financial assets. Fixed assets are to be valued on the basis of residual value computed by reducing their initial (balance-sheet) value by depreciation. In order to determine the size of the registered capital the following main items are to be subtracted: (1) the remaining money in economic incentive and profit funds, channelled to create the enterprise's privatisation fund; (2) short, medium and long-term credits and loans extended and not repaid on time and short and long-term borrowings; (3) value of property covered by special privatisation arrangements, as well as the cost of the social, cultural and other facilities to remain in state or municipal ownership.

5.2.3. *Differentiation Between Levels of Property*

As late as 27 December 1991 the Supreme Soviet of the Russian Federation adopted a decree 'On the Differentiation of State Property in the RF into federal property, the state property of the republics within the Russian Federation, territories, regions, autonomous regions, autonomous districts, the cities of Moscow and St. Petersburg, and municipal property'. In line with this document all the property on the territory of the RF was divided into several groups, by level of power, though the federal government retained some control over the transferred property. Keeping in mind that the lack of such differentiation in 1991 was one of the basic factors that retarded the process of privatisation at the official level, it is difficult to overestimate the significance of this document. At the same time, and we can say here that it is one of the paradoxes of privatisation, the emergence of that differentiation, though conducive to the order of this process from the formal point of

view, became a new source of conflicts at the same time (struggle between various levels of power for property) and a new brake on privatisation (for there was delay in compiling a list of enterprises by level of property).

In addition to this document the President of the Russian Federation approved (on 18 march 1992) an order on the composition of federal, state and municipal property on an item by item basis and on the procedure for registration of property rights. This document sets forth a rather complex procedure of compilation and approval of the list of items of property to be put under the control of various jurisdictions, which actually threatened new delays in the entire process and spelled an aggravation of the conflict situations surrounding the distribution of property. Equally it affected the procedure of legal registration of property rights. It is quite easy to imagine that in addition to everything else it opened the door for extra corruption and made it possible to square accounts, and the lack of final guarantees for securing the appropriate items of property on the list served only to prolong the uncertainty with reference to the authorised sellers of state property.

Nor could one expect any greater order from an organisational pattern of privatisation bodies resting on two parallel structures - committees and property funds. Organisationally it was a paradoxical situation: in one and the same city one could have a number of structures operation simultaneously (committees and property funds) in the name of city, region, national autonomous districts and so on. Naturally enterprises whose privatisation projects did not fit into the existing legislation took advantage of all this and sought the most 'loyal' of all

these organs. It was quite typical of the behaviour of the directors of many enterprises to use such means of promotion of their goals as confidential talks in the backrooms of governmental agencies (in case of local authorities) or parliament, using personal channels of communication or 'pushing' special instructions from the authorities on a specific enterprise when that enterprise did not fit the framework of the standard legislation.

In the struggle for the division of property (in the course of dividing the property by levels and in general in the process of privatisation) the central bureaucracy was not slow to set up new departments, concerns, associations and so on, and a wealth of them appeared on the stage as alternatives to the former Union and Russian departments. At this level the struggle was essentially for a dominant influence and for the right to dictate the terms of privatisation in a substantial sphere of the economy. In particular, that was the nature of contradictions between the GKI, the Ministry of Industry, the Ministry of Fuel and Energy and other departments of the Russian Federation. Lack of coherence in legislation and in the distribution of powers and terms of reference only magnified these contradictions.

As to the local authorities, the confrontation between the committees on the management of state property (operating under the executive bodies) and the property funds was classical. Because of the contradictions, lack of coherence and continuous changes in legislation and the various precedents set by Russia's supreme organs of power (which conferred power on some territories through special enactments or invested certain organs of power with an exclusive privatisation right beyond the

limits of the law), any of the opposing parties could prove equally well that it had its rights and powers.

For example, in Moscow, after the law of the RF 'On regional and Area Soviets of People's Deputies and regional and Area Administration' came into force on 3 April 1992 the city property fund which was actually left without rights, made some futile attempts to win back the seller's rights of the municipal property by citing the provisions on the transfer of rights to the Soviets in the law.

Another problem ranking as high in importance was the struggle between federal and local authorities for purely 'departmental' property, as well as for a part of the potential revenue gained in the course of privatisation. It is hardly necessary to comment on how such problems affect the prospects of participation in privatisation by any serious investor 'from outside'.

5.2.4. *Privatisation and Restructuring of Enterprises*

Usually the process of privatisation includes some operations that may be called 'restructuring'. These may involve legal restructuring (incorporation, commercialisation), financial restructuring (debt), operational (managerial) restructuring and physical restructuring (investment in production), and demonopolisation [OECD, 1993, p.18].

Genuine market demands define the restructuring needs of enterprises and usually the best policy is to sell them and let the new owners carry out the necessary operations. This

principle, adopted in many East European countries, is especially valid for Russia to effect operational or physical restructuring. However, this approach is also associated with some negative consequences. For example, because many privatised enterprises have an enormous burden of debts (and no intention to reduce their debts) investors may not be attracted. On the other hand, there will be no effective management and investment in the situation when employees become shareholders of the major block of shares (according to option 2, for example).

As for demonopolisation, Russian law stipulates that preparation of the enterprise for privatisation shall incorporate some reorganisation, including detachment of divisions of an enterprise to act as independent enterprises, including determination of their authorised capital. In practice this process (see Table 7) is now going on quite spontaneously, with a minimal role of the competition authorities and, in many cases, to the detriment of industrial technological complexes.

However, there is also a reverse trend; a characteristic of this is the formation of new holding structures or more amorphous financial-industrial groups. The legislation that exists in this area is not definite regarding the procedures for the creation of such structures and contains (often quite deliberately) many bans and limitations. And yet this process (in addition to the objective needs of enterprises in many cases) directly reflects the interests of certain layers of the *nomenklatura* and the team of directors, and there is no doubt the process will go on. Now the holding companies are being set up on the basis of special decrees of the organs of federal power, primarily in the 'strategic' branches associated with

high technologies, the fuel and energy complex and the defence sector. As to the financial-industrial groups, by September 1994 only 4 such structures were registered (also see Chapters 6 and 9).

In the course of reorganisation it is important to distinguish social infrastructure assets on the balance sheet of an enterprise and have guidelines for using such assets. Should such assets be included in the property for privatisation, the buyer must have the right to use them in any manner consistent with the requirements of legislation in force in the RF. The fact that the balance sheet of practically all medium-size and large enterprises contains a variety of items in the social sphere creates a multitude of problems, both from the point of view of valuation of the enterprise and from the point of view of conflict between the enterprise and the local authorities, and there is also a problem from the point of view of the social atmosphere in regions. One of the most acute problems is the substantial number of 'enterprise towns', quite large settlements whose social infrastructure depends entirely on the operations of a single enterprise. Should the latter give up the idea of support of such infrastructure, social conflict is inevitable there, for it is too much for the local authorities to shoulder the burden /25/. So far no one has found a key to solve the problem.

As to legal restructuring, the processes of incorporation carried out in Russia can hardly be included wholly in this category of restructuring. Because of many objective factors, the Russian ideology of mass privatisation favours speed of privatisation rather than the quality of individual projects and transforms this process into a unified and simple procedure (see

Chapter 7).

Many people reproach the advocates of Russian privatisation, saying that privatisation actually ignored the issues of restructuring and attraction of investment. Indeed, one could hardly combine this with the major goal of the first stage (see Chapter 7), but there was also a political reason for this: to launch any kind of privatisation programme in Russia, it is essential to build in a political compromise between various social groups (interests), but it was that very compromise at the first stage (such things as vouchers and colossal privileges for work collectives) that excluded the possibility of immediate restructuring and actual investment in production. It is to be hoped that this problem can be solved at the next stage of operations.

5.2.5. *Foreign Investors and Privatisation*

We shall survey here only the technical aspect of foreign investment, abstracting from such problems as political risks and general property rights guarantees.

Formally, foreign investors may participate in privatisation on an equal footing with Russian entities and citizens in auctions and tenders or investment bidding. The legal regime for foreign investors 'cannot be less favourable than the regime for the property, property rights and investment activity of juridical persons and citizens of the RF' (art. 6 of the Law on foreign Investment). Foreign banks may finance privatisation transactions on commercial terms without restrictions.

As for the objects of privatisation, the following restrictions are imposed:

- foreign investors shall be allowed to take part in the privatisation of enterprises and facilities in public catering and consumer services, as well as small-scale industry, construction and road transport, only at the decision of local authorities;
- decisions to allow foreign investors to participate in the privatisation of enterprises and facilities in the fuel and energy complex, enterprises producing and processing precious metal ores, precious and semi-precious stones, precious metals and radioactive and rare-earth products shall be made by the RF Government (governments of republics within Russia) at the time when the decision is made to allow privatisation.

As for land, a few regulations declared the right of Russian and foreign individuals and legal entities to acquire land following the privatisation of an enterprise and the right to acquire land in order to expand production. Nevertheless, failure to recognise the right of private ownership of land, the conflicts between the executive and legislative authorities throughout Russia and the fact that the basic standard price for land is set by administrators account for legal instability in this sphere. Experts believe that as domestic buyers are more interested in long-term development, this will not scare them away. To foreign investors, however, such unsettled arrangements are not acceptable.

Should privatisation of a specific property be initiated, a

foreign investor (just like a Russian one) shall be guided by the regulation regarding the procedure for processing and filing an application for the privatisation of public and municipal enterprises.

At the same time the purchase of stocks, shares, etc of a Russian enterprise by a foreign investor is treated by the legislation (Law on Foreign Investment, Art. 13) as a manner of setting up a venture with foreign investment subject to the general conditions. Yet quite a few laws refer to the 'peculiarities' of foreign investors' participation:

- Law on Foreign Investment (Art. 37): 'The terms of their (foreign investors') participation in the competitions and auctions for privatising public and municipal enterprises shall comply with the effective law on the territory of the RF';
- Provisional regulations on privatising public, municipal enterprises in Russia by auction competition): 'The peculiarities of participation of foreign legal entities and foreign nationals in auctions (competitions) shall comply with the law currently in force'.

On balance, in the absence of the aforesaid peculiarities, a foreign investor will be subject to the same simple procedures as a participant. However, apart from the barriers that apply to all investors, including corruption, a foreign investor will have to face the following problems: (1) making copies of the statutory documents in Russian; (2) lack of required information on projects intended for privatisation; (3) access to regional (local) publications and bulletins; (4) arrangement and

principles of deposit and final payment in rubles by a foreign investor (despite the special provision that 'mutual payments in transactions with foreign investors shall be made in the currency of the RF taken from special bank accounts', the foreign exchange aspect of foreigners' participation in privatisation is virtually omitted in the current law); (5) discrimination, compared with a Russian investor, regarding (a) direct contacts with the seller, (b) drafting of required papers, (c) opportunities to visit the privatised enterprise, which are restricted by the need to obtain a visa, (d) making preliminary studies (for details see Radygin, 1993a).

If an enterprise that is of interest to a foreign investor is on one of the restricted lists provided by the State Privatisation Programme the investor will have to deal also with a host of problems arising from inter-agency conflicts in Russia. The point is this: no single state body is capable of resolving the entire complex of issues associated with the use of foreign investment. As a result of this, despite the recognition of the national regime for all the subjects of the privatisation process and the common rules of regulation, a foreign investor, within the framework of the effective procedures, is sure to find himself at a disadvantage compared with the Russian participants.

Not touching upon the ideology as a whole, frequent changes in privatisation (and taxation) mechanisms are a strong deterrent to any serious investor. The adverse effect will be especially strong on the organisational and technical side, in view of the heavy expenditure foreign companies incur in terms of time and money at the early stages of drawing up a major investment project report.

Orientation to a relatively fast privatisation at a time of economic instability not only suggests but calls for a comprehensive system of privileges as payment by the state for investors' risk. For the time being, this is not in the plans; moreover, any mention of privileges for foreign investors has been deleted from the State Privatisation Programme.

For more than two years draft amendments to an obsolete RSFSR law 'On Foreign Investments' (of 4 July 1990) have been discussed. The draft decree (as tradition has it) has disappeared in the machinery of the government. It is a draft on how to provide incentives for foreign investment into the priority fields of the economy. On 24 November 1992 an important and significant decree of the government, No. 908, 'On Measures to be Taken to Provide Information for Russian and Foreign Investors on the Privatisation of State-Owned Enterprises', was adopted. It provided for creation of a special State Information Centre for Facilitating Investment. However, at present we have no evidence that the organisation is in operation.

It goes without saying that there should and will be certain restrictions on the operations of foreign companies from the point of view of national security and strategic interests of Russia. But the problem here is quite different: today, as in 1992-1993, there are no signs that the GKI is serious about attracting foreign investment.

By virtue of this very fact many potential investors would rather choose other options to privatisation, such as setting up joint ventures, buying shares in an additional issue, awaiting

the completion of the privatisation process and participating in the secondary securities market, and using the services of intermediaries (also see Chapters 6-8).

5.3. The Second State Programme of Privatisation

The first version of this programme was considered as early as 16 November 1992 at the collegium of the Government of the Russian Federation, for it was planned that that programme would be accepted as the basic one for privatisation in 1993. However, because of the confrontation between the government and the Supreme Soviet, the programme was adopted only on 24 December 1993 in the form of a special decree of the President of the Russian Federation. And up to that time it was the first programme, of June 1992, that was in force.

In the area of privatisation policy the formal medium-term targets in the new State Programme were actually the same: formation of a stratum of private owners, the completion of 'small-scale privatisation' and privatisation of large and medium-size enterprises in industry and construction, improvement of enterprises' efficiency on the basis of after-privatisation support, creation of a competitive environment and the development of the stock exchange, providing help for implementing the social protection measures, including the protection of rights of shareholders.

Actually the programme boosted further the ideology of the 1992 privatisation programme and incorporated the basic provisions of the regulations of 1992-1993. The main methods of privatisation and the privileges for employees in the case of closed

subscription were practically unchanged. The special feature of the second programme may be emphasis on the conduct of the programme of voucher auctions, which was considered a central goal of privatisation at that time. A positive feature is the increase in the quota for managers of the third version of benefits to 30%. At the same time none of the methods advanced offered a final solution to the problem of investment.

The extremely large section on the sectoral peculiarities of privatisation was quite hazardous, in our view. What it meant in practice was that a large part of the Russian economy was actually pulled out of the sphere of open sales for the benefit of an extremely limited (compared with the scale of the country) circle of individuals, in which there was no room for citizens of Russia as a whole, nor for investors in particular.

In our view, to include such details on particular branches of the economy in the programme was erroneous and actually has retarded the process of privatisation (and not only retarded the process but may result in a complex intertwining of organisational and legal forms, shares, portions of shares, blocks of shares, etc, creating a situation that would be difficult to remedy). Some special features of incorporation and privatisation should be provided only for a very narrow circle of truly strategic branches, i.e. for the fuel and energy complex, the military industrial complex and for some other such areas.

In May 1993 the President of the RF had stated that the number of bans on privatisation must be limited - as applied to the state programme, this primarily meant a revision of the lists of items limited by the programme. At the same time, if one takes

all the subdivisions, then one can see that that limitation list increased compared with the 1992 state programme. In our opinion, there was a sharp reinforcement of the 'pro-sectoral' orientation of the GKI, to the detriment of the regional approach. So, in spite of numerous statements, the GKI has not advanced at all in the area of simplification of the procedure of decision making as far as privatisation of enterprises is concerned. The lists of limitations continued.

The main advantage of the programme is the introduction of certain regulations on the privatisation of real estate (such items as non-residential premises and land of enterprises), as well as the rights of shareholders in investment funds. The refusal of the GKI to impose rigid and formal assignments on the regions (in the form of certain schedules) on privatisation can only be applauded. Instead it has recommended calculation procedures. It is also extremely important that the creation of the foundations for the general Russian stock market is stipulated in the programme.

As was a case with the first privatisation programme, a separate section of the second programme was devoted to the issue of foreign investment. And although the permission for foreign investors to buy vouchers and participate in appropriate tenders and auctions without any limitation (behind which lies a long struggle between the GKI and the Ministry of finance) should be regarded as positive, its significance can hardly be rated as very great if one takes into account the real terms of the second privatisation programme.

In a similar fashion, despite all the statements by top officials of the GKI on the removal of all restrictions for

foreign investors, all the previous restrictions remained in force: permission is required from the local authorities to participate in a small-scale privatisation (and one can mention here some decisions of the court cancelling such deals), and, in the case of some industries, permission from the government is necessary. And a new form of restriction was introduced: foreign investors are prohibited from participating in privatisation if it takes place within a closed territorial formation. The new programme backed up a foreign investor's right to act as a single buyer of an enterprise at an auction or at a tender (i.e. the right to effect a direct purchase) but so far there is no procedure by which this kind of sale can be carried out.

