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TITLE: **AN ASSESSMENT OF THE RUSSIAN VOUCHER PRIVATIZATION PROGRAM**

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ABSTRACT

In spite of achieving impressive results when measured by the number of enterprises privatized, the Russian voucher privatization program has failed to realize fundamental objectives that could facilitate economic development. Undesirable features of voucher privatization have made other privatization methods more attractive to the personnel of most enterprises. Voucher privatization does little to effect needed enterprise restructuring, and it has not achieved even modest equity goals. The political agenda which has dominated the privatization program created difficulties that predictably undermined political legitimacy among the Yeltsin reformers. A significant failing of the program has been to divest the state of property without first having developed measures to promote the survival of newly-privatized enterprises in an alien economic environment.

The principal policy implication of this analysis for the U.S. government is that Western policy-makers who study Russian privatization should quickly move beyond a simplistic emphasis on the pace of privatization, to the neglect of both political and organizational factors that could create a stable foundation for market relations among newly privatized enterprises.

EXECUTIVE SUMMARY

Introduction

"People's privatization" was to be the principal focus of Russia's privatization program during 1993, and voucher privatization was the centerpiece of that initiative. By year's end, about 11,000 of Russia's larger privatizing firms had been converted into joint stock companies. The form of ownership had been changed in enterprises which employed more than 30 percent of Russian industrial workers, and shares of about 7,000 of these enterprises had been sold at voucher auctions. About 110 million vouchers had been invested by that time in either enterprises or investment funds. Two-thirds of the Russian population had used their privatization vouchers by the end of 1993.

These widely-circulated figures mask, however, less positive qualitative features of voucher privatization in Russia. In reality, it was clear by the end of 1993 that inadequacies of voucher privatization were contributing to the worsening of Russia's economy and to significant political unrest. In this paper we discuss aspects of the voucher privatization program that are implicated in these unwanted outcomes.

As part of our ongoing study of Russian economic and political reform, we collected data in 1993 from directors and other management personnel in 599 enterprises. Our research was carried out in Moscow, Ekaterinburg, Voronezh and Smolensk and included interviews with executives of all privatized and privatizing[1] production enterprises in Voronezh and Smolensk that agreed to interviews (the overall response rate for directors was 84 percent), most in Ekaterinburg[2], and about half of the Moscow total[3].

A Hard Sell among Enterprise Directors

Of the 390 production enterprises in the study that had undertaken privatization by June 1993, 164 had already distributed shares among either enterprise personnel or shareholders outside the enterprise or to a combination of these two categories of owners. Personnel in these 164 firms owned at least 50 percent of the total number of shares in 95 percent of the enterprises (n=156). In 85 of those enterprises, personnel owned 100 percent of the shares (54 percent of enterprises where personnel were majority shareholders). In only 33 enterprises (20 percent) had any shares been distributed through voucher auctions, but in only five cases did the percentage of voucher-auctioned shares that were held outside the enterprise match or exceed the number of shares held by workers.

Throughout Russia, among those enterprises that had been transformed into joint stock companies by the end of 1993, more than three-fourths had chosen the variant of privatization which allowed workers to own 51 percent of a company's shares from the start, with an opportunity to buy additional shares[4]--thus effectively precluding the possibility of "people's privatization" in those enterprises. Although this outcome was not in keeping with the government's plan, it was entirely consistent with the overall perspectives of the directors we

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[1]There are several different definitions of the terms "privatized" and "privatizing," but that issue is not germane to this study.

[2]We were unable to secure the lists we needed from the property management committee in Ekaterinburg to be certain of the total number of privatized(ing) production enterprises there.

[3]From late June until early August 1993, we interviewed more than 5,000 respondents in the four cities. The subsample of enterprise executives we refer to in this paper includes 390 directors, vice-directors and privatization specialists in enterprises that had begun or completed privatization by June 1993. (We interviewed 229 directors, 106 vice-directors and 55 privatization specialists in these enterprises.) The 84 percent response rate for the directors' subsample included 209 executives of either nonproduction enterprises or enterprises that had not yet started privatization, in addition to the 390 studied in this report.

