TITLE: Implementing Privatization in an Unraveling Economy in Russia and the Russian Far East

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IMPLEMENTING PRIVATIZATION IN AN UNRAVELING ECONOMY IN RUSSIA AND THE RUSSIAN FAR EAST

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Introduction

The economic situation in Russia has deteriorated seriously during the second half of 1992. The government faces pressure from the industrial lobby and the parliament to slow the pace of reform and to bail out failing firms in the military-industrial complex, but the resulting inflationary pressure threatens hyperinflation and a collapse of market exchange. Trade between Russia and the republics of the former Soviet Union has fallen back to barter. Domestically, the Russian government is expanding the sphere of allocation according to "state contracts."

Still, in the face of short-run crisis, privatization of small firms in consumer sectors is proceeding rapidly. The transformation of much of large-scale state industry into joint stock companies, the distribution of 10,000-ruble privatization vouchers to all citizens, and the sale of state assets to citizens are all underway as well. Starting on the first of December, citizens will be able to spend their vouchers on shares of state firms, including their own firms, exchange vouchers for shares of new investment funds, or sell vouchers for cash.

In the foreign market, the government has responded to a deteriorating trade balance by licensing the export of most important raw materials and by restricting the list of organizations that may engage legally in foreign trade, but it has also guaranteed the legal right of domestic firms and individuals to hold foreign assets. Although today the net flow of foreign investment out of Russia to the West undoubtedly exceeds inflow, a rapid expansion of commercial contacts between Western and Russian business groups is laying the institutional foundations for a surge of trade and investment once the political and economic uncertainties abate.

A Polish quip says that privatization is the sale of assets with no known value in firms nobody owns to people with no money. In Russia, the Western observer can only hope that privatization will prove a policy with no alternative.

Fall, 1992: The Russian Economy

The decline in economic activity in Russia accelerated alarmingly in the second half of 1992. After a drop in national income of 11 percent during 1991 according to Soviet official figures and 15 percent according to Western re-calculations, the pace of economic activity continued to fall in 1992. Plan Econ's Russian Monthly Economic Monitor reported in October, 1992 that economic activity during the third quarter of 1992 was 30 percent below the already-depressed 1991 level.

Industry and construction led the decline due, in part, to a fall in gross investment to half of previous levels. There were decreases in most other sectors as well--in livestock

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1 I am indebted to Alexander Karp for research assistance in preparing this paper.
and dairying, in the production of consumer goods, and in demand for transport services. In August, 1992, oil output was running 12 percent below the reduced levels of 1991 with the year-end total production expected to be less than 400 million tons. One bright spot in an otherwise dim picture was a modest recovery in grain output and an increase in grain imports, financed largely with Western credits. So Russia appears to have adequate food for the coming winter. However, once more this winter there will be serious regional shortages of gasoline for transport and fuel for power and heat, notably in the Russian Far East.

If the declines in economic activity had been concentrated in sectors of the former military-industrial complex, then average real per capita income of the population might have declined less drastically than industrial output. Unfortunately, such is not the case. The January 1992 price liberalization in Russia generated a drop of one-third or more in real incomes, with the real value of retail trade and consumption falling correspondingly. Then, as the Russian central bank accommodated the explosion of inter-firm credit in mid-1992, inflation accelerated again in retail markets too. Today, the hyperinflation has spread from the credit-based producer markets to the cash-based consumer. In recent currency auctions, the value of the ruble has fallen to 490 rubles to the dollar.

Foreign trade continued to fall as well. In the third quarter, exports outside the CIS were down 34 percent and imports 21 percent below 1991 rates. Meanwhile, in inter-regional trade, each of the former republics attempted to pay for its imports from the other regions with new ruble credits, contributing to a credit explosion. Without a stable unit of account for inter-regional exchange, the payments systems of the 15 states of the former Soviet Union virtually collapsed. In place of markets, there has been an extension of state allocation to more than 150 important products—a development that promises a further decrease in inter-republican trade to the low levels that can be maintained by bilateral balancing and barter.