Because it came into force only in December 1993, the second programme did not play any role at all in the development of privatisation in Russia. To begin with it represented only a compilation of the documents already adopted and in effect by that time. Secondly, it gave no orientations and stipulated no procedures to boost privatisation after 1 July 1994 (the end of voucher privatisation). The definite necessity of a new privatisation ideology in the post-voucher period required urgent elaboration and adoption of new approaches and correspondingly the adoption of a new programme (see Chapter 9).

Chapter 6. Basic Features of Development of the Process of Privatisation in 1992-1994

6.1. Key Factors of Destabilisation

If we can characterise 1990-1991 as the years of spontaneous privatisation, 1992 will enter the history of Russia as the year of the start of large-scale reform in the area of property relations on the basis of privatisation legislation, and 1993-1993 are the years of intensive build-up of 'critical mass' of these transformations. At the same time it seems prudent to single out some major factors which affected the process of privatisation in the most negative fashion (see also Krasnoselsky & Radygin, 1992; Radygin, 1993 (b)).

First of all, there is the extremely high political instability in society. The ideology of privatisation and the privatisation process itself (first of all the value of the privatisation voucher, the rate of submission of applications and the dynamics of auctions and in some cases the prices of shares on secondary markets) fell victim in 1992-1993 and continue to fall victim to each political crisis, and the political ambitions of the parties, factions and individual professional politicians, including the politicians within the framework of the previous Supreme Soviet. All their usually unfounded declarations on 'the stabilisation of the privatisation programme', revision of the privatisation legislation, indexation or cancellation of vouchers, new privileges for work collectives, or all-Russia holding companies, accompanied by traditional demagoguery about 'universal justice' are aimed at one target: to halt or at least to discredit the policy of privatisation as such, for the new property relations and rights (with all their distortions)

create new rules of the game which do not suit everyone.

Only political motives (and to some extent regional and *nomenklatura* interests) can explain the scandal in Chelyabinsk which broke out on 18 March 1993, when the regional Soviet took a decision 'to temporarily suspend the conduct of voucher auctions in the region'. The same political motives can account for the exceptionally irrational explanation offered by the regional Soviet: 'the commercial structures from Russia and other republics of the CIS will buy all the good things for a trifle'. Most probably from the point of view of halting the privatisation campaign (as well as undermining the presidential power in Mordovia) Chelyabinsk (at that time) became a 'regional test range' when it became impossible to push through a proposal on banning voucher auctions all over Russia at the level of the Supreme Soviet of the RF.

Though later on the decision was overruled, the chain reaction was the main danger left intact: similar decisions were taken or were about to be taken in Novosibirsk, Voronezh, Bryansk and Barnaul. Analogous trends could be observed in Tula, Arkhangelsk and Lipetsk regions, in the Northern Caucasus, in Tartarstan and Bashkortostan, and all in all the trend affected one-third of the provinces of Russia. Local authorities had a mercantile motive for ignoring the voucher auctions. For instance, up to the end of March 1993 the authorities of Nizhny-Novgorod (whose small-scale privatisation model was so much praised by Goskomimushchestvo as a real model to follow) were conducting only cash auctions, contrary to the current legislation.

Nor should we forget here the increasing importance of the

nomenklatura and sectoral interest in destabilising the Russian privatisation process. It is this factor that we can consider the dominant one throughout 1993. This is not surprising for it was in 1993, when mass privatisation started, that large-scale sale (transfer) of shares, though formal to a great extent, became an all-around phenomenon, and this way the loss of leverage by the *nomenklatura* became irreversible. (And it should be emphasised here that we mean *nomenklatura* leverage and not the real power of the state.) At the same time what we have today is an optimum version of turning state property over to private hands. Practically no responsibility to superior organisations, almost no responsibility for property, and an exceptionally thin line separating what is, from what is not one's own (Galkin & Privalov, 1993). So it was the interest of the *nomenklatura* that caused a powerful attack on the principles of privatisation in 1993 within the government itself. These interests can be seen in the following policy:

- 1) the desire of sectoral ministries to cancel decisions on privatisation already taken (The Baltic works);
- 2) attempts to introduce limitations on incorporation and privatisation from the sectoral point of view (estimates show that in the first half of 1993 the fuel and energy complex saw 65% of state property removed from the process of privatisation);
- 3) unjustified attempts to secure ownership of federal property controlling blocks of shares of enterprises (as a rule, delegating the authority to run them to the appropriate department or agency); for instance, by the end of 1993 controlling blocks of shares in 305

enterprises were in federal ownership, while the authorised capital of 158 enterprises included a 'golden share';

- 4) formation of gigantic holding structures including the delegation of the controlling block of shares in the parent company to the corresponding departments (for example, in 1992-1993 GKI received as many as 100 applications, out of which 35 were accepted as applications to be processed, including 5 in the area of atomic power, 2 in the military-industrial complex, 3 in communications, 5 in mechanical engineering, 2 in instrumentation, 3 relating to raw materials extraction and 6 associated with construction materials).

Let us analyse one of the best known examples, which directly contracted many legal norms: RAO Gazprom, uniting 95% of the gas industry of Russia. The authorised capital of this holding company (235 billion rubles without revaluation) is divided as follows: 40% of the shares are in federal ownership (for a term of three years), 15% belong to the workers of the industry, and 10% of the shares may be bought for vouchers by RAO itself at the nominal value with subsequent sale on the securities market, 33.9% are for closed voucher auctions nominally for the 'peoples of the North' and actually for the workers of the enterprises, and 1.1% is sold to the AO Rosgazifikatsiya.

But this is not the main point: it is quite possible that 35% of the shares that are now in federal ownership will be passed over into trust to the RAO itself with the right of an irrevocable option to buy at the nominal rate of 30%. This will actually mean a new 'nomenklatura-bureaucratic' privatisation

within the framework of the existing legislation.

There is also a great danger of 'localisation' of the privatisation process in regions and of the latter usurping the prerogatives of the central bodies of power which are responsible for the conduct of federal privatisation policy. A catalyst for this may be, in particular, a reanimation of the idea of creation of super-holding companies and, in general, reinforcement of the administrative and pro-sectoral trends within the government.

Another major factor is the legal environment. By the time a full normative base for privatisation was elaborated and adopted (over 200 key documents in 1992-1994) certain documents already became obsolete,, while the agenda had some new items associated with the post-privatisation experience of many enterprises.

There are many problems today associated with the mass violation of the privatisation legislation. In 1993 alone as many as 7000 violations were detected by the Office of the Public Prosecutor, all of them relating to the issue of privatisation, while the courts of arbitration received as many as 700 lawsuits. The most typical crimes are deliberate reduction of the book value of enterprises, forgery in lease contracts, sales of enterprises not authorised for privatisation (in the form of granting a lease with a subsequent buy-out right) and creation of close joint stock companies by-passing the law, use of the services of 'dummies' at auctions and contests and so on. It is inevitable that we shall face a new wave of crimes and law violations in connection with a policy of property redistribution.

The above facts point to a key problem: the creation of a

favourable legal and economic environment for shaping a responsible and efficient owner, in the situation where the initial structure of the property for such owners is only just being formed, in the course of privatisation (and here we mean both domestic and foreign owners). This structure does not promote the shaping of such owners. That is why, while maintaining the stability of the current legislation, it is also essential to provide for reasonable revision of the current regulation base (see Chapters 8-9).

6.2. General Privatisation Dynamics

Paradoxically, with all the tensions in the area of political confrontation on the issues of Russian privatisation, both in the 'upper echelons' and 'in the field', the actual process of privatisation in 1992-1994 was quite dynamic (see Tables 5-6).

The quantitative success of the privatisation programme is quite evident /26/. Within the framework of small-scale privatisation, by 1 July 1994 Russia had already privatised 50% of all small businesses. In the course of large-scale privatisation, by 1 July 1994 more than 20,000 joint stock companies had been established on the basis of the medium-size and large state enterprises. By the middle of 1994 Russia had about 50 million shareholders in the new joint stock companies or voucher investment funds.

By 1 July 1994 there were 100,000 privatised enterprises or 74% of all state enterprises with a separate balance sheet at the same period, while on 1 January 1993 the corresponding figure was 10% /27/. In relation to the total number of enterprises

available at the start of the privatisation programme (see Table 4, evaluation 3) as many as 40% have been privatised.

It is of interest to point out here that whereas in 1992 the number of state-owned enterprises with a separate balance increased (this was mainly due to the commercialisation of the sphere of services and commerce), the characteristic trend for 1993 was a steady decline caused by the on-going privatisation process. Among the privatised enterprises, compared with 1992, one can see a considerable growth in the number of enterprises in federal ownership that were converted into joint stock companies.

While in January 1992 there were about 1500 applications for privatisation, by 1 July 1994 the figure was already 137,501, and of this figure some 74.8% have already been implemented (see Table 5). As to the revenue from privatisation, the result (even if one takes into consideration the rate of inflation, voucher payments and the delays in payments from enterprises) needs no comment: while the selling price of all the transactions carried out in 1992 amounted to 157 billion rubles, and the total cost value of the privatised property 193 billion rubles, for the period 1993-1994 these indicators grew by 5 and 7 times respectively. It is important here to stress that by September 1993 the selling price (543 billion rubles) exceeded for the first time the cost value of the property (531 billion rubles). It is quite certain that the reason for this is the intensive development of the system of voucher auctions and in particular the intensification of competition at these auctions from the summer of 1993.

As reported by Goskomstat RF (*Privatisation...*, 1994), the main

sources of money from privatisation were the resources of enterprises that were recognised by buyers (38.5%) and personal savings of citizens (11.3%). The balances on the accounts of economic incentive funds accounted for 5.2%.

The means of foreign investors were as a rule modest. For example, for the entire 1993 they comprised only 121 million dollars and 570 million rubles, with 70.8% going for federal enterprises /28/. This should be considered against the total volume of investment in the Russian economy (together with credits) of the order of 6.6 billion dollars (Efremova, 1994). The major portion of foreign investment was from Germany and went into manufacturing industries, as well as from the USA and Italy in other fields of industry as well.

As reported by Goskomstat RF, the sectoral structure of foreign investment in 1993 was: mechanical engineering and metal-working - 23.2%, fuel industry - 16.3%, commerce and the catering sector - 15.2%, construction - 5.3%, wood-working and paper and pulp industry - 4.5%, production of construction materials - 3.8% (Delyagin, 1994). The most attractive regions were Moscow (which is at the same time a zone of risk and uncertainty from the point of view of investment), Krasnoyarsk, Omsk and Arkhangelsk.

Experts' estimates (see Bolmatova & Evseev, 1994) show that Russia could absorb some 10-12 billion dollars of private investment per year, and ideally the figure could be as high as 40-50 billion dollars annually. And yet - and I share this viewpoint - during the last two years the investment climate for foreign capital in Russia deteriorated. The privileges and guarantees provided by the law on foreign investment were

eliminated, there were no more tax holidays, and no right to dispose of currency gains freely. Duty-free export of goods of one's own production and customs benefits for the import of goods for one's own production needs were also abolished. Probably what is happening is that the 1992 policy of creating a favourable investment climate for foreign capital is giving way to a policy of protectionism with regard to domestic enterprises (major monopolists in production and state-owned enterprises).

It is a paradox but in these conditions (see also Chapter 5) practically all observers report a surge of foreign investment in the sphere of Russian privatisation from the end of 1993. As the preliminary GKI data show, not less than 10% of the stock of the enterprises privatised in 1992-1993 now belongs to foreign-owned companies. By various estimates the growth of foreign investment comprised from 138 to 400 million dollars in the first quarter of 1994 (see also Chapter 8).

As far as small-scale privatisation is concerned, by 1 July 1994 as many as 75% of the enterprises were privatised in the field of trade (according to GKI statistics), 66% in public catering and 76% in consumer services. If we take the calculations of Table 9, the figures are somewhat more modest: 55%, 47% and 55% of privatised enterprises respectively.

The most common method of small-scale privatisation in commerce and public catering is a lease with a buy-out right - approximately 46% and 52%, while the numbers of units privatised by contest were 39% and 30%. In consumer services the prevailing form is sale through a contest (46%). Some 12% of all small enterprises were converted into joint stock companies, and 10% were acquired by natural persons (not by the workers).

And although the majority of buyers of the units in small-scale privatisation are the workers themselves (about 70% of all deals), nevertheless, as the estimates show (see Rubleva, 1994), only 10% of the work collectives in St. Petersburg could go about it without any 'sponsor'. The latter actually means the appearance of a large co-owner at the majority of small privatised enterprises.

Among the major problems typical of most of the objects of small-scale privatisation, it is important to note the requirement for retention of the profile of the business after privatisation, access to credits, and relations with the distribution warehouses ('bases'), which became independent enterprises (Margolin, 1994). Whereas prior to 1990 Russia had only 1400 commercial enterprises (since only wholesale and retail trade associations together with their 'bases' operated as legal entities, by November 1991, as commerce became more and more commercialised, some 70,000 independent enterprises had appeared. In many respects this caused disruption of the former supply links.

However, in our view the main problem remains the fact that most of the enterprises are being privatised without the premises, which are leased, and this is a kind of 'hook' by which the local authorities hold these enterprises.

The aggregate analytical data on the privatisation process in Russia in 1993-1994 on the whole exceeded the corresponding indicators for 1992 (see Table 6). Although some indicators of the rates of privatisation visibly fluctuated within the year, and this was especially noticeable in the regions, the rates of privatisation intensity went up significantly (the number of

applications implemented / the number of enterprises subject to privatisation rose to 0.820 in June 1994 and average figures were of the order of 0.369 and 0.582 in 1992 and 1993).

Yet it should be noted that such apparently successful results of privatisation can be accounted for not only by the enthusiasm of the 'microlevel' and the activities of GKI but also by the build-up of certain countertrends: the rates of submission of applications diminished, which led to high implementation figures. In other words, by the end of 1993 we can say that the peak of the voluntary and initiative privatisation had been passed at the microlevel, and those enterprises that were left can hardly be as active as in the period 1992-1993.

Even at this stage of analysis the above information makes it possible to arrive at very important conclusions from the point of view of the prospects of further participation by 'outsider' Russian and foreign investors in privatisation:

- 1) those enterprises that are already involved in privatisation (from the act of application submission to the post-privatisation stage), because of the existing methods of privatisation or lobbying by interested parties, have little interest in most cases or are not easily accessible for a serious foreign investor, at least at the stage of the initial placement of the shares (for greater detail see Chapters 7-8);
- 2) those enterprises that have not yet travelled the path of privatisation may be divided into four groups: first of all, direct candidates for bankruptcy that do not have a strong management or plans for development and cannot

imagine life without state subsidies; secondly, enterprises where the situation is the opposite, i.e. they have clear-cut plans and partners for transformation but tried by all possible means to avoid voucher privatisation, hoping for a 'money stage'; thirdly, a group of enterprises on the prohibited list of the state privatisation programme; and fourthly, the 'nomenklatura paradise spots', which will be privatised but where it will be privatisation 'for our own people'. So only the second group is likely to be of practical interest for investors.

As to the prospects of development of the Russian privatisation process as a whole, the key task today is not so much the formal build-up of the rates of privatisation (this will require tremendous political and administrative efforts) as the work with those who have already made their intentions clear (and in this category we have more than half the total number of enterprises in Russia). Above all it concerns average and large enterprises which are at different stages of the incorporation and privatisation process and correspondingly are in different degrees of readiness for the sale of their shares in one form or another. Yet this does not mean that the issue of the privatisation rate is of secondary importance, for the irreversibility of the privatisation process and the problem of economic reforms remains topical today.

Chapter 7. Mass Privatisation Model in Russia
(October 1992 - June 1994)

The very popular term 'mass privatisation' combines two independent but closely related processes:

- corporatisation of medium-size and large state-owned enterprises with subsequent sale (transfer) of their shares into the hands of citizens and non-state legal entities;
- providing all (or part) of the population with investment coupons (cheques, certificate, vouchers, etc) which give a right to a part of the property being privatised (voucher privatisation).

In other words, within the model of mass privatisation corporatisation is the supply side and issuing the population with vouchers is the demand side. In the Russian version a policy of sale of shares by means of closed subscription and voucher auctions acts as a 'synthesis' of these processes. A system of intermediary investment institutions is also a necessary element in the model.

At the same time, a wide spread mistake is equation of large-scale privatisation with a voucher programme, while actually voucher privatisation is just one of the many methods that may be employed. Flexible use of these methods should provide a balance between attempts to accelerate privatisation and to achieve social justice and economic effectiveness, the necessity of creation of an effective owner, and attraction of new capital. With all the shortcomings of the Russian model, the

major task of Russian mass privatisation, forming a broad layer of owners, was nevertheless achieved by July 1994.