[4]"O sotsial'no-ekonomicheskom polozhenii Rossii v 1993 godu (po materialam Goskomstata Rossii)," Ekonomika i zhizn', no. 6 (February 1994), 8.

interviewed, 42 percent of whom favored turning ownership over to the personnel in an enterprise. Only 6.5 percent preferred voucher privatization to other alternatives.

The Unsatisfied Need for Restructuring

A second inadequacy of the voucher program is that this approach does not clearly promote fundamental restructuring within enterprises. Most management teams have remained intact after privatization. Most workers have kept their old jobs. At most plants, long-overdue modernization has not begun. Most privatized production enterprises have no foreign investment, and most have not sold shares for much-needed working capital. Because of marked inattention to such critical factors for economic development as the maintenance of supply and distribution networks during the transition, severe disruptions have resulted. The burden of coping with skyrocketing inflation has produced a nonpayment-for-goods epidemic and a severe shortage of working capital.

Voucher auctioning has not insured that outside owners would be brought in, because personnel were themselves free to purchase shares of their enterprises with vouchers, and in the enterprises we studied, this was the trend. The exclusion of outside investors might be seen as self-defeating for enterprises if outsiders were offering money in exchange for ownership of shares, but voucher auctions do not bring much-needed money to enterprises. They do, however, threaten to distribute an enterprise's profits among outside shareholders who have invested no valued resources in the enterprise.

The Equity Issue

Third, voucher privatization has failed to deliver on its promise of equity. After considering a variety of options, the Russian reformers ultimately incorporated the concept of free distribution of property, "the people's property," to citizens as a keystone of their program[5], and equity considerations were showcased as one of the voucher program's key strengths[6]. Public confidence in the voucher program has been seriously weakened, however, by special regulations which benefit those enterprise personnel who work in the relatively small

[5]See Oleg Bogomolov, "Razdaetsia nicheinoe bogatstvo," Nezavisimaia gazeta, no. 13 (23 January 1993), 4.

[6]See, for example, World Bank, Russian Economic Reform: Crossing the Threshold of Structural Change (Washington, D.C.: The International Bank for Reconstruction and Development/The World Bank, 1992), 88-89.

number of enterprises that are seen as particularly desirable, and by the disappointing potential of many enterprises that were targeted for "obligatory privatization" as "the people's property."

Because of the manner through which vouchers are distributed at auction, in firms where shares are in high demand among outside investors, a voucher will buy less; because the purchasing power of vouchers is dependent on demand. But the purchasing power of vouchers used by an enterprise's workers is not subject to the fluctuating value of vouchers for other investors. The result is that outside investors who want to purchase shares of an attractive privatizing enterprise have to pay the much higher market prices--even as much as 1,000 times more--for shares that are in high demand.

Nor does the opportunity to exchange personal vouchers for shares in investment funds offer a promising solution for most of the millions who have chosen that option. By the end of 1993 more than 600 voucher investment funds were registered in Russia. Together, these funds had attracted more than 51 percent of all the vouchers that had been issued. Most investment funds are not paying dividends, because of the difficulties faced by the enterprises where funds have invested the vouchers they purchased. By now, many funds have either stopped functioning or are selling large numbers of vouchers at stock exchanges in the hope of being able to make at least a one-time payment to investors.

Politics in the Name of Economic Reform

A fourth conspicuous flaw of the voucher program should have been obvious, and its inevitably negative consequences recognized, from its inception. There is a fundamental contradiction between the program's underlying political objectives and its stated economic ones. Although the second aim listed in the 1992 State Program for Privatization was "to increase the productivity of enterprises,"[7] it was clear by the time the Congress approved the program that the primary focus of privatization had changed. The government's chief concern had shifted to dismantling the state control system as quickly as possible. Questions about efficiency were largely ignored.

Russia's privatization planners inherited a faltering production system, certainly. Their mistake was in not seriously addressing problems of industrial performance and misplaced incentives. The Russian government's privatization program established a process for divesting the state of property without first developing procedures for facilitating the survival of those

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[7] "Gosudarstvennaia programma privatizatsii gosudarstvennykh i munitsipal'nykh predpriiatii v Rossiiskoi Federatsii na 1992 god," 15-18.

newly-privatized enterprises in an alien economic environment. Divestment was the simpler of the two tasks. The second need was not adequately, or even seriously, addressed by the privatization planners. This has been the privatization program's most costly defect, whose negative consequences have already been enormous and threaten to accelerate even further in both the economic and political spheres. The inadequate preparation of Russian enterprises to operate in a market economy may insure, if uncorrected, that Russia's production system will not recover from its recent precipitous decline in the foreseeable future, and that the Russian political system will not soon establish a stable democratic legislative structure which could check excesses of executive power.