The lack of a ruble mechanism for exchange creates incentives for President Yeltsin to use oil as a weapon in Russia's bargaining with its neighbors. Although Russia currently lacks the capacity to refine all its own crude oil, it is undertaking expanded oil-for-gas swaps with Western Europe rather than ship oil to Estonia and the Ukraine for processing.

Meanwhile, political and ethnic conflicts in the Trans-Dniepr, the Georgian Caucasus, Tadzhikistan, Armenia, Azerbaizhan, and elsewhere create incentives for Russian involvement, as do Estonia's restrictive policies towards its Russian minority. So there are many potential developments that could impede the willingness of Russia and the Western governments to work together to build the institutions of a market economy in the former Soviet Union.

A Retreat from Reform

The deteriorating economic picture has already generated a partial retreat from reform with further administrative measures in prospect. Still, the government continues to press ahead with privatization in the face of opposition from the Russian parliament and from the Union of Industrialists and Entrepreneurs, headed by Arkady Volsky. It appears that 1993 will mark a period of at least partial retreat from reform as Russia and the CIS attempt to cope with the consequences of hyperinflation. But the changes accomplished in 1992 are sufficient to tip the scales toward economic reform again once the economic collapse is stabilized.
Yegor Gaidar achieved some promising macro-economic changes in the early months of 1992 when he freed most consumer prices, introduced partial convertibility of the ruble on current account, reduced government subsidies, and introduced new taxes. However, Gaidar's initial success in reducing the size of the government deficit and slowing the growth of money supply to the consumer economy was offset by an unprecedented expansion of inter-firm credit to the traditional priority industries. In mid-July, when Viktor Geraschenko took over as acting chairman of the Russian Central Bank, he issued almost a trillion rubles of new credits to bail out state enterprises, generating accelerating inflation.

The announcement by President Yeltsin in January, 1992 of an ambitious program to privatize industry was followed by an outpouring of new enabling legislation and presidential decrees. (This legislation was described in *Recent Changes in the Environment for Investment in Russia and the Asian Newly Independent States*.) Since then, implementation of privatization has moved forward in spite of competition between agencies established under the executive and legislative branches of government and in spite of overlapping jurisdictional claims between central and regional authorities.

Today, the executive branch of the government remains weak, unable to implement measures negotiated with the International Monetary Fund or to enforce President Yeltsin's policy decrees. Initially, the domestic position of reformist ministers was bolstered by the expectation that economic reform would open the tap to an inflow of hard currency credits from the G7 countries and from multilateral organizations. However, most of the promised funds have yet to appear pending progress in economic stabilization, privatization, and a settlement of Russian and CIS foreign debt.

Economic policy-making in the coming months is likely to be marked by the continuing gradual replacement of reformist policy makers by a new group representing the interests of Russia's large state enterprises. Yeltsin's appointment of Minister of Fuels and Energy Viktor Chernomyrdin and Vice Premier Vladimir Shumeiko already marks a stalling of reform initiatives. Further changes will precede the opening of the Congress of People's Deputies on the first of December.

**Economic Policies of the Industrialists**

The economic policies articulated by Arkady Volsky, head of the Industrial Union, are summarized in a recent article in the Russian newspaper *Market Transactions* (Birzhevye sdelki). In this interview, Volsky describes his vision of a dual, or two-level economy. In the first sector of a dual economy, whose boundaries are not precisely delineated but which appears to include traditional heavy industries, he would re-establish a system of "government regulation" much like old-style central planning. In the second sector--apparently the consumer sectors--he would allow mixed forms of ownership including privately-owned firms. Foreign investment is mentioned only in the context of the second sector, but elsewhere Volsky has indicated that foreign investment would be welcomed so long as active control over Russian industry and resources remained in Russian hands.

4 *Birzhevye sdelki*, No. 20 (October 1992), 6-7.
Privatization of state enterprises would be based on the formation of joint-stock companies owned, in part, by managers and workers, with a controlling stake held by the state. Financial control of the economy would be achieved, in part, through price controls, with certain sectors of the economy such as energy, transport, and basic foodstuffs receiving direct subsidies from the government budget. We see these views already influencing the corporatization of state industries and the center's economic policies toward industry and foreign trade in the fall of 1992.