7.1. Reasons for the Launch of the Programme and Its Basic Conception

Both the critics and the advocates of the voucher model which expired on 30 June 1994 agree on one thing: the formal, quantitative success of the programme of mass privatisation is indisputable and evident. As to the results of the programme which are beyond simple quantitative measurement, they always were and are now a subject of heated and meaningful discussions as well as of irrational speculations for political purposes. So to attempt to sum up the results let us go back to 1992 and try to understand the real situation and purposes of the privatisation voucher.

Let me note at once that in the last and now my own position regarding the introduction of a voucher model was and is rather negative if we look upon the privatisation voucher - and the mass privatisation model as a whole - as a technical means of 'immediate enhancement of economic efficiency', 'ensuring social justice' and so on. Under the circumstances there is nothing more naive (or dangerous) than an attempt to evaluate the actual qualitative results of the voucher privatisation by comparing these results with the proclaimed goals.

Let us recall the conditions in which a strategic decision was taken to launch a voucher model (summer 1992) as a method of stimulating the privatisation process in Russia:

- absence of effective demand of the population;
- zero interest in privatisation in Russia on the part of foreign investors;
- the presence of over 240,000 state-owned and municipal enterprises (which required standard procedures for privatisation);
- the necessity of the highest possible rate of legal privatisation (at the first stage) to block intensive spontaneous privatisation and ensure an irreversible type of economic change;
- the relatively favourable public opinion.

All these factors were crucial for the development and launching of the Russian voucher model /29/. So what were the strategic goals? Naturally, the goals were not those that had been laid down in the first and second state privatisation programmes. It seems to me that the real goal was as follows: **temporary massive redistribution and strengthening of private property rights in Russian society with a minimum of social conflicts, hoping for further transactions in favour of efficient responsible owners.**

Taking into account the conditions in which privatisation was started in Russia and especially this real goal of the Russian version of mass privatisation, one can reconcile oneself to the issue of the voucher. And now let us look into the basic components of the Russian model

7.2. Voucher Programme

The conception of Russia's voucher programme was approved at the sitting of the Government of the RF on 11 June 1992. Privatisation vouchers represented state federal (and only federal) securities with a limited term of validity, each voucher with a face value of 10,000 rubles, and were issued to the bearer, with the right of sale.

The documents issued later specified the government's conception somewhat more fully: a rigid schedule of actions was drawn up, a Special Co-ordination Committee was established, and territorial commissions were set up in all the regions. From 1 October to 31 January 1993 the overwhelming portion of the vouchers was issued to citizens: 148 million vouchers. There were no serious problems (such as the panic in Czechoslovakia when coupon books were issued during the last few days) in the course of handing out privatisation vouchers to individuals. Yet there were some other problems.

In the course of implementation of the voucher programme one of the key issues was that of the real purchasing power and market price of a voucher. The initial position of GKI was that it had to take into account the real value of state enterprises and other property that could be sold for vouchers (35% or 1.4 trillion rubles in old balance sheet prices). It was stressed that vouchers were for use to acquire property at the old prices of the last balance sheet valuation and for that reason the actual purchasing power of the voucher should be considerably higher than the equivalent sum in 1992 rubles, and that its

market price would therefore have a tendency to go up. So while in October 1992 representatives of GKI gave an optimistic purchasing power estimate of 200-300,000 rubles per voucher, in December that figure dropped only 12-13,000 rubles.

Immediately (in the first days of October 1992) an exchange and over-the-counter market in vouchers was formed and it showed a price spread from 200 rubles to 70,000 rubles. The first stock exchange transactions were begun at the Russian Commodity and Raw Materials Exchange, with a voucher value of 5000 - 10,000 rubles. During 1993 the rate went up from half to twice the nominal rate and on average it stayed at the level of 20,000 rubles during the first months of 1994 and finally, with all its fluctuations, reached some 40,000 rubles.

Up to the end of 1992 the commercial banks and other commercial structures were rather active in buying vouchers (primarily for tax considerations); after the crisis at the beginning of February 1993 another key 'investor' began to dominate the market for vouchers: the enterprises being privatised (both work collectives and autonomous managers) were buying the vouchers for use in closed subscription and purchasing 'their' shares at voucher auctions. Quite often bargains were struck between brokerage houses and directors of enterprises buying the vouchers, so that both sides gained by exploiting the difference between the cash and non-cash rates. Isolated cases were reported when foreign investors also appeared in the market, usually through their branches and middlemen.

To a great extent the dynamics of the voucher price were conditioned by the political situation, the rate of inflation and speculative exchange and over-the-counter trading. To an

extent a privatisation voucher acquired the characteristics of a security (it became a sort of financial instrument) that was considered by the owner separately from its real purpose. All the same, the price of the voucher remained related to the privatisation process.

To begin with, the current market price for the voucher was taken as the basis of the preliminary 'market' valuation of shares and enterprises after voucher auctions. Obviously, however, the actual market price of the shares could only be determined on the secondary market, and this market, of course, is still in a rudimentary stage.

Secondly, it was the current market price of the voucher (real expenditure for its purchase) that one considered to assess the profitability of purchase of any particular shares at voucher auctions. And yet again one has to make a reservation here: the voucher price of shares is set not so much by the financial position of enterprises, but rather by the number of shares offered for sale.

Thirdly, the current rate for the voucher influenced the volume of purchases of vouchers, especially by the enterprises themselves.

Because of this any attempt to measure the real cost (statically or dynamically) is doomed to fail, if only one voucher valuation is used. In our view, it is only if we take a range of voucher prices that we can give a real picture. In current conditions an attempt to value the voucher through the 'profitability' of the enterprises (even in an indirect way - through the shares acquired) can hardly be fruitful and thus only 'quasi-market'

and 'property' approaches are possible:

- the current market rate in exchange and off-exchange trading (both cash and cashless);
- the market rate in terms of the issue value of vouchers in autumn 1992 with a corresponding inflation adjustment;
- a weighted average rate at voucher auctions (the number of times the nominal value per voucher) as the most probable indicator of the true situation;
- a weighted average rate at voucher auctions taking into account the revaluation of the fixed assets of the enterprises.

It is essential to note that in only 20% of the regions were the values of privatisation vouchers and fixed assets estimated to be balanced. For example, while voucher coverage of assets was only 53% in the North, 58% in Eastern Siberia, 76% in the Central and Black Earth area, 78% in the Far East and 92% in the Povolzhie area, in the Urals the voucher excess was 3%, in the North-West 8%, in Northern Siberia 21%, in Volga-Vyatka 22%, in the Central Area 25% and in the Caucasus 67%. As a result there was a certain localisation of the voucher markets in some central points and another characteristic feature is that it became quite profitable to play on the differences in the rates. One could get as much as 200% profit in this way.

More than once the government took steps to support the voucher price on the market (considering it as a pledge of its prestige): these included increasing quotas for voucher payment

for property up to 35-90%, bringing land, housing and municipal property into voucher sales, granting permission for enterprises to purchase vouchers out of their privatisation funds, mandatory payment of 50% of the closed subscription by means of vouchers and so on. However, accelerating the incorporation process has always remained the key issue to ensure further voucher auctions.

7.3. Incorporation of State-Owned Enterprises

The Decree of the President of the RF, No. 721, on obligatory incorporation of federal enterprises, issued on 1 July 1992, can be interpreted as the first radical step by the government in this direction. And although the quality of drafting of the standard documentation and the deliberately primitive nature of certain procedures of incorporation can hardly be regarded very highly, nevertheless the very fact of accelerated transformation of some 6000 enterprises into joint stock companies may be justified by the following considerations:

- the issue of vouchers in conditions of a likely investment crisis was considered by GKI as a major effort to feed the 'investment demand' of the population and, in this sense, turning a considerable number of enterprises into joint stock companies and the issue of shares were necessary measures to ensure adequate 'investment supply';
- the corporate form of property (even if the owner was not changed) seemed to be more appropriate for creating the conditions for attracting capital and stimulating the flow of capital among economic agents in a situation where

there was a crisis with the sources of finance (problems with profits, the budget and loans from the banks).

The incorporation of large state-owned enterprises began practically at once after the decree of the President, No. 721, came into force (see Table 7). The situation was as follows: by 1 January 1993 the register of enterprises subject to mandatory incorporation included 4979 enterprises, while 674 enterprises were registered as joint stock companies; by 1 July 1994 these figures had risen to 7121 and 4368 enterprises. All in all by 1 July 1994 over 20,000 former state enterprises were registered as joint stock companies with a total authorised capital of 1.1 trillion rubles (in old book values), and at various stages of incorporation (and included in the All-Russia register of enterprises being incorporated) there were over 30,000 enterprises with an estimated authorised capital of more than 1.3 trillion rubles. It is of interest to note that about 23,000 such enterprises joined the process of incorporation by their own free will. Thus, if we treat this phenomenon purely formally, it appears that the area of 'supply' (within the terms of mass privatisation) was prepared well enough.

Yet at this very time one could also see one negative trend progressing: with the reduction in the proportion choosing options 1 and 3 of privileges for workers in the course of incorporation of enterprises, option 2 was becoming more and more dominant; by 1 July 1994 as many as 75% had chosen it (see Appendix 1). This means that as many as three-quarters of the enterprises (against two-thirds in 1992) planned to buy the controlling interest with the help of the work collective, in spite of the coefficient of 1.7 times the nominal share value and the 90-day term for payment of the entire sum. The other

motive for preferring option 2 was the workers' aspiration to have total equality of rights for all, from the members of the management to the category of unskilled manual workers.

From the medium-term perspective such a trend is dangerous: first of all the problem of corporate control may be exacerbated and, secondly, the mobilisation of investment resources may suffer. And although in the course of incorporation (privatisation) closed joint stock companies are not to be formed, the very fact that the controlling interest rests with the work collective may well lead to a situation when the diktat of the worker-shareholders (or of a narrow group of managers who are not controlled by a formal owner) will mean the prevalence of current consumption at the expense of long-term development, or management may pursue its own policy to the detriment of the interests of shareholders. In other words, in the case of a closed subscription two equally negative ways of development of a new type of joint stock company are likely: the appearance of an 'aggressive consumer majority' (the presence of worker-shareholders) or the diktat of managers on the basis of dispersion of property.

It goes without saying that in the foreseeable future a major portion of the shares will be held by the current 'investors' (see Chapter 8). Yet any intervening period between the moment of the original distribution of shares and the appearance of a serious owner of a large block of shares will certainly hinder effective control of a joint stock company, with all the subsequent consequences. From this point of view it seems prudent if gradually the rights of the workers at the enterprise are diminished.

So far an outside Russian or foreign investor intending to buy at least a part of the block of shares that are distributed through closed subscription will have to enter into negotiations (directly, through a branch in Russia or through a Russian intermediary) with the workers on the subject of the immediate purchase of their shares (or buying these shares after the end of the subscription). Practice shows that this is no problem, but it is hardly likely that this kind of approach will be of interest to a large investor who aims at a controlling interest.

Moreover, there are numerous technical problems associated with the sale of shares by closed subscription for the workers. Firstly (Mikhailov, 1993) there is (a) a problem of payment for the privileged shares of options 1 and 3 because of the indivisibility of the voucher; (b) difficulty in concluding personal agreements on the acquisition (transfer) of shares at large enterprises, which leads to an increase in the period for subscription; (c) if the subscription period is tight, not all the potential participants have enough time to exercise their rights; (d) additional purchase of vouchers in the market by large enterprises which have chosen option 2 generates some individual and financial problems. There were also many reports of direct violations of the Provisions on the conduct of closed subscriptions.

Finally, what is just as important, many of the stock companies that appeared in Russia have little similarity with the 'classical' ones. This concerns both the joint stock companies set up on the basis of state-owned enterprises and, above all, their organs of management. In particular, the principles of formation of the Board of Directors which are now in force, as applied to the newly created stock companies, make it quite

possible for the local authorities to secure a controlling interest (up to 20% of the voting shares belong to the local property fund, whose representative, together with a representative of the local authorities, are members of the Board of Directors, together with the General Director and a representative of the workers).

In this connection the most important current and to an even larger extent medium-term problem to be analysed is that of the post-privatisation existence of the newly instituted stock companies. It covers a broad spectrum of unsolved issues: management of the state blocks of shares, delegation of the rights to manage the shares, payment of dividends, the existing voting systems (voting trusts, powers of attorney, and so on) in large corporations, property trust operations, registration of deals on the secondary markets (the latter is especially important to ensure effective transfer of property rights) and so on.

7.4. Sale of Shares and Voucher Auctions

In accordance with the course set by GKI to ensure priority backing of the voucher privatisation, the regulations stipulated a rigid sequence in the sale of the shares of an enterprise: a closed subscription for workers, sale of shares (it should be stressed that we speak here about shares and not blocks of shares) at a voucher auction, and only then out of the fund for incorporation for the workers of enterprises and other techniques. All enterprises that were forced to effect incorporation were divided into 5 arbitrary groups, and for those that incorporated voluntarily the group depended on the

period of registration as a stock company. Each group would have a time limit to conduct voucher auctions (see Radygin, 1994a).

The number of shares subject to sale at a voucher auction was determined as the total number of shares that were subject to sale for vouchers (from 35% to 90% depending on the level of property), minus the number of shares sold for vouchers via a closed subscription and to the officials of the administration on preferential terms. Later a single mandatory quota of shares that were put up for voucher auction, 29% of the total number, was determined. The first type of application - without indication of the minimum of shares per voucher - should be satisfied completely, and the second type of application - with an indication of the price - should be satisfied depending on the demand for shares. Taking into account the experience of the first auctions, provision was also made for splitting the nominal value of the shares to satisfy all the applications of the first type.

Despite rather rigid legislation, during the entire period of the conduct of auctions negative trends such as resistance by the authorities persisted in a number of regions (according to the Analytical Centre of the Administration of the President of the RF, in 1993 in some 30-40% of the regions less than 3% of the vouchers were used, while 10 regions accounted for 50% of all sales of shares) and in a number of ministries.

The first model-type voucher auctions were carried out in December 1992 in Moscow, St. Petersburg, Vladimir, Nizhny-Novgorod and some other cities. All in all, in December 1992-June 1994 more than 15,000 enterprises were put up for auction

(in 86 regions of Russia), with a total authorised capital of over 1.1 trillion rubles and employing over 16 million people or half of those in industry (see Table 8). On average 18.9% of the shares of each enterprise were put up for auction (against 29% required by the law), and all in all (taking into account the closed subscription) - on average 71% of shares were sold for vouchers (against 80% required by the regulations). The authorised capital of the joint stock companies whose shares were put up for auction fluctuated from 1-2 million up to 30 billion (RAO Norilsky Nikel) rubles, while the average is about 100 million rubles. Almost the same spread is characteristic of the proportion of the authorised capital put up for auction: the minimum was 3%, in the joint stock company Stroitel' in the city of Vladivostok, and the maximum 60%, in the joint stock company Sverdlovskdorstroi.

According to GKI estimates, the most popular (until the shares of the fuel and energy complex appeared) were certain types of enterprises in mechanical engineering, and in the food, tobacco, furniture and wood-working industries, as well as hotels, enterprises located in the most prestigious regions, the largest enterprises (in view of the liquidity of their shares) and small businesses (the hope here being that it would be easier to establish control). A marked spread of the rates can be observed, depending on the region, with the weighted average for all regions being 1.8. The 'cheapest' shares were in enterprises in provincial areas (up to 405,000 rubles in nominal value of shares per voucher) and the most expensive were in enterprises in the capital which were small in size and located in the centre. Here there was a direct relationship between the number of shares put up for sale (and accordingly the size of the authorised capital) and the auction rate.

Analysis of the sectoral structure of the vouchers invested in the actions shows that enterprises of eight branches of industry accounted for 70% of the vouchers; the distribution by sectors of industry is as follows: mechanical engineering (11.4%), metallurgy (11.1%), chemical industry (10.5%), oil and gas extraction (9.1%), oil-refining industry (8.9%), power industry (8.1%), postal services and communications (5.8%), transport engineering industry (5.0%) (Privalov, Bessonov, Kalinichenko et al., 1994, p.61).

It goes without saying that the special features of these industries are not associated with any serious financial analysis (at least in most cases) prior to making investments. The basic factor accounting for such outsider investments is psychological perception of an industry or enterprise as a more or less 'reliable' sector, this often being an erroneous perception which affected the rates at an auction. As to institutional investors, the reasons here are quite different and they, as a rule, are interested in a particular type of enterprise.

Among participants in voucher auctions one should single out the enterprises themselves (and their intermediaries), voucher investment funds and large institutional and private investors. And if small investors tried, first of all, to invest their vouchers in those enterprises that seemed 'reliable' from the point of view of the average person, the motives of funds and large investors are quite different: a plot of land, a building, the actual profitability of an enterprise, re-sale of a large block of shares, the possibilities of reconstruction and increase of capacity and, finally, export potential.