Russia faces enormous problems—problems that are likely to worsen—with a government that is too weak to implement difficult policies and a parliament representing traditional ministerial interests. There are risks of a slide into hyperinflation, of a disastrous decline in production, of a crisis of governance, of a loss of will to reform. But the Russian people have shown remarkable resilience so far.

Western observers, like economist Stanley Fisher of MIT, raise urgent calls for a greater level of engagement on the part of the Western industrial nations in assisting the new states of the former Soviet Union, but specific proposals beyond humanitarian aid, technical assistance, and the IMF's traditional agenda of stabilization are few, in part because Russia's economy is so large and its economic institutions so disrupted that it is hard to forecast the outcome of even well-conceived and coordinated Western initiatives. As a new administration in Washington D.C. defines its policy agenda, there is at least a consensus that the Western economies, like the Russians, have much at stake in how Russia's manages its multiple crises.

Implementing Privatization

So far, privatization continues to move ahead in spite of economic disruption. Under the original privatization legislation, the executive branch created the State Committee for Property Management (Goskomimushchestvo), headed by Anatoly Chubais. Implementation of privatization was first entrusted to this agency, which established and staffed branches at republic, territorial (oblast'), and municipal levels of government. The State Property Committee received assistance in initiating small-scale privatization from the World Bank affiliate, the International Finance Corporation, and from a consortium of Western advisers including Deloitte-Touche Tomatsu, J. Henry Schroder, Wagg and Company, White and Case.

Then, the Russian parliament passed further legislation, dividing the responsibilities for privatization between the State Committee for Property Management and a legislative agency, called the Russian Fund for Federal Property, headed by F. Tabeev. When the basic legislation on commercialization came out in July, 1992, the Russian State Property Committee, Goskomimushchestvo, was given the primary responsibility to draw up lists of firms subject to commercialization and to review the privatization documents submitted by these firms. However, once enterprises are re-constituted as joint stock companies, the lead role in further privatization shifts to the Russian Fund of Federal Property.

The initial privatization legislation focused on the rapid privatization of small-scale, consumer-oriented sectors, particularly of firms under territorial and municipal control. But the program of commercialization of large scale firms into joint stock companies initiated during the second half of 1992 is accelerating institutional change in assets under federal control as well.

In 1992, the local branches of the State Property Committee and the State Property Fund are to implement the privatization of small-scale firms in consumer sectors, focusing particularly on firms under the jurisdiction of municipal governments. Regional, and
municipal branches of the State Property Committee received compulsory assignments for 1992 privatization, specified according to shares of firms to be privatized and revenue targets. Although sales are running behind schedule, a steady flow of small consumer services firms are being offered for sale on local markets. These small firms are sold at auction, on the basis of a competitive tender that specifies a variety of non-price conditions of sale, or by establishment of an open joint stock company.

Each region and municipality publishes implementing legislation based on the national privatization legislation. The territorial or municipal State Property Committee identifies properties offered for sale. Then, a territorial or municipal Property Fund under the local legislature has the authority to implement the privatization.

During the first half of the year, large firms with over 10,000 workers, firms producing for the military, firms in extractive, energy, and mineral processing industries, large construction and building materials enterprises, railroads, airlines, and sea transport could not be privatized. However, with the compulsory corporatization of large firms as joint stock companies this fall, much of large-scale industry is currently undergoing a formal change of management as well.