As to the enterprises that bought back their own shares, it goes without saying that they were primarily after a controlling block of shares and, if possible, any other blocks of shares in addition to the controlling interest (this being done to retain dividends among the members of the work collective and because of the fear of job losses if other owners appear). It is these types of enterprises that welcomed auctions; however, there are other advantages not to be overlooked: a possibility of becoming a full-fledged buyer (and thus trust-holder) in privatisation when the share of the state is reduced to 25% of the authorised capital, the buy-out of a plot of land (this being possible only after a voucher auction) and some other such considerations.

Naturally, in most cases the initiative to buy back shares would come from the management, operating on the basis of the pattern tried out recently. A typical example of such activities is one of Russia's largest enterprises in the motor industry, AO GAZ, which used 15 dummy companies and over 1 million vouchers to buy back shares at its 'own' voucher auction (Romanova, 1994). In addition to the fact that such investment is not legally permitted (with an assigned state share GAZ cannot operate as a buyer in the course of privatisation), the funds used for these purposes are also probably state-owned. It is also evident that until the work of the Government Commission is completed the applications (and the funds) of all legitimate investors are frozen, especially if one takes into account the fact that the previous results of the auction may be cancelled and a new auction may be ordered.

Another trick designed to 'cut out' unwanted investors that

submit their applications at the very last minute is closing the place that receives the applications earlier than it should have been, as was done by AVTO-VAZ in Moscow (Kalinichenko, 1994). To attribute some appearance of legality to this trick it is necessary to obtain the right organiser of the auction for one's shares, a trick that was quite successful with the largest oil companies in Russia. Another trick is holding a formally open voucher auction but on the closed territory of an enterprise or at some other inaccessible place /30/.

Because foreign investors use the services of intermediaries at auctions, it is quite difficult to distinguish their sectoral priorities or to identify their sphere of participation.

In general the participation of foreign investors acting through intermediaries can be estimated rather roughly at around 10-12% of shares put up for auction. There are many reasons why the figure is not higher: in addition to the general climate for foreign investment, there is the difficult access to auctions of enterprises of the fuel and energy complex, the *a priori* indefinite nature of the results of auctions, the impossibility of buying a controlling interest at auctions, the desire not to make purchases public and other reasons. In addition to the recent problems with the acquisition of vouchers and their investment, it is the impossibility of buying a controlling block that is perhaps the most weighty reason for non-participation of foreign investors in auctions.

7.5. *Investment Funds*

It is quite clear that when investment resources are dispersed

(as is the case with the population's vouchers) and when the population lacks knowledge of securities markets and investments, the role of the voucher privatisation funds should be exclusively to carry out mass privatisation.

A major package of documents adopted in October-November 1992 (Decree of the President of the RF of 7 October 1992 'On Measures to Organise a Market for Securities in the Process of Privatisation of State-Owned and Municipal Enterprises' and other such documents) determined most of the required procedures for the institution and operation of investment funds in Russia. As a result, Russia's legislation provided for the creation of investment funds, known throughout the world, and specialised privatisation funds that would accumulate privatisation vouchers on behalf of the population. In any case, any stock companies of the open type that simultaneously carry out activities associated with the attraction of the funds of the population through the offer of their shares and investments of their resources in the securities of other issuers, as well as trading in such securities, are recognised as investment funds.

In contrast to all other investment funds, a voucher fund had exclusive rights to exchange its own shares for citizens' privatisation vouchers and as such could only be a closed-type fund and could obtain its license only from GKI. Although a closed-type voucher fund should, by its very nature, stimulate long-term investment, keeping in mind the gain in the market value of shares, and limit the possibilities of a manager to establish majority ownership and control, nevertheless the non-liquidity of the Russian fund market and the appearance of a considerable number of such funds (basically second-rate funds) considerably undercut shareholders' possibility of voting with

their feet'. In other words, having exchanged his privatisation voucher for shares in the privatisation fund, the shareholder becomes a hostage forever of the operations of this fund.

By the end of 1992 GKI had issued licences for 34 investment funds, and in June 1994 there were as many as 630 such funds. For 1993 and the first half of 1994 the funds acquired more than 45 million vouchers, and more than 25 million people became shareholders in them. By May 1994 all the funds together had invested as many as 27 million privatisation vouchers (*Funds...*, 1994).

The most active stage in the process of setting up voucher funds was the first half of 1993. Then the number slowed down from 15% in August to 1% growth rate in December 1993. In 1994 there was no marked growth of funds. On the contrary, the number was already being reduced by reorganisation or merger, as well as bankruptcy, because some funds were closed since they had not started operation.

One can mention three centres with a high degree of concentration of investment funds: Moscow and the Moscow area (143 funds), St. Petersburg and its suburbs (43), Sverdlovsk region (23), i.e. 33% of all the funds in Russia. And it should be remembered that the share of these centres, if judged by the size of their assets, the number of vouchers accumulated and the number of shareholders attracted, is considerably higher because all these funds are large.

On the subject of differentiation of funds, using net assets as a criterion, 1% of funds, eg. Alfa-Capital, First Voucher Fund and MN-fund, may be included in the category of the largest ones

(with net assets over 10 billion rubles), 10% of funds may then be regarded as large funds (net assets ranging from 1 to 10 billion rubles) and over 50% of funds are medium-size funds (with net assets from 200 million to 1 billion rubles) (INIOR, 1994). First Voucher may be regarded as the largest fund in Russia by number of shareholders: 2,100,000 people. The funds may also be subdivided into regional, inter-regional, sectoral, intersectoral, specialised social protection funds, funds for army personnel and so on.

There are also differences between funds by the structure of their investment portfolio. Some experts (Gorbatova, 1994) distinguish the following types:

- large funds that pay primary attention to regional enterprises when trying to buy packets of shares (the price of shares being less than in Moscow); their main goal is obtaining a large packet to get (in future) a controlling interest and manage the enterprise (growth funds);
- purely speculative funds, usually small or medium-size funds, which do not hold shares on their balance sheet for a long time, i.e. for more than 1-3 months (it was speculation on the difference between the auction and post-auction prices that yielded maximum profits in 1993-1994);
- agitation-type funds, with no strategy of their own, and trying to invest in the most popular enterprises;
- funds with an extremely diversified portfolio, mainly

regional funds that invest in local businesses without any strategy of their own;

- 'privileged' funds that got all sorts of benefits from the local authorities to stimulate their privatisation effort (access to closed auctions, obtaining state packets of shares for a trust form of ownership, and other such forms).

In 1993 it was the speculative activities of funds on the market that became their main source of income. And these activities were extremely intensive in May 1993, after a Decree of the President of the RF 'On Guaranteeing the Rights of Citizens in the Course of Privatisation' was issued. That Decree put an end to the funds' sale of accumulated vouchers and stipulated that funds should invest the vouchers only in shares that are put up for auction.

The main category of speculative activity was the purchase of shares at a voucher auction in order to resell them to a client not present, as well as to ensure the purchase of rather large packets of shares (5-15% of the authorised capital) of the enterprises being privatised for the sole purpose of future resale to the administration of the enterprises (through all sorts of 'dummy firms' controlled by the management), and purchase of shares in privatised enterprises to the order of clients.

Yet a majority of funds are low income yielding or even loss-making, so dividends may be received only by the shareholders of a very limited number of funds. For example, out of 150 funds analysed by the Skif association in 1993, less than 30% were

making profits. GKI experts believe that on average each share in voucher funds carries 4 rubles of losses. Even the largest funds recognise that they could not provide gains for their shareholders. More than half of the funds decided that they should pay no dividends after their 1993 results and for those funds which did make payouts the dividend did not exceed 2000-5000 rubles per share (Shimov, 1994). GKI estimated that the funds that did pay dividends for 1993 paid 130% per annum (with the spread of the declared dividend size varying from 10% to 200%) ('on some results...', 1994). There are funds that paid dividends in the form of shares.

Although the largest funds do have difficulties of their own, it is the small funds that face the largest problems. They have neither their own analytical base, nor enough free money to cover their current expenses, and often they are 'eating up' their authorised capital. And although the possibility of merger of funds exists, this does not save them from the prospects of going bankrupt. As yet there are no legislative mechanisms to regulate the process, nor mechanisms to protect the shareholders or to control the operations of the fund managers.

One problem for the funds is the question of taxation. Actually the shareholders of the funds were subject to taxes indirectly, through the imposition of taxes on the profits of enterprises whose shares are in the portfolio of the fund (32%), dividend tax when the fund receives dividends as a legal entity (15%) and the tax imposed on natural persons (shareholders of the fund). The second state programme of privatisation (December 1993) freed voucher funds (for the first two years from the time of registration) from the dividend tax when these dividends were

paid out by enterprises on shares owned by these funds, from the transfer of the advance tax payments on profit, and the tax payable when a prospectus for the issue of securities is registered. Yet that programme was adopted by decree of the President of the RF, while according to the law, all questions relating to matters of taxation are within the province of the legislative branch. This makes it likely that the decisions may be reconsidered.

Only half of the operating funds had held general meetings of shareholders by September 1994 and approved their results for 1993. In addition to the technical problems (how to arrange a meeting of the millions of shareholders of the largest funds or shareholders in various regions of the country), the characteristic feature of most meetings - when a first attempt was made to get together - that a quorum of 50% of votes could not be obtained. When there was a second meeting, when decisions were taken by a simple majority of votes among those present, it was quite evident that the basic rights of the main mass of small shareholders were violated.

Many experts believe one of the most acute medium-term problems will be that of the illiquidity of the assets of voucher funds. Now there is practically no secondary market in the shares of the investment funds. And while at the early stage the voucher funds virtually faced no competitors in selling their shares for the population's vouchers, now the secondary market means sale of the shares for cash and this changes the situation drastically. The point is that large investors may have no interest in such funds. there is a hard struggle for the free capital of the population and the funds face competition from commercial banks and certain companies whose efficiency from the

point of investment is much higher, both in terms of the size of dividends paid and in terms of the liquidity of their securities. It is quite clear that only some of the funds can ensure the liquidity of their shares (see INIOR, 1994). To a great extent the destiny of the voucher funds will depend on the strategy they adopt (or on the lack of such strategy), the legal regulations on the conversion of voucher funds into 'common' investment funds, as well as on the securities situation in Russia and the macroeconomic situation.

7.6. Investment Contests and Other Methods of Initial Sale

In addition to closed subscription for shares and voucher auctions, the following types of privatisation are likely in accordance with the second state programme:

- sale of blocks of shares through an investment tender;
- auction for money of 10% of the shares from those sold for privatisation vouchers;
- sale of enterprises that are not joint stock companies by auction or commercial tender (including a limited number of participants);
- sale of property (assets) of active enterprises, those that are being liquidated and construction projects still in progress, by auction or tender (including an investment tender);
- sale of defaulting debtor enterprises;

- privatisation of leased property.

Though on the surface there are a number of ways to effect privatisation for a large investor who wants to have a controlling block or close to a controlling interest, the choice in fact is not too great. One may, of course, participate in auctions and tenders for the acquisition of an enterprise as a whole, primarily municipal ones, but in that case a permit must be obtained from the local authorities (for a foreign investor). Moreover, as practice in 1993 showed, the main interest of large investors is concentrated on the items of federal property which are incorporated. As to purchase of a defaulting enterprise as such, or a part of its assets, this is also hardly possible today without considerable procedural and legal difficulties. As a rule, leased enterprises are bought out by the workers of those enterprises themselves. Finally, there is a money auction on the basis of the provisions of the order on selling shares at auction for rubles up to 10% of the total number of shares of the stock companies sold at a specialised voucher auction. Shares can be acquired there, but even the simplest calculation shows that one can not get more than 2-3% of the authorised capital.

In this connection, the most promising and actually the only means that will make it possible to acquire a controlling interest or a packet of shares close to a controlling interest is an investment tender. Under the Russian law the tender can only be open, and the criterion for selection of the victor is the amount of investment, discounted over the entire period of investment at the rate of the Central Bank of Russia at the time the tender is held. The period for making investments shall not

last more than 3 years, with the payment for the packet of shares acquired being on the basis of the nominal price.

In the course of the initial distribution of shares the winner at the tender may count on some 18-22% of the authorised capital, but after his investment is completed (amounting to not less than 50% of the authorised capital) the joint stock company must, if the tender winner wishes, make a second issue of shares and transfer shares to him equal to 50% of the authorised capital formed at the moment of creation of the joint stock company. In other words, an outside investor who is the victor in a tender may rather rapidly, legitimately and without considerable expenses become the owner of the controlling block of shares.

By the beginning of 1994 privatisation plans in Russia provided for some 280 investment tenders, out of which 160 had been carried out by January 1994 (3.1% of the number of mandatorily incorporated enterprises); the average size of the block of shares offered was 18-22% (Isaev & Minaev, 1994).

Because the blocks offered were split, the number of tender winners reached 208, including a few foreign investors - 15 foreign companies proper and 7 joint ventures. One can also mention here the participation of two commercial banks. The total sums to be invested amount to 1.2 trillion rubles, \$1 billion and DM 35.6 million, with an average investment programme running for some 2-3 years. So in principle even this small experience has shown that this method may be applied quite efficiently from the point of view of the attraction of resources and for that reason it is thought that in 1994-1995 the share of investment tenders among all methods of sale should

be considerably increased.

Naturally, this kind of sale is not without problems. The first is that the tender winners may not carry out their investment commitments and to avoid this they resort to some techniques that are on the verge of legality. For example, a considerable problem for many regions (and the reason for the failure of many tenders) is the absence of investors and resources for investment. Many enterprises with a promising future are hoping for mobilisation of investment resources once they are privatised. For a serious investor the assigned period of one month is not enough to research the market and take a decision on participation in a tender.

Today one of the main reasons for participation by a foreign firm in an investment tender is to secure a certain segment of the Russian market. For example, the British Morgan Crucible Co., which controls 24% of the world market for electrical carbon, acquired 15% of the shares of Uralelektroglia on condition that it invests \$1.5 million and with the right to increase the authorised capital. At the same time (Boreiko, 1994) a primary goal of the British firm today is just finding a place for itself in the Russian market.

In the view of some experts, one of the goals of those few foreign investors which did directly participate in privatisation bids is just their desire to weaken potential Russian competitors in the promising Russian market. Thus, analysing the policies of Procter and Gamble Co. with reference to Tula Novomoskovskbytkhim, A. Kosorogov, Chairman of the Board of Directors of Alfa Capital investment fund, put it this way: 'what they want is to absorb the plant and then brush it aside

as a competitor on that market'. Moreover, according to the same source, despite the apparently impressive volume of investment programmes, on the basis of the results of the tenders already held (as reported in May 1994), 'not a single enterprise, when the investment bidding was won by foreign firms, has yet provided its money' (Privalov & Chernakov, 1994, p.4).

Nor is it a secret that now the system of investment tenders (albeit open) is nothing but a veiled form of direct sale to a previously determined investor, who participates in the elaboration of the investment programme from the very beginning and is involved in setting the terms of the tender.. The best example is just formalising existing business relations, as was the case with Proctor and Gamble with Novomoskovskbytkhim (Tula) and Illingworth Morris with Bolshevichka (Moscow). Technically it is not difficult to do (and in a number of cases it is necessary), but for an investor who lacks direct contacts with an enterprise an additional obstacle arises - the difficulty of 'sensitive' talks with the management of the enterprise and the officials of the corresponding departments. In the case of a 'hostile' investor a whole battery of tricks may be used: concealing information on the tender and its terms (Kransnodark Tobacco Factory in favour of Phillip Morris), refusal to extend the period for submission of applications (this way the Hilton Group was cut off from participation in the bidding for the Hotel Moskva), arbitrariness in determining the best bid and the price of the packet and other problems.

It may also involve direct violation of the law, and these violations may be committed by the creators of the law themselves: the GKI instruction no. 255-p or 4 February 1994

was certainly against the law (it was issued when a voucher auction of Avtovaz was held). According to this instruction 7% of the shares of Avtovaz were to be transferred to the authorised capital of All-Russia Automobile Alliance (thus the share of the investment tender was effectively reduced from 22.5% to 15.5%). An amendment may be made to the privatisation plan which affects the second issue of shares for the winners of the tender. And all this is done despite a strict ban on changing a privatisation plan in the process of a voucher auction for all other subjects.

7.7. Qualitative Results of Implementation of the Mass Privatisation Programme

First of all, the expiry of the validity of the voucher marks the end of the first stage of Russian privatisation /31/. This stage started in 1992 and was completed on 20 June 1994. Despite various economic, political and social problems connected with the circulation of the voucher, the real basic task formulated in section 7.1 - the mass redistribution and fixing of property rights throughout Russia has been fulfilled. It may be objected that it was done formally and not always in the most civilised way, but all the same it is due to this privatisation that by the middle of 1994 Russia has:

- a corporate sector in its economy;
- an exchange and off-exchange securities markets, including an infrastructure for trading privatisation vouchers, a system of auctions for privatisation and a secondary market in shares of privatised enterprises (see also

Chapters 8-9);

- a system (so far of a transitional type, but quite powerful nevertheless) of institutional investors in the form of voucher investment funds and other structures;
- a social stratum which, with all the reservations about it, and taking into account its heterogeneity and legal weaknesses, we can nonetheless call a stratum of owners.

We can also say that in many respects it is due to the privatisation programme carried out in 1992-1994 that it would be difficult to revert to the old monopoly and administrative and bureaucratic control of Russian enterprises, although it is too early to discard such a possibility completely. And from a broader perspective, we can say that the gigantic changes at this time in the area of property relations paved the way for modification of the power relations in Russian society too.

At the same time, during that initial stage of the sale of property (shares) the question of structural change in Russian enterprises, and the attraction of investment was not, as a rule, raised. At best, large outside investors have acquired a share of capital that does not represent a controlling interest, at least at the first stage of distribution of the shares. Under these circumstances, the prevailing structure of property in Russia, its likely future evolution, the special significance it may have for a potential investor, and the role of transactions on the secondary market, as well as the changes in the ideology of privatisation in the middle of 1994, will be crucial. We shall discuss all this in Chapter 8 and Chapter 9.

Chapter 8.A New Ownership Structure and a Secondary Market in Shares

8.1. Formation and Evolution of the Initial Ownership Structure

In the process of the initial securing of ownership rights to the property being privatised one could clearly distinguish two trends: formation of the capital of Russian corporations closed to outside investors and retention of regional and sectoral monopolies.

The first trend was a result of the use of options 1 and 2 (see Appendix 1). A package of vast privileges for enterprise workers (free shares and shares on beneficial terms, an incorporation fund and a privatisation fund formed from the profits of the enterprise) have made it possible, together with the reduction of prices (practised all around) of the property being privatised, for them to become owners of major national firms with the minimum of costs. That was done through keeping a controlling equity interest in the hands of the work collective and administration, or through shares which belong to the state placed in trust. As a result of closed subscription for shares or the conduct of auctions with limited admission of institutional investors or the broad masses of private investors, an original capital structure was formed which, while falling under the legal status of an open joint stock company, in most cases was more reminiscent of a capital structure of the closed type.

The second trend is the effect of the sectoral and regional monopolies, which under the new conditions set clearly

designated borders for the effective movement of capital through the creation of financial flows which, while remaining closed would at the same time allow redistribution between less and more profitable units within the structure itself, without resort to a stock market. A preference for territorial and financially closed-type enterprises prevents free movement of capital. This trend is seen quite clearly in the attempts to form holding companies and industrial groups incorporating (as a necessary element) a commercial bank, or sometimes an investment company. Given the continuous technological, production and business links, however, an even greater incentive is an aspiration to re-create the old financial systems that would mobilise the local capital and erect a barrier in the way of penetration by 'outside' trading and banking business (see IET, March 1994, pp.164-168).

These trends will affect the viability of Russian corporations differently for they are far from being homogenous (see Shmeleva & Radygin, 1994; Radygin, 1994b). A supplementary brake on further transformation of the capital structure of the new joint stock companies is the policy of the property funds, which were in no hurry to sell the reserved packets of shares which comprised 10-20% in the majority of enterprises.

At the same time, despite the seeming closeness of the capital structure of Russian privatised enterprises, what we see is a rather intensive process of transition of the property rights obtained in the course of the initial placement of shares, a transition in favour of outside investors as well as the managers of enterprises. In other words, the initial placement of shares in the privatised enterprises, with all the restriction on changes in the structure of their capital, is

nevertheless a rather short stage, which will inevitably be followed by a whole series of secondary transactions (the ideal result of which should be the appearance of an 'efficient owner').

Another important conclusion is that the process of concentration of the capital initially dispersed in the course of the voucher privatisation has already started.

The third important conclusion is that within the context of the effective model of privatisation (that was in force from 1992 to the first half of 1994), one of the most promising ways of participation for any serious investor, whether foreign or domestic, in the capital of the Russian enterprises being privatised was through acquisition of a portion of capital on the basis of secondary transactions in the shares of the first issue or in the course of an additional issue.

To carry out a more detailed analysis it is most important, first of all, to consider some typical versions and the evolution of the capital structure of new joint stock companies that appear in the course of the initial placement of shares (see Tables 10-11).

First of all, what we witness here is a process of 'erosion' of the initial block of shares received by the personnel of enterprises through a closed subscription. In practice, at most enterprises the management is quite capable of getting some 15-25% of the stock by employing a mechanism of proportional distribution of shares by closed subscription, rather than a single minimum for all, using an option right and the buy-out of shares from the workforce after the closed subscription is over,

as well as buying vouchers at auctions and using dummy firms.

As interviews with 426 representatives of industrial factories shows (the opinions were polled in January 1994 by the All-Russia Centre for the Study of the Public Opinion), the share of directors in the equity is higher at medium-size and small businesses. Of special interest is the fact that in December 1993, compared with 1992, the economic situation improved at those enterprises where the share of directors in the equity was higher. The same is true of those enterprises where the share of foreign investors is rather high, and where banks and shadow figures play a pronounced role. Where the role of the work collective is higher, however, the trend of the economic situation was rather negative (Table 12).

Another typical situation is where representatives of the engineering groups and of 'working aristocracy' are the holders of quite large blocks of shares (1-2%), while many rank and file workers sell their shares within 2-3 months. A contributing factor to this may be the fact that only one-third of all privatised joint stock companies intended to pay dividends for 1993. In many cases the market price offered by intermediaries may be quite attractive for a worker. For example, in summer 1994 many workers at Mosenergo were selling the shares that they got through a closed subscription at a price of 120-200 rubles per share, a minimum price of 1000 rubles.

Naturally, the shares of most enterprises are not very liquid and sale may be allowed only to an intermediary who is acting in accordance with a specific order (it may be an outside buyer or the management) or with the aim of reselling the packet accumulated at a better price on the market. New problems also

cropped up: almost total discrimination against outside shareholders by the management, unlawful prohibition of employees to sell their shares to 'outsiders' under threat of dismissal, unlawful charter limitations on the upper limit of a holding of shares and many other things (see also Chapter 9).

At voucher auctions big buyers were predominant. The lion's share of the average 20% of stock put up for auction by a medium-size enterprise is usually bought by investment funds, intermediary firms which will resell the stock to an investment holder, and again the management (see Chapter 7). So while originally the ratio of management to outside investment institutions as buyers of shares at voucher auctions was 4:1 (that was the situation in St. Petersburg, for example) ('On trends...', 1993), in the second half of 1993 and first half of 1994 the situation changed in favour of outside investors. At the same time, that did not mean any antagonism between the two groups. Quite the contrary, one can speak of a trend toward a merger, because many voucher funds were created (in an indirect way) by the privatised enterprises themselves. In that case the voucher funds served to accumulate the means for a 'self-buy-out' of enterprises and for purchase (through a power of attorney or other means) of a portion of the capital of related agents and contractors. Another version of voucher fund merger with management is joint control of certain blocks of shares held by the management and the shares acquired by voucher funds.

Many big 'outside' investors who participated in the auctions took into account, first of all, such factors as the size of the block of shares sold, the size of the state share, the availability of preferred non-voting shares, the size of the authorised capital, which all shows that there is a priority

orientation to establishing control. The size of the enterprise's land is also a potential basis for obtaining credits.

In 1994 the major trend in this sphere was a further reduction of small investors at the auctions in favour of the above buyers. While on average small private investors bought about 15% of the shares for auction (with half of them being the shares of the personnel of the enterprise), in 1994 that portion dropped to 5-10%.

The same trend - growing wholesale selling of shares of the enterprises being privatised - was also characteristic of the first floatation of shares on the regional exchanges (eg. the South-Urals Exchange, International Vladivostok Exchange, Perm Commodity Stock Exchange, Ekaterinburg Exchange) which, together with the local property funds, were engaged in regular bidding.

As has been shown above, the investment tender, while an extremely promising method of attraction of large investors, so far has not become a very significant phenomenon. The total nominal value of the shares that went to winners of investment tenders was not more than 10 billion rubles by the middle of 1994. All the same, one can hardly call the winners of the tenders that were conducted small investors.

Thus even the first wave of the initial floatation of the shares of enterprises being privatised in Russia suggests that the equity ownership structure of the emerging joint stock companies has a clear trend not toward the dispersed-type Anglo-American model but rather the continental European model with a clear-cut majority controlling interest, this going, naturally, together

with the specific Russian features and the costs of the transition period. It is quite clear that this trend should intensify after 1 July 1994 as money privatisation proceeds. Estimates of the level of participation in the process of privatisation in that period by citizens of Russia range from 1.5% (the Veteran investment fund) up to 6% (GKI). This conclusion is supported by the results of the investigation of potential investors in the money stage of privatisation carried out by the Association of Marketing in March-April 1994 (see Appendix 2).

At the same time, it seems hardly possible that a capital structure will be formed in the near future which will markedly influence the efficiency of the privatised enterprises. This is because a considerable part of the blocks of shares, though concentrated in the hands of large institutional holders, is still intended for resale at this stage. Because of this many current holders can hardly be interested in long-term investments that go hand in hand with reconstruction and development of enterprises.

Because of the trend toward a majority controlling interest even at the stage of the original sales, any outside investor will have to deal with an institutional holder, whether it is a property fund, the management, some kind of middle man who has bought some shares for the purpose of resale, or a voucher fund. Taking into account the large volume of non-privatised property, the presence of *nomenklatura* 'oases' (i.e. certain profitable, export-led and other enterprises with an informally closed capital structure), and the present infrastructure of the securities market, it must be said that in the long run there will need to be contacts between an investor and a holder of a

block of shares. This in turn will underline the acute nature of the problems of information in the area of investment.

From a broader perspective we can conclude that in Russia all the necessary conditions exist for redistribution of the property initially formed in the course of privatisation on a scale that could be compatible with the scale of large privatisation at the first stage. The noticeably vigorous activity of the secondary equity market in privatised enterprises' shares in 1994, though mainly speculative in its motives, is the most convincing proof for that conclusion.

8.2. The Secondary Market in the Shares of Privatised Enterprises

Usually in countries that have a well established stock exchange the ratio of the volumes of the primary and secondary markets ranges from 80:20 to 95:5 in favour of the secondary market. In Russia the situation is diametrically opposite (see Table 13), though compared with the moment of emergence of the stock market in Russia the role of the secondary market in the total volume of trading in securities is rising. In 1991 the share of the secondary market may be estimated at 5-7%, in 1992 it was 10-12%, while in 1993 it rose to as much as 16-20% (INIOR, 1994).

The secondary market in the shares of privatised enterprises was formed practically at the same time as privatised joint stock companies appeared. The volume of trading outside the stock exchange varies; such trading goes on in the shares of practically every issuer, which is connected, in particular, with the formation of large blocks of shares before the first

meetings of shareholders and re-election of the boards of directors (Mikhailov, 1993).

The trading on the secondary market is confined to an extremely limited number of privatised enterprises. The first such deals occurred in 1992-1993 (the shares of certain Far Eastern and South Urals enterprises, the department store GUM and some other enterprises). As far as the structure of turnover, as reported by the Moscow Central Stock Exchange, is concerned, in 1993 only 10.6% was in securities, and of these the shares of joint stock companies accounted for only 13.6%, while 65.7% consisted of trading in securities of commercial banks and brokerage houses. The low liquidity of the shares of privatised companies is confirmed by analysis of off-market trading at the start of 1994: of the joint stock companies mentioned in the middle of 1993, three were listed on stock exchanges and twenty-one were not listed; the three were Permavia, Voctochny Port and GUM.

In January-September 1994 all the stock exchanges in Russia together were trading in the shares of some 70 enterprises. While at the outset all occasional trading was on the regional stock exchanges and involved the shares of local enterprises, when the auctions of major enterprises and enterprises of the fuel and energy complex were completed, the markets in these shares became more dynamic, especially on the Moscow stock exchanges.

Yet the exchange and off-exchange markets still exist as markets divided into closed regional enclaves which do not have sufficient connections for safe circulation of securities and other related monetary assets. More than 90% of the securities (basically local issues within a region) traded in all

transactions in June 1994 were quoted only on one exchange, and more than 97% on no more than two exchanges. As a result, investors' funds are locked in their own regions and are pumped out to the Moscow financial market through the bank networks, bypassing the securities market (Mirkin, 1994a).

If there is competition, share prices on stock exchanges or other markets may reach several hundred times the nominal value. It goes without saying that the underlying reasons are not the classical economic factors that affect prices, but again a desire (and we should mention here directors first of all) to do the utmost to establish control of an enterprise. This is why, for example, the fact that the market price of the shares of one of the largest enterprises in the fuel and energy complex, Surgutneftgaz, is 12 times the nominal value does not at all mean that the company is less attractive for an investor than the Komsomolets paper and pulp factory, for which the tender price for shares exceeded the nominal value 291 times (MIFR, 1994a) or the Lebedinsky Integrated Mining Works, whose shares were sold at a price exceeding the nominal value 1127 times.

All in all, to judge by the results of the first half of 1994, the volume of stock trading at the 17 leading stock exchanges of Russia exceeded 50 billion rubles, with 75% of the total turnover on 5 Moscow exchanges: the Central Russian Universal Exchange, the Moscow International Exchange, the Russian Exchange and the Russian Commodity and Raw Materials Exchange (stock division). Almost 20% of the total turnover consisted of the shares of privatised industrial and trading enterprises. It should also be noted that privatised industrial and commercial enterprises were the issuers of the largest blocks of shares sold in 1994 on the stock exchanges.

Starting from July 1994 there was a marked shift in the sectoral structure of the stock exchanges with shares of industrial and trading enterprises coming to the forefront. For example, for one week alone in August 1994 the volume of transactions in this segment amounted to 15.5 billion rubles or 63.1% of the exchange turnover (MIFR, 1994b). In absolute terms this sum is 1.5 times higher than the corresponding figure for the entire first half of 1994. This is attributable to a series of factors.

Firstly, more and more new securities of privatised enterprises are being floated on the Russian market, and these securities, irrespective of their quality, outweigh other segments of the market/32/.

Secondly, shares in the largest enterprises of industry and the fuel and energy complex, /33/ which are in strong demand, are now on sale. There is a fierce competition for these blocks of shares and the major participants are large shareholders, the management and foreign investors. In cases the management of these enterprises tried in every way possible to block the appearance of new shareholders, including foreign shareholders.

Thirdly, and this is the most important factor in the dynamic growth of quotations of major enterprises, the first half of 1994 saw the volume of portfolio investment by Western financial institutions in the stock of Russian privatised enterprises reach \$400 million. Estimates are that if the conditions are favourable the second half year may see investment go up by some \$600-800 million (Skatershchikov & Zinkevich, 1994). Actually, with almost no secondary retail market in the shares of the largest enterprises and with heavy demand from foreign

investors, the prices of shares are being determined by a narrow circle of representatives of foreign investors and Russian intermediaries.

As a rule, that strategy of foreign investors is to acquire initially at least 2-10% of the shares in a company, with a subsequent aim of acquiring a controlling interest of 25-30%. The acquisition of 10% of the shares will make it possible to nominate a member of the Board of Directors. Most foreign buyers make use of the services of Western intermediaries, who either act directly or themselves employ Russian institutional intermediaries or brokers.

At the same time, there are no signs that in the near future one can expect any marked growth in the number of enterprises whose shares are the object of secondary trading in the 'classical' sense. First of all, the fixed assets of most of the enterprises are severely depreciated and therefore profits are likely to be used for the purpose of modernisation rather than dividends. The market value of shares is expected to increase due to simple revaluation of the fixed assets (if we abstract from the demand associated with the struggle for control); however, getting revenue from the resale of shares will be limited by the illiquidity of most of the shares (Shvetsov, 1993). At the same time, these factors do not play a significant role in investment decisions.

The control motive still remains a dominant force for most of the trading. The most important motive for foreign investors is the relative cheapness of most of the assets of Russian enterprises. Finally, speculation was an important factor in the rapid growth of quotations of certain shares in summer 1994.