Local Privatization in the Russian Far East

Privatization has proceeded more rapidly in the Russian Far East than in most other regions. At the beginning of 1991, the shares of output already produced by privatized firms in the Russian Far East were: in Sakhalin, 6.7 percent of output; in Khabarovsk, 9.8 percent; in Primorsk, 3.6 percent; in Yakutia-Sakha, 3.1 percent; in Amur, 20 percent; and in Magadan, 18.9 percent.5

During 1992, 210 firms with an appraised value of 566 million rubles are to be sold in Khabarovsk territory, including 23 retail and 12 wholesale firms, 10 firms in light industry, 13 in food processing, 36 in construction and building materials, and 5 in forest products. The firms represent a small share of Khabarovsk total assets, worth 20 billion rubles at 1991 prices. The majority are tiny, having only three or four employees, but a few, such as Far East Construction Company and Komsomolsk Metallurgical Construction, are substantial units with several thousand employees. As of January, 1991, all but 16 of these firms slated for privatization were profitable.6

In Amur territory, the privatization effort is larger. In April, 1992, the Small Council (Maly Soviet) of the Amur parliament published a territorial Program for Privatization of Territorial Enterprises.7 The program provides for sale of 60 percent of restaurants and automotive service establishments, 50 percent of food retailing, wholesaling, and building materials, and 20 percent of food processing and agricultural services. There follow specific lists of firms selected for privatization by sector together with an equally long list of firms that were initially reserved from privatization. Similar implementing legislation has been published in each territory.

The territorial branches of the State Property Committee and Property Fund regularly publish a Bulletin of Information on Privatization in each territory describing

5 Priamurskie vedomosti, 1 August 1992.
assets presently on offer. A typical offer of a small scale property from the Khabarovsk Fund of State Property includes:

1) Type of privatization (whether auction for a price or competitive tender);
2) Initial price and required collateral;
3) Form and schedule of payments;
4) A detailed description of the property;
5) Necessary conditions for purchase including requirements for future investment and production and employment guarantees.

A typical example is a small retail store offered at a starting price of 25,000 rubles. It must be purchased by a one-time payment if purchased by a non-employee or with 30% down and the balance in a year’s time if purchased by a group representing at least one-third of the employees. Prospective bidders receive information on buildings, equipment, inventories, debts, and employees, and they must present a security deposit of 10 percent of the initial price in order to bid. There is a detailed individual valuation of equipment and structure. Sometimes a parcel of land is associated with the sale, but it is usually not valued, since ownership of land is not included in purchase of the firm.

Usually a lengthy set of conditions is associated with the sale. These may include a requirement that the unit not change its line of business as well as restrictions on daily hours worked and amount of sales of major commodities. The unit may be required to employ former workers at the same wages for some period of time. Sometimes the “necessary conditions” spell out necessary repairs or equipment purchases. Prospective bidders write to the Municipal Property Fund indicating acceptance of these conditions and offering a specific price and other considerations.

There are frequent press reports of progress in small-scale privatization. Far from all of the firms put on offer receive purchase bids. In Chita, for example, potential purchasers of stores were dissuaded by the requirement to employ existing employees in the former line of work.8 Many municipal units have a heavy burden of debt and the burden of taxes from all levels of government is considerable.

Privatization of Housing

Privatization of housing is also gaining speed under the direction of the local legislatures. In Sakhalin and Vladivostok, municipal and industrial stocks of housing are to be given to their occupants with only a symbolic fee for processing of applications. With privatization, the Sakhalin Municipal Housing authority adopted a monthly municipal utility charge of 8 rubles per square meter for services on top of existing charges for water and electricity.9

In Khabarovsk, too, municipal housing is being distributed to its occupants, although no change was announced for housing controlled by firms producing for the military or by the railroads. At the end of 1991, 542 apartments in Khabarovsk had been privatized and another 4500 applications were pending.10 In July, the Khabarovsk city administration issued a decree allowing construction of private apartments and spelling out the procedures for registering as legal owner of a new apartment.

8 Sibirskaya Gazeta, No 6, 1992.
There are also market sales of housing. For example, recent sale prices of apartments were:
- one-room apartment, 500,000 rubles;
- two-room apartment, 750,000 rubles;
- three-room apartment, 850,000 rubles.\(^\text{11}\)

It is still not possible to buy land outright, but rights to long-term use of land are being auctioned off by the Municipal Land Commissions. The first auction of land in Vladivostok in June resulted in these sales:
- a centrally-located waterfront parcel (900 square meters) bought by Dalkombank for 16.5 million rubles;
- a well-located commercial parcel (2800 square meters) bought by Daleko for 16.5 million rubles;
- a large commercial parcel near the central market (7000 square meters) bought by Galina Co. Ltd. for 42 million rubles.\(^\text{12}\)

The privatization of assets in large firms is being handled at the center by the Russian Fund for Federal Property, but there have been some local and municipal sales of unfinished enterprises, plants, and structures. The Moscow city government was supposed to put 166 such unfinished project up for auction during the summer of 1992.\(^\text{13}\)

Until recently, the ruble-dollar exchange rate used for purchase of capital assets was far less favorable than the commercial and auction rates. (In the draft legislation on concessions, the implied rate was 5 rubles to the dollar.) But since July 1, 1992, foreign investors have the right to purchase Russian assets at the same prices as domestic buyers, although there are provisions requiring government approval of foreign purchases of significant shares in large firms.\(^\text{14}\)

**The Voucher Program**

Mass privatization is proceeding through the distribution of "privatization checks", or vouchers under the management of the State Property Committee.\(^\text{15}\) Distribution of vouchers with a face value of 10,000 rubles each per person began on October 1 and is expected to take three months. Vouchers may be applied to privatization purchases beginning December, 1992 and continuing through December, 1993. Once citizens receive vouchers, they will be able to bid for shares in firms, including their own, exchange their vouchers for shares in investment funds, or sell their vouchers for rubles. This round of distribution of privatization checks is to be followed by subsequent rounds in 1993 and 1994.

The Russian voucher program is the largest yet attempted in Eastern Europe. During the fall of 1992, every adult and child in Russia will be able to claim a 10,000 privatization check simply by presenting an internal passport at one of 40,000 local savings banks around the country and paying a nominal 25-ruble registration fee. Along with the

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\(^{11}\) In 1992, one- and two room apartments were renting for 4-5,000 rubles, three room apartments for 8-10,000 rubles.

\(^{12}\) *Vladivostok*, 13 June.

\(^{13}\) *Vostochnyi express*, No. 20, May 1992.


\(^{15}\) This program is established by the resolution "On the Procedures for the Application of the System of Privatization Vouchers in Russia," published on July 15, 1992, re-printed by *Commercsant*, July 21, 1992.
voucher, the citizen receives a booklet explaining the complex and changing details of the program.

The total value of vouchers made available for distribution in 1992 was determined by calculating the book value of industrial assets slated for privatization. Thirty-five percent of this value was reserved for free distribution via vouchers, with the balance to be sold for rubles. The value of a voucher equals roughly twice the monthly wage of an industrial worker, although this value is falling rapidly in an inflationary environment. The voucher certificates are securities, stamped, water-marked and registered with serial numbers. They may be bought and sold freely, but once used in an auction, they will be cancelled.

Initially, their use was to be restricted to purchase of shares of large state firms that are currently restructuring themselves as joint stock companies or to exchange for shares in investment funds that would hold shares of large state firms, but, when the initial price of vouchers fell to 7,000-8,000 rubles a week after initial issue began, the government announced that it would be possible to use vouchers in purchases of municipal firms and housing as well.16

Under the current procedures for privatization, some of the shares of state firms will be available for purchase with vouchers only and some will be available for cash only. Currently, voucher-only and cash-only auctions are to be held separately to shelter the value of vouchers in an inflationary environment. Employees of privatizing firms will be able to pay for some, but not all, of their purchases of shares of their own firms with vouchers. (These arrangements are described below.)

For the Russian government, the voucher program provides neither revenue for the state budget nor new investment capital. (Indeed, if vouchers are used to purchase a share of the property under territorial and municipal control, then that form of purchase will reduce the extra-budget revenues that local authorities expected to put toward local infrastructure.) Still, it is intended to answer accusations that the public's patrimony would be sold out to speculators and the nomenklatura and to generate support for private ownership.