In the short and medium-term perspective one can probably expect the following developments on the secondary market, which, despite the overall demand, may cause a sharp drop in the prices of shares which are of far from first quality:

- financial difficulty or lack of real strategy for the future - something quite characteristic of many enterprises - may cause a direct sale of a portion or the full block of shares that have been accumulated by the management;
- voucher funds may sell a number of blocks of shares they have acquired at voucher auctions to pay their own shareholders and to improve their financial position;
- if the secondary market is overheated, one can expect dumping of a part of the stock accumulated by the intermediaries who were buying in order to resell later;
- it is quite possible that blocks of share will be resold if they are secured in the form of federal property;
- many enterprises may try to improve their situation by resorting to a second issue of shares, which can hardly be placed by means of open subscription, without a specific investor interested in it.

Thus, while a potential investor may have a good chance to acquire a considerable portion of the capital of an enterprise on attractive terms, there may be a situation of crisis for the securities market, which is quite weak by itself. This model of

privatisation has provided no solution to the problem of attracting real investment. The question of the strategy of privatisation since the middle of 1994 and the problem of a favourable environment for the post-privatisation development of Russian enterprises is now extraordinarily important.

Chapter 9. Reform in the `Post-Voucher Epoch`

9.1. Radical Change of Landmarks

As in the case of the two previous privatisation programmes, the adoption of the new programme was preceded by a long and extremely politicised debate in the State Duma, the government, the business community and public circles in Russia. The first Parliamentary hearings in March 1994 on the issue of privatisation began although, the necessity of drawing up a new programme served only as grounds for most of the factions and parties to wage a bitter fight - a fight that was largely irrational and designed for self-advertisement - to criticise the voucher privatisation and its architects. However, it may be regarded as an indisputable achievement that now practically nobody spoke against privatisation as such. And, without the slightest doubt, one should take into account not only ideological motives but the critics' awareness that it would be suicidal for their political career if they opposed privatisation when more than half the enterprises in Russia had already been privatised.

Through most of July 1994 no solution could be found to the question to present a new privatisation programme from the legislative point of view - through a federal law (this is a prerogative of the Parliament) or through Presidential decree. Only on 22 July 1994 was a temporary solution found (until a law is passed by the federal government): the President of the RF signed a decree which set forth the Fundamentals of the State Programme of privatisation of state and municipal enterprises in the Russian Federation after 1 July 1994. Since it does not run counter to the current programme of privatisation, the programme

approved by the President in December 1993 also remains in force.

First of all, the second stage of Russian privatisation, which was begun in July 1994, should be qualitative in nature, in view of the real purpose of the previous stage (see Chapter 7). In its broadest sense this stage should be directed to ensuring effective and legally guaranteed passage of the property rights acquired in the course of the initial distribution to owners who bear real responsibility (see Chubais, 1994).

As far as privatisation as such is concerned, the new programme is a change over from the system of free allocation of property to real sale, from accelerated 'privatisation for the sake of privatisation' as a quantitative reform base - to a rather slow privatisation designed to ensure restructuring and investment. In other words, the new privatisation model should incorporate two key ideas determining the procedure of 'large' privatisation: investment orientation of sales and opportunity for an investor to get a major shareholding in the initial placement of shares. Let us now look at the key innovations of the Fundamentals in greater detail.

- 1) The main items of privatisation at the new stage comprise three types of property: state-owned blocks of shares in privatised enterprises, land of privatised enterprises and property. The value of the latter will equal if not exceed that of the previous stage, this approach was based on evaluation of the effective demand (Appendix 2).

As to the traditional list of restricted branches and lines of production, the norms set out in the second

programme remain in force. This means that a considerable number of specific sectoral features will remain; there are, of course, too many of them. Yet at the same time reduction of these prohibition lists is necessary owing to the dilemma that the state faces today: either it must attract the financial resources to support these enterprises or it must privatise them.

- 2) Transition to a money model of privatisation is expected greatly to enhance the budget receipts of all levels from sale of state-owned blocks of shares, newly privatised enterprises and property. At the same time there is a broad range of estimates of the likely revenue of the federal budget in 1994. While the budget passed by the Parliament on 24 June 1994 (first reading) sets revenue from privatisation at a figure of 1224 billion rubles (and all revenue in excess of this sum is to be directed to a special fund for housing for the military), the GKI estimate is much more modest: about 500-600 billion rubles or, at the utmost, 900 billion rubles. Some absolutely unreal figures were also advanced: one envisaged up to 20 trillion rubles. One should also bear in mind the fact that the revenue from the sales agreed in 1994 will mainly go into the budget in years to come. In addition to everything else, this means that there is a potential social conflict over failure to fulfil commitments by this fund.

- 3) As to the valuation of property in the course of privatisation GKI retains its formal position: the final selling price should be determined on the basis of auctions and tenders (i.e. through open bidding and money

auctions). Yet the initial reserve price has been raised and it is based on one of the revaluations carried out after 1 January 1992. Although in total (after all the revaluations that have been made) the book value of the enterprises has gone up approximately 800-1000 times (Demchenko, 1994), for the privatised enterprises it means that there is an increase in the book value of property of some 10-20 times. Such growth, in the opinion of the GKI management, reflects the existing market conditions that have to be taken into account when selling property at auctions (Vasiliev, 1994a).

This sort of revaluation should also affect the state-owned blocks of shares in enterprises that have already been privatised, which will be offered for investment tenders. Many of these blocks are now very close to controlling blocks of shares and for that reason their real value is not reflected by the nominal value determined according to the old book prices.

- 4) A new scheme of distribution of the privatisation revenue is introduced. While earlier almost all privatisation revenue went into the budgets of different levels, since July 1994 51% of the sale value of the enterprise (shares) is transferred to a special account of the enterprise itself for investment purposes. In practice this means that a potential buyer pays only half of the required price since the other half should be returned to restructure and develop production. Although such an approach does discriminate against the enterprises that have already gone through privatisation at the first stage, nevertheless this is a powerful incentive for a

potential investor to participate in privatisation.

- 5) Originally it was planned that an absolutely new model of the benefits for workers and managers of enterprises would be adopted, with two possible options: receipt of 25% of privileged non-voting shares or purchase at face value of 10% of voting shares with a 30% discount and payment deferred for a year. The grounds for such an approach were the ending of vouchers (as a privilege for the entire population) and a new policy emphasis on the initial formation of large 'external' holders of enterprises' shares.

GKI did not manage to make such a drastic cut in benefits for the workers in a 'pure' form, since, in line with the Fundamentals, the previous model remains in force (see Appendix 1). Yet in a veiled form there is a provision promoting use of the new model of privileges; as Chubais said, indexing the value of property when its value rose many times should mean that only new schemes will be adopted because most work collectives do not have the means to buy out 51% of shares valued using the new prices (Karpenko, 1994).

- 6) In order to attract 'strategic' investors who will improve control and management of an enterprise, and who are interested in its long-term progress, it is planned that rather large blocks of shares, not less than 15-25% of the authorised capital of an enterprise, will be put up for auction and for investment tenders. It is especially important that this is done with regard to the blocks of 10-20% secured as federal property but with practically no

one being in charge. At the same time, on the basis of the infrastructure of the specialised voucher auctions, a system of special money auctions should be set up to sell retail shares to small investors.

The Fundamentals provide for the following methods of privatisation:

- free transfer of shares to the workforce;
- sale of shares to the workforce by means of closed subscription;
- sale of shares by an investment tender;
- sale of shares by a commercial tender;
- sale of shares by auction, including use of the services of the stock exchanges;
- sale of shares at a specialised auction;
- sale of enterprises by auction;
- sale of enterprises by a commercial tender, including a tender with a limited number of participants;
- sale of enterprises by an investment tender;
- buy-out of leased property;
- sale of property (assets) of active, being liquidated and already liquidated enterprises;
- sale of construction projects in progress (special procedures);
- sale of enterprises in default (special procedures).

With certain exceptions (enterprises belonging to the state and municipal agencies, banned from privatisation, with foreign participation, or subject to sale to partnerships with special preferences) all enterprises with a book value of fixed assets over 20 million rubles

on 1 January 1994 are to be changed into public companies. Shares that have not been sold previously (except for federal blocks) that belong to the joint stock companies established earlier are to be offered for sale before 1 January 1995. Sale to an investor of 35% or more of the authorised capital of the issuer, or stock that carries more than 50% of the votes of shareholders must be done in such a way that the anti-monopoly legislation is observed. The norm that regulates the possibility of issuing supplementary shares is more liberal now: to do this it is enough to leave in the hands of the state as much as 25% of the authorised capital (no more now).

Small businesses whose fixed assets have a book value of less than 20 million rubles are subject to privatisation by auction or through a commercial or investment tender.

- 7) As to foreign investors, the very fact of the ending of vouchers is already a powerful incentive for many of them because it introduces the customary means of payment, in money. More simplified procedures for taking decisions in the area of privatisation of some enterprises and holding investment tenders are also a definite advance. At the same time all the previous restraints imposed by the second privatisation programme remain in force.

Despite some optimistic views of the leaders of GKI on the likely inflow of foreign investment into privatisation, some experts associate the question of stability and growth of the volume of foreign investment in privatisation and the Russian economy as a whole with the results of the presidential elections that will be held in

1996 (Fedorova, 1994), and it seems that these ideas are not groundless.

8) For the first time one can see legislative provisions for enterprises which claim resources out of Western technical assistance funds for purposes of reconstruction:

- the share of the state shall not exceed 25%;
- enforcement of all the requirements of the Russian legislation on joint stock companies is required;
- there must be no restrictions on the purchase and sale of the shares in the enterprise;
- there must be an independent registrar who keeps a record of shareholders of the enterprise.

Behind these provisions lies a long ideological battle between departments in the Russian Government connected with the selection of priority objects of help (state-owned or already privatised enterprises). Leaving aside the debate itself, it is important to note that there was such a discussion, and at least one 'ethical' consideration in favour of the approach adopted: a financial contribution to the restructuring of already privatised enterprises may be considered a kind of compensation for participation in voucher privatisation, which is a sure sign of shortage of investment funds.

It goes without saying that it is necessary to look into many new procedures and draw up a number of 'technical' normative acts. Many positive proposals were withdrawn from the initial version in the course of making adjustments. On the whole the Fundamental provisions are a progressive document which gives a

good basis on which to develop the privatisation process at the second stage. At the same time there are a number of key issues which are beyond the Fundamental provisions but which are vital for subsequent privatisation and post-privatisation policy. We shall focus on such problems as the development of the securities market and corporate control.

9.2. Securities Market

As shown in Chapter 8, a major reason for making the secondary market in shares of privatised enterprises more vigorous is the process of redistribution of ownership rights initiated after privatisation, which is associated with the desire to establish or at least enhance the degree of control over the enterprises. At the same time, the key issue to be solved by the securities market is providing effective conditions of the inflow of investment resources to these enterprises and ensuring the enterprises' access to capital. In this sense a fundamental task of state regulation should be creation and provision of guarantees for adequate legal mechanisms.

Even today it is absolutely essential to shift the accent toward development and strengthening of the infrastructure of the securities market, keeping in mind the future operation of the privatised enterprises. Though most of the issued shares of privatised enterprises will not be traded on the secondary securities market, even 10-25% of these shares are capable of forming a liquid market and will make up, in one estimate (Boiko, 1993), a sum of the order of 10-15 trillion rubles in new prices. If there is no developed infrastructure, the possible 'dumping' of the shares already issued, as well as

detering new issuers involved in privatisation, may give rise to some knotty social and economic problems.

The initial elements of the securities market infrastructure were formed by the share divisions of the commodity exchanges, and then the stock exchanges. In the middle of 1994 Russia had about 70 stock exchanges, or about half the total number in the world. Naturally, this artificial boosting of their number makes it predictable that in future the number will be reduced to a 'reasonable' level, that may be determined only by the evolution of the market. Despite their number, compared with the transactions on exchanges in other countries, the figures for the Russian exchanges look more than modest (Table 14). At the same time, they clearly show the point Russia has reached (Mirkin, 1994a).

The end of 1991 saw regularly operating stock auctions through which certain types of shares were placed, including the shares of the enterprises being privatised. At the beginning of 1992, when the necessary technical base was set up, Russia's first electronic trade network, ELBIS, began to operate, just like NASDAQ, with about 80 participating investment institutions in many regions of Russia, the Baltic countries and the CIS. The so-called stock shops became a special feature of the current infrastructure which is characteristic only of Russia and which appeared in the middle of 1993. They provide for 'retail' trade in securities, with a volume per transaction in the 10,000 - 100,000 rubles range.

A distinguishing feature of the emerging securities market in Russia is the high level of institutional investors, investing in securities also issued by institutional investors. That

means that a considerable portion of the investments from the population and from non-financial institutions is re-cycled within the financial sector, which has greatly expanded in the course of the last few years (see Table 15). What we have as a result is a decrease of investment in the sphere of production. And it should be admitted that this stage is inevitable and is closely associated with the formation of the infrastructure for the market distribution of investment (movement of capital).

As to the technical infrastructure (operation of depositories, clearing centres, information networks, etc.) 1994 was the year of formation of that infrastructure. The institutions primarily engaged in this operation are commercial banks and groups of banks, because it requires considerable means, large volumes of transactions and plenty of qualified personnel. By the middle of 1994 clearing houses had not been created. As to the network of depository institutions, it is tending to grow in number because of the appearance of the shares of privatised enterprises and because of the demand for new services (keeping a register of shareholders, depositing, safekeeping and cancellation of vouchers, registration of bargains and validation of property rights and so on). At the same time, many other functions of a depository (depositing, storage and recording of securities, servicing dividend and interest payments, accrual and payout of dividends, pledge of securities, loans in the form of securities and so on) are not yet in demand. As a result, the depositories set up are geared to the execution of one or two functions and when there is a requirement to perform a more complex function the creation of a new depository is necessary (see INIOR, 1994).

So far we cannot speak about a unified stock structure in Russia

that would unite the exchange trading, depository and clearing networks, and information and analytical services. the latter are especially important if we take into account the fact that the publicity provided for securities 'in 99 cases out of 100 is clear disinformation' (Makarevich, 1994). The quite feeble attempts of the government to combat this situation have not yet resulted in any truly reliable analysis of securities (to judge by international standards).

A great number of problems of privatised enterprises are associated with the keeping of registers. It is quite clear that registration of shareholders is necessary. At the same time the process of re-registration of exclusively registered shares (as required by the law) and making operational entries in the register is so complex that many dealers refuse to trade even in the shares of attractive enterprises (Skatershchikov & Malakhova, 1994). In most cases, to purchase the shares of an enterprise one has to travel to the area where the business is located, and this is possible only for rather large buyers. But even when there, the buyer will usually confront the resistance of the management of the enterprise, which will try both to prevent the transaction and may fail to register it.

Usually what the management is afraid of is leakage of information and the possibility of purchase of a controlling interest if the register (as required by the law) is maintained by an independent registrar. As a result, the necessary data are not in fact entered in the register, which undercuts the whole technical infrastructure of the secondary share market, which is an important condition for the operation of that market.

The poor technical market infrastructure, as well as disregard of the investment qualities of the securities (and thus of the functions of the secondary market as an instrument of mobility and concentration of capital as a whole), create a situation when shares remain extremely illiquid. At the same time, many experts estimate that 1994 will be the year that sees the start of mass use of the securities market as a source of investment by many privatised enterprises (Table 16), which intend to make a second issue of shares and prepare for subsequent issues by considerably enlarging their authorised capital. As a poll conducted in Moscow, St. Petersburg, Volgograd, Ekaterinburg and Perm showed, approximately 6-8% of enterprises (or 700-800 potential issuers) plan to make their second issues of shares (Vasiliev, 1994b). Other estimates (Savvateeva, 1994) put the number of such businesses as high as 25-30% of the total number of privatised enterprises.

Hence it is extremely important to provide a reasonable balance between satisfaction of the real needs of enterprises for additional investment and an eventual conversion of the Russian securities market, as Makarevich put it, into a 'big dumping ground'. What is essential is a marked increase in the requirements for the prospectuses of issues, and above all, maximum disclosure of information about the issuer.

In addition, only a really liquid securities market can serve as a guarantor of the rights of shareholders, including the right to 'vote with their feet' and, *vice versa*, deprive a potential buyer of a monopoly position and make market methods of determination of the value of shares a reality. So far the fact that it is impossible to sell one's shares without hindrance on the open market turns small shareholders into hostages of the

management.

Another major problem here is that of the role of state regulation in this sphere, which may be regarded now as negative in most cases. Without touching upon the activities of the state as an issuer, let us dwell upon such aspects of the state's role as its legislative and institutional activities.

The basic legal provisions which serve as the rules regulating the activities of joint stock companies and the securities market proper emerged in 1990-1991. In the judgement of the Chief of the Department of Securities and Financial Markets of the Ministry of Finance of the RF, B. Zlatkis, the quintessence of these documents is as follows: a joint stock company formed as a merger of the capital of shareholders by its guarantees is wholly and fully accountable to all its shareholders. The State does not interfere in the affairs of joint stock companies, while companies are not responsible for the affairs of the State (Zlatkis, 1994). By 1994 certain rules of taxation, licensing and anti-monopoly regulation, as well as rules on transactions, existed. In 1992-1994 quite a number of documents were issued, associated with the circulation of securities of joint stock companies that appeared as a result of the privatisation effort.

Naturally, in addition to a rapid ageing of many legal provisions, they also incorporate quite a few contradictions and dual interpretations (which can be associated with the lack of fundamental laws on joint stock companies and securities, and other 'blank spots' - i.e. trust operations, pledge of securities, loans of securities, new types of institutional investors, bearer shares, paperless issue of securities, self-governing associations of participants in the securities

market). The tax system in this sphere is quite controversial and complex and also serves as a brake on development of the ranks of small investors. By some estimates the existing legal basis is already retarding the development of the securities market and actually lessening the volume of investment in securities. That was quite possibly true for the 1992-1993 period, but not for the conditions that may appear in 1994-1995.

If we look into the institutional picture, the situation there is even more complex, for right now we have no specific state-run body wholly responsible for the regulation of the securities market. The Ministry of Finance, GKI, the Central Bank, the Russian Federal Property Fund, the Anti-Monopoly Committee and other agencies are all involved. We also have a Commission on securities and stock exchanges operating under the President of the RF but it lacks 'interdepartmental' co-ordination of powers. This situation of diversity in matters of regulation of securities leads (in practice) to the following negative phenomena from the point of view of development of a stable market:

- struggle between the agencies for their spheres of influence on the securities market, which was especially noticeable in summer-autumn 1994 when a new draft law on securities was being prepared;
- the contradictory nature of norm-setting documents produced by different organs of state power;
- refusal of the State to supervise the activities of non-state participants in the securities market and see that the latter observe the rules set. All this leads to

disregard for the stipulations of the law and greatly magnifies the risk for investors, especially small investors.

It is this latter trend that led to a whole chain of financial scandals in summer-autumn 1994 (associated with MMM and other such companies). They prompted a new round of debates on the role of the state in this area. It goes without saying that it is in the interest of investors to have this control, but, in our view, this is not the main danger: it is the enhancement - under the pretext of such control - of administrative and bureaucratic methods of regulation of the securities market, which is in the interest of the departments concerned. So, taking these facts into account, what should be the measures of state regulation in this area?

In terms of legislation, 1994 did see the introduction - at least at the level of the legal system - of independent registration of shareholders in privatised enterprises and some norms of regulation of depository agencies (for privatised joint stock companies). What is now vitally necessary is the institutional registration of such elements of the securities market as:

- settlement and clearing activities, execution of operations in the collection, comparison and adjustment and preparation of the paper documents to conduct transactions with securities in order to effect mutual settlements and to identify the means that should be used to transfer assets from one account to another (in order to reduce the costs of security operations);

- development of a depository network to carry out activities associated with the safekeeping of investors' securities, execute his orders and organise the supply of securities;
- a rigid and detailed system of 'openness of information' on the securities of the issuer, to limit risks and protect investors' interests;
- a Federal Commission on Securities and Stock Exchanges, invested with all the necessary rights, that sets forth the basic rules and standards for market participants;
- gradual selection of stock exchanges through an increase in demand for capital, number of securities listed, volume of turnover and so on, with corresponding facilitation of floating shares;
- support for institutional investors (mediators) on the securities market, with a simultaneous increase in demands for capital adequacy, the quality of assets and liquidity of non-bank investment institutions;
- adjustment and elaboration of a system of taxation incentives;
- introduction and support of self-governing associations of participants in the securities market as a necessary condition of forming organised markets.

As we noted above, a key function of the securities market is the accumulation of investors' funds and provision of access to

capital for enterprises in order to finance investments. Today, at least as applied to the problems of privatisation, this function is not yet being performed, for now the market is used (and to a considerable extent) to serve the process of redistribution of property after privatisation. Today it is a market of large blocks of shares and institutional sales geared to acquisition of a substantial share in the capital and control. However, this is only the first stage of securities market development, for in the long term it cannot operate without being geared to the means of many investors (including the population) and splitting the securities in order to build up investments. Most probably, the second stage of development of the market - if the primary structure continues to be eroded and if simultaneously ownership of the privatised enterprises continues to be concentrated - will see trends toward concentration of the market as the basis of a mass and liquid market.

So far, however, this is only a proposal for consideration. We cannot speak of any established or fixed model for the Russian securities market. What we see in Russia now is a kind of intermediary model, a mixture of the European model of a universal commercial bank which has a large portfolio of holdings in non-financial enterprises, and the American model in which securities operations are conducted primarily through non-bank financial institutions /34/.

A final selection will occur as the outcome of a fierce struggle between bankers and non-bank investment institutions such as voucher investment funds, insurance and pension companies and so on (for greater detail see Mirkin, 1994b and 1994c). It is difficult to say how the structure of enterprise financing will

affect the future situation. That structure has a direct influence on the securities market model (predominance of share capital and commercial paper, with a low portion of direct bank loans, as in the USA, or a German-Japanese model with a noticeable influence of banks on the securities market). It looks as though what Russia will have eventually is a sort of mixed model, with both banks and other active investment facilities. This would reflect a general world trend to reduce the share of banks in financial assets and is in line with the situation now prevailing on almost half the securities markets in the industrialised nations.

9.3. Corporate Control

As in the case of the securities market, one cannot yet speak about an established model of corporate management and control in Russia /35/. It seems clear that two key factors will be decisive:

- the proportions of the private, mixed and state-run sectors of the economy (GKI estimates that in the industrial sector at the turn of 1994-1995 some 70% of enterprises will be primarily private, with a small share owned by the state, 20% will be scheduled for privatisation and some 10% will be turned into 'budget' type enterprises;
- the final establishment and operation of the securities market model.

While the first factor is important for the development of a

system of management of the state enterprises and state-owned blocks of shares in privatised enterprises, the second is decisive in determining the role of small shareholders in matters of management and the exercise of their rights.

The Anglo-American model of corporate management gives primary significance to the liquidity principle, since shareholders' control over the managers is based on the purchase/sale of rather dispersed shares in the corporation. In this case the controlling block is rather small, financial information is disclosed, while the transactions as such are under strict regulation. In the German model, on the contrary, and to some extent the Japanese model, liquidity of the shares is of smaller importance, for from the point of view of control the role of banks is of key significance (often acting as a creditor and shareholder or intermediary trustee) at the same time. In this case access to information for small shareholders is much more limited.

In view of the mixed nature of the Russian securities market, it is difficult to state definitely which model is more likely to emerge ultimately. It is clear, for example, that it makes no sense to speak about an Anglo-American model, owing to the almost total illiquidity of the shares of Russian enterprises and their almost permanent concentration in the hands of large shareholders. At the same time, although the trend is in the direction of large shareholders, it is not yet clear how the contest between banks and non-bank financial institutions will be resolved. Most probably even in the long run Russian practice will not fit neatly into either of the classic patterns. Nevertheless, now that there are millions of formal shareholders, it is essential to establish a comprehensive

system of protection of the rights of shareholders.

In this sense it is effective corporate management that must provide protection for small and outside investors, as well as ensure real access to information for shareholders and regulate the ethics of behaviour of managers with regard to shareholders and corporations, and, when necessary, limit the rights of company personnel.

Regulation of the activities of joint stock companies in Russia started even before the wave of broad privatisation of state property (see MTsIER, December 1993, for details). The initial decrees which specifically touched upon the problems of management and control in Russian joint stock companies were adopted on 25 December 1990: the Law of the RSFSR 'On enterprises and Entrepreneurial Activity' and the 'Regulations on Joint Stock Companies' approved by the decree of the Council of Ministers of the RSFSR, No. 601 (see also Chapter 2). The decree of the President of the RF, No. 721 of 1 July 1992 established a procedure for incorporation and a typical charter of a joint stock company (see Chapter 7). Various drafts of a full-fledged law on joint stock companies appeared in Russia as early as 1991, though even by autumn 1994 none of them had been approved (see Mostovoi, 1994).

To a large degree both these documents only modify the existing management structure, introducing some separate formal elements into it, elements that are characteristic of joint stock companies. This primarily concerns the unclear nature of the powers of the management bodies of joint stock companies. Many important management aspects remain outside the scope of regulation so far and some items are not even on the agenda.

As stated in decrees no. 601 and no. 721, there are three organs of management of a joint stock company: the meeting of shareholders, the Board of Directors and the Management. In addition each company (joint stock company) must have an Audit Commission. Neither decree provides for a clear distinction between the powers (and, therefore, the division of power) between the various management bodies and there are few regulations on the nature of their activities. The main shortcomings of the existing management in running a company are in the combination and interlinking of the functions of the Board of Directors and the Board (both personal and functional) and, as a result, the practical absence of any regularly operating control body of owners (shareholders/stockholders). The meeting of shareholders is described as the supreme management body of the company but in essence this is a rather formal proclamation.

Another problem is the fact that under the existing legal norms the former General Director of the state enterprise becomes an unlimited ruler in a joint stock company too, for he is the head of the Board of Directors and the Management. being in control of these two bodies, as well as having a major shareholding, and retaining his influence over the workforce (who also have a considerable number of shares), the General Director can enhance his position as effective owner of the corporation (firm) while bearing only minimum responsibility for the running of the business.

Formally a meeting of shareholders has rather wide powers, including powers to control not only the use of assets (capital) but also to take other major decisions. Naturally, much depends

on the shareholders themselves. (For example, 10% of the general meetings of shareholders that were held in 1993-1994 resulted in a change in the company's leadership.) However, under the current system and with shareholders' lack of knowledge how to act, this is rather difficult to do.

When large blocks of shares fall into the hands of outside investors, who, however, for one reason or another, cannot ensure control in the Board of Directors and who cannot appoint their own general Director, there may be a sharp confrontation of interests and one group may attempt to block the decisions of the other.

Nevertheless it is important to retain the current system under which the executive management bodies can be removed by the owner (shareholders). The Board of Directors cannot exercise real control over the Management, for the two bodies overlap and both operate under the leadership of the General Director. Actually they are two units of the general management of the corporation and the people working for a corporation often wonder what the reason is for having two bodies which duplicate each other's efforts. In practice it is the managers of the line units and the main deputies of the Director that form the Board of Directors (those deputies may be in charge of production or in charge of commercial matters), while the leaders of the functional units form the Management. It is unlikely that such a formal division of personnel is capable of enhancing the efficiency of management of the company.

Naturally, this may be the cause of numerous violations. let us give some examples of the most typical violations of the rights of shareholders as they occur in newly created joint stock

companies:

- the presence of clauses in the charters of privatised joint stock companies which discriminate against different groups (participation quotas in the authorised capital, prohibition on the Board of Directors changing the composition of the Management of the company and so on);
- the practice on the part of many managers of joint stock companies of prohibiting the sale of shares by their owners to 'outside persons';
- deliberate delay in notifying shareholders of meetings;
- setting a fee for participation by a shareholder in a meeting;
- voting on the basis of a show of hands instead of observing the principle of one share one vote;
- issue of 'special' shares (which are different from those stipulated in the law) and which give 'special' dividends;
- creating 'puppet' Boards of Directors made up of a Director, Chief Accountant and some other managers of the company;
- purchase of the company's shares, using its own funds, at reduced prices from shareholders who do not know their real market value;
- selling the property of the company at reduced prices

through 'dummies' without the knowledge of the shareholders;

- issue and placement of new shares, also without the knowledge of the ordinary shareholders, in the hands of 'dummies' at a reduced price;
- refusal to register the purchase/sale of shares in the company or charging high commissions for registration;
- manipulation of the votes of shareholders in order to obtain complete control over the votes (shares/stocks).

A separate problem is that of state participation in running (supervision) of newly created joint stock companies.

The continuing strong influence exerted by state structures on the business activity of newly established joint stock companies (via retaining state control over a controlling block or a substantial number of shares, through 'golden shares', through various forms of concerns, associations and holding companies) is inevitable in a transitional period. However, this cannot be regarded as an efficient measure of state industrial policy. That is why such forms of control should go on only for a limited period (as a rule, no more than 3 years) and they should not be prolonged through structures with new names but similar in essence. Even more important is to prevent any direct or indirect intervention on the part of ministries and departments in the process of decision making by joint stock companies, except in the form of voting a package of shares held by the state.

The decree of the President of the RF, No. 1392, of 16 November 1992, 'On Measures to be Taken to Implement Industrial Policy When Privatising State Enterprises' and the second privatisation programme (December 1993) specified the enterprises (by kind of activity) in which there were to be state-owned controlling blocks of shares or a 'golden share' for a period of up to three years, as well as providing for possibilities of creating holding companies.

In principle the development of the latter is quite possible and can play a certain 'corrective' role but now it is fraught with the risk of establishing an additional (and not only financial but also administrative) control over companies, which can hardly be conducive to their rational integration into the system of market relations (see Chapter 6).

On the whole, creation of the legal framework for the corporation to function within is a much more effective strategy and is more important than direct institutional control. The creation of holding companies, whatever the restrictions imposed on them, inevitably tends toward monopolisation and cartelisation and reduces competition. It is quite clear that the so-called benefits of 'agreeing on investment policies' cannot compensate for the real negative effect on the formation of a competitive business environment, which should enjoy priority in the strategy of economic transformation. Yet up to the present it is not clear how extensive state influence in the sphere of business is to be. What is happening in the government is a continuation of the struggle between the adherents of the stricter and more liberal tendencies in the evaluation of the role of the state at the macroeconomic level.

The transition period in the Russian economy provides for the existence of some business elements and the inevitable compromises with the old forms and their representatives. This makes it still more necessary that the compromises that lead to the continued existence of old structures (though in a transformed way) or to previous leaders' retention of positions of power be supplemented with clear and detailed legislation, that the terms of reference be clearly identified and that effective and multilateral control (supervision) be established. In this sphere the main task of the state (as well as in other spheres) would be not ensuring itself the possibility to interfere in business but rather setting the rules and terms of economic activities and maintaining strict control over those rules. However, one should try to avoid an eclectic combination of elements of various systems of regulation of corporate activities. Charging the Board of Directors with the functions that are characteristic of American legislation, and at the same time endowing the Management of the company with powers in the spirit of German joint stock companies can only lead to a situation where both structures will be incapable of carrying out their functions.

The main idea that lies at the roots of construction of the system of management and control in a joint stock company is that the various interrelated but potentially competing interests in the company must be taken into account. These are the interests of the owners (shareholders), employees, managers, suppliers and consumers of products, local authorities and society as such.

Conclusion

With all the shortcomings of the Russian privatisation model, its first stage of implementation is completed.

Naturally, the emergence of a considerable number of private enterprises and millions of new owners in Russia in 1992-1994 does not mean that there are no administrative and bureaucratic control issues still on the economic agenda, nor that new incentives have already been created to ensure the effective growth of production. However, while that might not have happened at the first stage, the main thing that has happened is that a new system of property rights has emerged on a national scale. That system lacks proportion, it is not at all protected, it is just being formed, but it is a system which is ultimately capable of implementing some key final goals of the privatisation reform - such as providing economic efficiency and creating a base for a genuine democratic society.

In our view it is wrong to judge the results by formal quantitative criteria. The positive qualitative result is different: what we can see is the start of the transfer of property rights; only after the actual capital market and system of property rights are formed can one speak about tangible positive results of the Russian privatisation model. It is essential to take the whole package of problems into account, both the economic problems we have discussed and those that relate to the social and political and the legal sphere.

To begin with, there is the problem of stability of the legislation in force, which is closely connected with possible destabilisation by political, regional, *nomenklatura* and other

factors.

Secondly, there is the problem of the balance of interests in the process of the reformation of property relations. One can hardly disagree that the current model of Russian privatisation generates multiple problems and controversies that are attributable to objective reasons and direct miscalculations by the government. However, let us not forget that this model was formed as the outcome of a multiple conflict and compromise negotiation process, the result of which is a balance of economic interests of all the participants, which is embodied in the present legislation. So only further strengthening of this balance can lead to stability and irreversibility of the economic reforms. The choice is really simple: either we pursue a stable and consistent privatisation policy to speed up the economic transformation or we follow a long and agonising process of 'quasi-privatisation' accompanied by social and political conflicts, strong reinforcement of state control and bureaucratic structures and actual roll-back of the radical reforms in the economy and society.

In this sense, the core of policy in this sphere should be rejection of discrimination for or against any of the participants in the privatisation process and, first of all, there should be no restriction of the interests of the private sector in the shape of slowing privatisation, strengthening the state sector to the detriment of the private and privatised sectors, or any attempt to return various mechanisms of the privatised enterprises to state control in the framework of spontaneous *nomenklatura* privatisation.