Citizens receiving vouchers may sell them for cash, exchange them for shares in investment funds, or spend them for shares of firms, including shares of their own firms. It is still too early to guess what share of citizens will choose to sell rather than to hold claims on assets. A recent public opinion poll cited in Moscow News sheds some light on possible popular participation in privatization: 17

1. I think privatization should go
   faster 49%
   slower 7%

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16 Trud, October 6, 1992.
17 This study was carried out during Fall, 1992 by the Institute of Sociology of the Academy of Sciences together with Virginia Commonwealth University, directed by Lynn Nelson. More than 5,000 were polled in Moscow and other large cities. "Moscow News" 1992, # 40, 1992. p. 11.
2. (Employees only) want to use their vouchers in order to
   - buy shares of their enterprise with their vouchers 44%
   - buy shares of other enterprises with their vouchers 10%
   - sell their vouchers 5%
   - undecided 36%

3. Support participation in privatization by foreigners
   - do not support 47%

4. Private individuals should own factories, their production facilities and and plots of land
   - they stand on 63%
   - should not 18%

5. The land should be
   - owned by individuals 33%
   - owned by individuals and the state 51%
   - owned by the state and collective farms 12%

Specialized Investment Funds

Existing commodity and stock markets are already trading vouchers and numerous private investment funds are already in operation. New regulations just published indicate that only those investment funds registered as Specialized Investment Funds for Accumulation of Citizens' Privatization Checks and conforming to just-published and forthcoming Russian regulations would be allowed to hold stocks purchased with vouchers.18

The Russian government has begun to put in place a regulatory framework that would allow specialized investment funds to hold shares of industrial firms on behalf of individual stockholders or on their own account, although these regulations are still being spelled out. Under legislation published on October 7, 1992, specialized investment funds would be allowed to hold no more than 10 percent of their assets in the stock of a single firm and allowed to hold no more than 10 percent of any single firm's assets. It would be illegal for them to hold bonds or mortgages and illegal for them to borrow against their holdings. Under the new regulations, commercial banks and insurance companies are forbidden to function as specialized investment funds.

Foreign investors will be free to buy vouchers and to use them in auctions or in purchase of shares. As in the rest of Eastern Europe, it is likely that Western investment funds will participate in the voucher market as well as in the direct ruble market for equity. Western investors may also organize specialized investment funds to hold Russian equity under the enabling legislation just published.

Commercialization of Large Scale Firms

In fact, commercialization of state firms has already been underway for the past three years. In the Russian Far East, as elsewhere, a de facto spontaneous privatization took place after 1989 accompanying the "de-statization" of state industry that preceded the current campaign of official privatization. During that period (and still continuing),

18 A presidential decree published October 7, 1992 provides a regulatory framework for organizing a stock market in the stocks of newly privatized firms. There follow several pages detailing the registration and regulation of approved investment funds. See Commersant, No 37 (12-19 October 1992), 16-28.
government and industry elites transferred former state assets and properties to new quasi-private commercial entities, frequently formed as closed joint stock companies. However, this early "apparamaya privatizatsiia" is sometimes subject to challenge.

A recent account of such a spontaneous privatization is contained in a trip report from Kamchatka by Peter Christiansen, written for the Institute of Current World Affairs. Christiansen details the "degovernmentalization" of Petropavlovsk's second largest fishing enterprise, UPF KMPO, which employs almost 3,000 workers. At issue is a new joint-stock company, Akros, formed by UPF KMPO executive director, V. B. Vorobyev. According to Christiansen, when Vorobyev and his partners formed Akros, they took 71 percent of UPF KMPO assets with them, including a hard-currency bank account and three state-of-the-art, Norwegian-built factory trawlers.

In a second case, a large Khabarovsk plant, Emalzavod, which produced enamel, was privatized in 1990. In December 1990, the former chairman of the territory executive council, V. Litvonov, transferred ownership to the management and workers. The personnel established an Association of Khabarovsk Territory Employees of the enterprises of the former USSR Ministry of Local Industry and took over the assets of the former USSR organization. The Khabarovsk Executive Council claimed the right to transfer title as government officials. However, in June, 1992, a special committee of the Khabarovsk Territorial Administration ruled to invalidate the December 1990 decision granting Emalzavod the status of a labor-managed enterprise. 19

The commercialization of large state firms currently underway should have a firmer legal status. The initial legislation on joint stock companies was approved by the Soviet government in "On Joint Stock Companies and Limited Liability Companies and Regulation of Securities" approved by the USSR Council of Ministers on 19 June 1990. The Presidential Decree "On Commercialization of State Enterprises with Simultaneous Transformation into Public Joint Stock Companies" published on July 1, 1992 established a set of procedures to convert state firms into commercial organizations by November 1, 1992. 20

First, managers of the firm were to submit to the State Property Committee a privatization plan, a valuation of the assets of the enterprise, and joint stock company charter. Then, all of this information would be forwarded to the federal or local branch of the Russian Fund of Federal Property. Commercialization is supposed to be compulsory for all large state firms, implying that the State Property Committee could intervene to commercialize any firm not complying with the program.

When a firm's management and employees commercialize their organization, they have the choice of three alternative arrangements. Under the first option, the employees of the firm receive, without charge, 25 percent of the firm's value in the form of non-voting, preferred shares of stock. They also have the right to purchase 10 percent of equity as common stock with voting rights. They may purchase this common stock at a 30 percent discount from nominal value, paying 15 percent down and the balance over a three-year period. The firm's management may purchase 5 percent as common stock with voting rights. Up to 100 percent of worker and management shares may be purchased with vouchers. The balance of the firm's stock, 60 percent, is held by the Russian Fund of Federal Property for eventual re-sale.


20 Published in Ekonomika i zhizn', No. 29 (July 1992) and translated in Commerzent, July 7, 1992.
A second variant allows the employees to purchase up to 51 percent of the firm's value as common stock with voting rights, but if they do so, they must pay the full price at once, and only 50 percent of the payments can be made in vouchers.

A third option is reserved for firms with under 200 employees and a capital value of less than 50 million rubles. In this case, the employees may buy 20 percent of equity (after a one-year lease) at a 30 percent discount of book value. In addition, they may hold voting rights over another 20 percent of the firm's stock, which is in the hands of the Federal Property Fund. They must agree to operate the firm in accordance with the privatization plan and to not liquidate its assets, but they may make up to 100 percent of their payment in vouchers.

The rights extended to a firm's workers in each of these plans are also available to pensioned and other former workers as well as to the employees of certain supplying and buying firms in a single technological chain.

By November 1, 1992 all state firms covered by the program were to have prepared privatization plans. Next, privatization commissions in each firm are to organize closed subscriptions for employees to allocate shares. Once a closed subscription for employees is held, then a voucher-only auction will be held at each company for the remaining part of the equity that can be purchased with vouchers. Finally, after the closed subscription and voucher-only subscriptions are completed, then the remaining equity is to be sold at a cash-only auction.

**Joint Stock Companies and the Russian Fund for Federal Property**

The Russian Fund for Federal Property (RFFP) began the sale of stocks under its control in July, reserving a substantial share of the stocks under its control for purchase with vouchers and offering the balance for cash. In an October issue of *Commerant*, Deputy Head of the Property Fund, Vitaliy Kliuchnikov, provides a list of shares currently on offer from the Property Fund.21 Over half of the value of properties on the list is accounted for by shares of the automotive factory, Kamaz, in Naberezhnye Chelny. The RFFP holds 35.7 percent of Kamaz' shares. In the remaining 49 firms on the list, the RFFP hold anywhere from 4 to 100 percent of total shares, with the mean holding averaging 50 percent. Stocks from four firms in the Russian Far East are included in the sale. They are: Barguzin, Chita, 51 percent; Sikhali, Vladivostok, 51 percent; Dal'tekhgas, Khabarovsk, 33.5 percent; and Dal'energomash, Khabarovsk, 56.9 percent. (The last of these is a large, medium-technology company.)