Thirdly, the absence of any interconnection between the reforms

of property relations and other directions of economic transformation is quite a serious problem. At the same time, the development of privatisation shows that it is essential to co-ordinate privatisation programmes with the process of formation of industrial (structural) policy and the financial system, which may be interpreted as a kind of institutional device that transforms savings into investment and selects directions for their subsequent use in the production sector of the economy via the mediation of financial markets and institutions (see Shmeleva & Radygin, 1993).

Fourthly, there is the problem of reasonable adjustment of the current normative base, taking into account the above facts as well as the quickest possible elimination of the 'blank spots' in the general legal environment in which Russian private, privatised and state enterprises operate. It is especially important to go ahead in such areas as the securities market, mortgages and hypothecation laws, regulation of trust operations, company law, land law and the property market. From a long-term perspective it is vital to have a civilised criminal and civil law as a whole, and to develop detailed and effective contract law in particular. Reforms in these areas - creation of the legal environment not for short-term accelerated privatisation but long-term operation of the privatised enterprises - has just been started.

This book leaves uncovered some issues which are not unimportant: the formation of property markets in connection with privatisation (including land), the problem of insolvency (bankruptcy) and some other such matters. The general distinguishing feature of these problems is the issue of many declarations of intent but a lack of practical action. There

are a great number of provisions (normative acts), including some of a progressive nature (eg. the 1994 Fundamental Provisions lay down the right of a new owner to unconditional buy-out of leased property, the right of the privatised enterprises to buy their land). There is a whole battery of documents on the issue of bankruptcy, including a law on that subject. We have deliberately left these issues aside, trying to keep our focus on the realities rather than the documentary provisions. Yet in the next year or two it is these very questions, together with the problems of the securities market, that will be crucial and will at the same time indicate the extent of the further progress of economic reforms in Russia.

It is this basis, as well as general improvement of the country's finances and vigorous anti-inflation measures and development of the system of private savings that will make it possible to attract really significant investment resources and effectively restructure enterprises. In other words, any state financial 'pumping' of resources for this purpose, as well as Western assistance programmes in this field, will be largely meaningless until a mechanism of fair control over the operations of corporations and mobilisation of resources on the private capital market is established, and civilised business law as a whole is firmly in place. In this sense the role of the state should be strictly limited through the creation of an appropriate legal environment on the basis of which it may be possible to effect indirect (soft) state regulation and strict state legal control.

FOOTNOTES

1. For convenience I shall use only the term 'Russia' although it may refer to a period prior to the collapse of the USSR. I shall use the term 'USSR' only for official documents or departments of the USSR proper.
2. As to my own approach, I shall try to avoid any politicised evaluations or recommendations. I would like to note that - and it is quite important methodologically - to me privatisation should be viewed in a narrow sense as a process of sale (transfer) fully or partially of the property (assets) of state-owned enterprises to the private sector (physical persons and non-state legal entities). This definition is quite characteristic of the ideology which is built into the Russian model. In a broad sense the term 'privatisation' means, of course, a process of modification of the management model of the state enterprise without alienation of the property rights on the basis of a team contract, lease, contract, full or partial change of the legal and financial status of a state enterprise. The latter is more characteristic for the privatisation technique of Western countries and is not taken seriously as a method of privatisation by Russian ideologists.
3. The vast literature on the topic which is already available means we do not need to analyse in detail the questions of the necessity of privatisation or the general goals of privatisation as an element of the systemic transformation in the transition economy, nor the problems of techniques and methods of privatisation in general. I

would like to mention in this connection only some papers: Aslund (1994), Aslund & Layard (eds) (1993), Blanchard, Dornbusch, Krugman, Layard & Summers (1991), Dhanji & Milanovic (1990), Frydman, Rapaczynski & Earl (1993), Kikeri, Nellis & Shirley (1992), Kornai (1990), Lewandowski & Szomburg (1989), Lipton & Sachs (1990), Vuylsteke (1988).

4. It is a paradox but in this context a process of spontaneous privatisation becomes an inalienable prerequisite with regard to effective execution of the official privatisation programmes which, as a rule, are launched only when a spontaneous process picks up speed.
5. For details see Malle (1994), Aslund (1994), Boiko & Shleifer (1993), Boiko, Shleifer & Vishny (1994), Dabrowski et al. (1993), McFaul & Bernstein (1993), Radygin (1992).
6. In particular, see Bohm & Simoneti (eds) (1993, 1994), Earl, Frydman, Rapaczynski et al. (1993), Im, Jalali & Saghir (1993), McFaul & Bernstein (1993), OECD (1993), Sachs (1992), Scott & Kroll (1993). I am grateful to Georgy Malginov for the preparation of useful material for this analysis.
7. In particular, see CEC (1991), IMF et al (1991).
8. See 'Main Directions...' (1990), 'Transition toward the market' (1990), Programme... (1991a-c), Decree... (1990), Ryzhkov (1989), Ryzhkov (1990), 'Accord for a Chance' (1991), IV Congress... (1990).

9. It is curious that later on some economists of the Soviet school (especially those close to pro-communist circles) became vicious critics of free distribution and many of those oriented to the West started that kind of distribution in practice or backed such a policy.
10. It is important to note that because the selected criterion is connected first of all with the techniques of privatisation, adherence to one or other type of approach does not always directly show the social and political aspirations of the authors (especially if we take into account the fact that most economists admit the possibility of combining various forms of privatisation). Yet a more thorough analysis of the differences in the interpretation of the essence and prospects of the methods suggested allows us to arrive at more accurate judgements on the entire spectrum of opinions before the first law on privatisation was adopted in Russia. When writing this paragraph I relied on the work of Elena Zhuravskaya, who has done a lot in the area of classification of the approaches that existed at that time. It should also be noted in this connection that this analysis reflects the author's personal approach toward privatisation only as far as the period considered is concerned.
11. See Popova (1991a-b), Tarasov (1991), et al.
12. See Bunich (1990), Glaziev (1991), Zaichenko (1991).
13. See Glaziev (1991), Grigoriev (1990a-b), 'Transition toward a market' (1990), Selyunin (1990).

14. See Assekritov (1991), Melikyan (1990), Popova (1991a-b).
15. See Bunich (1990), Filippov (1991), Piyasheva (1990), Rutgaizer & Shpilko (1990).
16. See Alekseev (1990), Grigoriev (1990a-b), Grigoriev & Yasin (1991), Popova (1991a-b).
17. See Isaev et al. (1992), Piyasheva et al. (1992), Selyunin (1992).
18. The following ideas were used as key ideas for this conception: (1) buyout of a portion of stock secured against the fixed assets and working capital, due to the monetary assets and a part of the shares with a security in the form of a plot of land of the enterprise, through the use of privatisation vouchers; (2) 90% of the common shares on a stage-by-stage basis (for 3-5 years) to be bought out by a work collective, actually through the use of resources of the enterprise itself.
19. For detailed estimate see IMF et al. (1991, Vol. 1-2).
20. See Chapter 2, as well as IMF et al., (1991, Vol. 2), Johnson & Kroll (1991), Radygin (1991), Radygin (1992).
21. In this chapter and in further references to the normative acts on privatisation in Russia see 'Privatisation of state and municipal enterprises...' (1993-1994), official publications in *Rossiiskaya Gazeta* as well as CEC, EBRD, GKI (1993).

22. After the dissolution of the Supreme Soviet in 1993 the Russian Federal Property Fund was put under the command of the executive branch (government) of Russia.
23. A detailed analysis of these reasons was carried out by E. Gaidar in his lectures at the conference on 'Privatisation: the next stage', organised by the Heritage Foundation (USA) in Moscow in January 1994, and at the workshop on the problems of Russian privatisation and business organised by the Centre for Research into Communist Economies (Great Britain) in London in April 1994.
24. In the course of debates before the programme was adopted the Communist factions imposed the 'second option of benefits' (51% of shares for the enterprise personnel) but in return they abandoned a demand to create only closed joint stock companies. In a broader perspective it was the forced agreement of GKI to this version that allowed the entire privatisation model to be switched.
25. Norilsk may serve as a good example; the social infrastructure depends wholly on the activities of the Norilsk Mining Integrated Works. Moreover, the payments from the Russian Joint Stock Company Norilsk Nickel, of which the Integrated Works forms part, make up one-third of the entire revenue of the budget of the Krasnoyarsk region of Russia.
26. Here and in other sections of the book, to analyse quantitative results of privatisation, I use statistical

data up to 1 July 1994 inclusive, for this date marked the official completion of the first stage of Russia's privatisation.

27. It should be stressed that such a calculation is not quite correct for here we contrast the number of privatised enterprises with the number of state enterprises on the same date. In our view, it would have been better policy to determine this indicator as the ratio of the number of privatised enterprises to the sum of privatised enterprises and state enterprises with an independent balance sheet on the same date. In this case we get 41% privatised enterprises by 1 July 1994 (see Table 9).
28. Here we speak only about the means that were used in the course of initial sales, i.e. without taking into account the volume of investment programmes in accordance with the conditions of investment tenders, secondary transactions and intermediaries.
29. Originally, in December 1991 it was suggested that the idea of vouchers be 'frozen' (in spite of the fact that there was a law on it) for an indefinite period of time. But by spring 1992, due to the factors considered, a strategic decision was taken to expedite the realisation of that model.
30. One more 'original' move was made by one of the largest Russian manufacturers of cars, Avto-VAZ. Its management decided to 'whip up' the prices of its cars (and this way drastically reduced the demand for the cars) to reduce the interest of 'outside' investors in the shares of the

enterprise when they were offered at a voucher auction (for greater detail see Ulyanov, 1994).

31. The expiry of the period of validity of privatisation vouchers was accompanied by a whole series of documents.

On 20 April 1994 a GKI instruction came out to the effect that from 1 May 1994 voucher auctions should accept only the applications of the first type for otherwise voucher owners were deprived of the opportunity of buying if the prices at the auctions were below the demand from applications of the second type.

On 6 May 1994 a decree of the government was signed with the title 'On Measures to Complete Voucher Privatisation and to Provide Guarantees for the Citizens of the RF in the Use of Privatisation Vouchers'. This decree set forth a list of rigid organisational measures to ensure a series of voucher auctions. The last vouchers, according to this document, had to be used before 1 October 1994.

Taking into account the fact that by 30 June 1994 as many as 144 million vouchers had been collected, out of 148 million issued (with the rate of voucher collection of the order of 1 million per week during the last week), it was recognised that it was necessary to postpone somewhat the date of final voucher liquidation. Originally, in accordance with the decree of the President of the RF on 28 June 1994 'On Measures to Protect the Interests of Citizens at the Stage of Transition from Voucher to Money Privatisation', the personnel of the enterprises whose plans of privatisation had been approved by 1 July 1994,

were allowed to use vouchers for a closed subscription for shares within the July period. Another decree of the President, of 20 July 1994, 'On Extra Measures to be Taken to Protect the Interests of Citizens at the Stage of Transition from Voucher Privatisation to the Money Privatisation', allowed local authorities (within September-November 1994) to accept the remaining vouchers at face value (i.e. actually as a money equivalent) as a means to pay for objects of privatisation which will be sold this time for cash. By 1 September it was envisaged that audits should be performed in the territorial agencies of GKI and the regional property funds (first of all to prevent second presentation of vouchers already accepted for liquidation).

32. At the same time this causes the supply of shares in privatised enterprises to run ahead of demand. For example, in May 1994 alone the supply of shares in privatised enterprises on the secondary market was 6 times higher than in April (data from 12 exchanges and 40 large dealers), while the volume of real bargains made went up only 1.5 times. Dealers who quote these shares maintain a vast spread - for the shares some 20 enterprises quoted by 15 Russian dealers the average spread turned out to be (in April-May 1994) about 150%. The spread on bank shares is 3-10% (Skatershikov & Malakhova, 1994).
33. EES Russia, Kominneft, Yuganskneftgas, Surgutneftegas, Lukoil, Rostelekom, Norilsk Nickel and some 20-30 other enterprises.
34. It is important to note that the model of securities

market selected will determine the future role of various interested agencies. That is why, when drawing up a draft of the corresponding law, the departmental lobbying is very powerful - not always reflecting the realities - interested state organs.

35. In this book by management and control we mean only those activities connected with the operations of corporations which are characterised by property relations between the subjects of property or by relations between these subjects and other interested groups (employees, clients, suppliers, state organs). This kind of activity requires strict legal regulation. We do not consider here the questions of management and control from the point of view of the organisation of the firm, i.e. the structures of functional and linear management, schemes of administrative subordination, functional determination of powers and other structural factors of the organisation, since these problems are solved by each company independently, taking into account its own purposes and strategy and do not require legislative regulation. I am grateful to Vladimir Gutnik for the material on Russian company law which was most useful for the analysis in this chapter.

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APPENDICES

Appendix 1

Privileges for the workforce and administration of enterprises being incorporated in accordance with the first privatisation programme.

Option 1: On a free basis all the members of the work collective in one particular period of time are given: registered preference (non-voting) shares which shall comprise 25% of the authorised capital but in total should not exceed 20 minimum monthly wages for one worker;

common shares up to 10% of the authorised capital but in total not more than 6 minimum monthly wages for one worker, with a discount of 30% from the nominal value and with deferment of payment for up to 3 years;

on the basis of the contracts concluded the authorised officials of the administration are given a right (option) to acquire common stock (shares) with a face value up to 5% of the authorised capital but not more than 2000 minimum monthly wages for one worker.

Option 2: All the members of the work collective are given a right to acquire common (voting) shares which shall constitute up to 51% of the authorised capital.

Option 3: If a group of workers makes itself responsible for the execution of a privatisation plan, for a guarantee against bankruptcy, and if it gets permission from the general meeting of the work collective, then the members of that group are given a right (option) to acquire (after 1 year) 20% of the authorised capital in the form of common stock (shares) at face value. All the employees of an enterprise can buy common stock that shall constitute 20% of the authorised capital but that sum shall not exceed 20 minimum monthly wages for one worker, with a discount of 30% from the face value and deferment of payment for up to 3 years.

Appendix 2

Some results of research on potential investors in the money stage of privatisation conducted by the Association of Marketing in March-April 1994 at the request of GKI.

The subjects of the poll were 4500 citizens of Russia, 2700 functionaries of state agencies, 165 managers of state-run enterprises, 343 top executives of JVs, 94 managers and executives of voucher funds, 86 directors of large banks, 1000 leaders of commercial structures, 1000 directors of small privatised enterprises, and 104 representatives of foreign companies in 26 regions of Russia.

Though the focus was on investment demand in the second half of 1994, the tendencies revealed, in our view, will be characteristic of the medium term as well (see Braverman, 1994). The aggregate potential investment demand for state property comprised (as reported in this study) 4887 billion rubles, including:

- 3993 billion rubles for newly sold property;
- 127 billion rubles for land taken by joint stock companies;
- 66 billion rubles for unsold packets of shares of joint stock companies (as many as 30.9% showed a desire to buy out these packets);
- 701 billion rubles to buy out currently occupied and additional non-residential premises leased by small businesses.

The most active segments of potential buyers are foreign

companies (34% of the aggregate demand), the population (24.8%) and commercial banks (22.6%). At the same time only 23% of foreign companies are ready to provide investment for privatisation, 6.4% among the citizens of Russia and 53.5% among large commercial banks.

As far as foreign investors are concerned, their reluctance to participate in Russian privatisation can be accounted for by the lack of guarantees of investment protection and lack of stability in the current political situation (50% of respondent indicated these facts). As to the commercial banks that did not wish to participate in the privatisation, they intend to invest their capital to back up their own development and to carry out operations on the financial market. About 79% of the citizens of Russia lack free monetary assets to participate in the privatisation, while 14.6% intend to invest their money in alternative channels of investment eg. they are going to deposit their money in banks, to put it in investment funds, trust companies, state securities, land, housing currency and other related projects. It is vital to note in this case that the monetary means of the population comprise 98.5% of all potential investors for channels of investment other than privatisation or, to express it in figures, 13,500 billion rubles.

Practically all the foreign companies and commercial banks demanded the opportunity to buy a large packet of shares (from 25% to 25%), viewing this as an obligatory condition for participation in privatisation. By their estimates, workforce collective and administration can claim as much as 10-30% and 7-10% of the shares respectively.

As to the methods of privatisation, the most preferable method

for foreign investors is purchases of shares in the markets (two-thirds of the packet), while one-third of the packet may be acquired at the investment tender. As to the commercial banks, their preference is for half of all shares to be acquired at an investment tender.

The most lucrative items for investors are enterprises of the fuel and energy complex (35.2% of the aggregate demand), followed by the chemical and food industries (15.4% and 12.9%).