The Russian Property Fund is supposed to implement commercialization in a manner that discourages the formation of monopolies and vertically-integrated conglomerates.22 However, the pressures from state industrial managers to retain traditional administrative links have grown stronger as the process has moved forward. The press reports that, as of November, 15 to 20 percent of state firms covered by the law have been exempted from commercialization.

In the federal government there are many signs of a re-centralization of industrial links. In August, President Yeltsin disbanded the Ministry of Trade and Material Resources (the former Ministry of Supply and Procurement), turning over its assets to two

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joint stock companies. One-hundred percent of the shares of these two companies are owned by the Federal Property Fund. Deputy prime ministers Shumeiko and Shokin, representing the industrial lobby, endorsed a resolution converting the former Ministry of Agricultural Chemistry (Agrokhim) into a holding company. First Vice-Chairman Ivanenko permitted the military-oriented Ministry of General Machine Building to absorb another military supplier, the Ministry of Medium Machine Building.

In September, a presidential decree postponed commercialization in the federal energy complex. In a special meeting on the electric power sector on Sept. 17, the government announced that electric power would be commercialized as a single unit. No individual firms in the sector would be permitted to leave the sector without approval of industry management. Workers and employees in the sector were to receive 49 percent of the shares of a joint stock company, 11 percent of shares were to be offered for sale, and the balance would be retained by the Russian Property Fund. Soon afterward, the Ministry of Nuclear Power suspended commercialization of separate, medium-sized instrumentation factories, offering instead to commercialize Atommash, the unprofitable producer of VVER nuclear reactors.

The Role of Western Investors

The original legislation on privatization published in June, 1992 restricted unregulated foreign investment to consumer-related sectors, unprofitable firms, and firms decreasing production because of shortages of imported parts, raw materials, or equipment. Under that legislation, a special decision of the Russian government was required for foreign participation in firms with more than 10,000 employees, all firms classified as monopolists by the Russian Anti-Monopoly Committee, firms in insurance and security markets. Foreign investment in high-technology firms, former military suppliers, and firms in the energy sectors required licenses from the Russian Committee on Foreign Investments. Foreign investors also needed formal approval from the Committee on Foreign Investments when an investment cost more than $10 million dollars or when it gave a foreign investor more than 50% of the voting power in firms.

Most of these restrictions appear to be relaxed under subsequent legislation. According to recent amendments of the Law on Privatization, foreign participation in ownership of privatized firms is allowed but must be fully disclosed in privatization documents. Anatoly Chubais, head of the State Property Committee, reports that the Russian government is already earning 10 billion rubles every two months from equity sales to foreign investors.23

In the case of small-scale privatization of firms under control of territorial and municipal governments, local regulations may apply, but, at least in the Russian Far East, there appear few barriers to Western participation beyond the requirement that foreign investors open ruble bank accounts.24 In the Maritime region, the Small Soviet of the regional Council of People's Deputies voted formally to allow foreign investors to participate in small-scale privatization.

The formation of joint stock companies and the widespread sale of equity is likely to result in a dispersion of ownership of large firms. To the extent that domestic and foreign investors purchase minority shares of stock in companies, the current privatization

23 Moscow News, No. 31 (October 1992), 11.
program creates a large population of passive investors who have relatively little control over the management of the firm's assets.

However, the kind of foreign participation that Russia needs is active investment that can bring to bear management skills, state-of-the-art technology, and familiarity with Western markets as well as direct foreign investment. This kind of infusion of Western technology will require a large-scale involvement of Western management. It is likely to involve outright purchase of Russian assets or enterprises or establishment of totally new firms.

So far, the cumulative total of direct foreign investment in Russia is small, less than $2 billion in the whole former Soviet Union. There remain many barriers to a large-scale inflow of investment—the lack of settlement of Russia's foreign debt, frequent changes in business and investment laws, and the current economic and political uncertainties. Russia's long run economic health will depend on how successfully her leadership addresses the environment for investment, since foreign investment is the key means of obtaining access to capital, technology, and management skill in the world economy.