Significance for United States Government Policy

The principal policy implication of this analysis for the government of the United States is that Western policy-makers who study Russian privatization should quickly move beyond a simplistic emphasis on the pace of privatization, to the neglect of both political and organizational factors that could help create a stable foundation for market relations among newly privatized enterprises. Only thus can the unprecedented opportunity which has been presented in Russia for both economic and political development be effectively realized. If United States policy-makers, following Yeltsin and Chubais's lead, continue to emphasize quantitative aspects of Russian privatization over its more sobering qualitative features, initiatives which could improve the chances for success in Russian economic and political reform will be forgone.

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Introduction

According to the Russian government's 1993 privatization program, which was approved by Yeltsin's ministers on November 30, 1992, the priority for 1993 was to be "people's privatization" ("narodnaia privatizatsiia")--the distribution of state property for vouchers. Of all the property to be privatized in 1993, about 23 percent was expected to be sold for money at auctions. The other 77 percent would be redeemed with vouchers. The State Property Management Committee considered 1993 to be the most critical year for "building a fair people's capitalism." As many people as possible would be involved in voucher auctions for state property.[1]

By December 1993, about 11,000 of Russia's larger privatizing firms had been converted into joint stock companies, among the 14,500 that had been earmarked for privatization. Thus, as privatization head Anatolii Chubais emphasized in a December 1993 press conference, "two-thirds of the large industrial enterprises which were to be privatized had changed their form of ownership."[2] At year's end, the form of ownership had been changed in enterprises which employed more than 30 percent of Russian industrial workers. These enterprises had either been transformed into joint stock companies or purchased by their personnel. Shares of about 7,000 of these enterprises had been sold at voucher auctions. About 110 million vouchers had been invested by that time in either enterprises or investment funds, and with these investments 55 million people had become shareholders. Two-thirds of the Russian population had used

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[1]Leonid Mikhailov, "Ot bednogo sotsializma -- k bednomu kapitalizmu," Nezavisimaia gazeta, no. 233 (3 December 1992), 2.

[2]Igor' Karpenko, "Anatolii Chubais: B strane uzhe 55 millionov chastnykh sobstvennikov," Izvestiia, no. 251 (30 December 1993), 2.

their privatization vouchers by the end of 1993. "All of this is a firm guarantee," Chubais added, "that by July 1994 every voucher of every Russian citizen will have been spent."[3]

These widely-circulated figures mask, however, less positive qualitative features of voucher privatization in Russia. In reality, it was clear by the end of 1993 that voucher privatization was not being embraced where its acceptance was the most pivotal--among enterprise personnel--and that the promise of fair property distribution among the population was not being realized. Inadequacies of the privatization program contributed to the worsening of Russia's economy and to the political conflict of September and October which produced the backlash among a substantial number of voters in December. In this paper we discuss aspects of the voucher privatization program that are implicated in these unwanted outcomes.

As part of our ongoing study of Russian economic and political reform, we collected data in 1993 from directors and other management personnel in 599 enterprises. As before, our research was carried out in Moscow, Ekaterinburg, Voronezh and Smolensk. Our 1993 work included interviews with executives of all privatized and privatizing[4] production enterprises in Voronezh and Smolensk that agreed to interviews (the overall response rate for directors was 84 percent), most in Ekaterinburg,[5] and about half of the Moscow total.[6]

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[3]Ibid. See also Nikolai Podlipskii, "Programma privatizatsii bydet deistvovat' polgoda," Kommersant-Daily, no. 244 (18 December 1993), 3; and Boris Krotkov, "Anatolii Chubais o perspektivakh privatizatsii--94," Delovoi mir, no. 267 (31 December 1993), 1; and Faina Osmanova, "Privatizatsiia sostoialas'," Nezavisimaia gazeta, no. 250 (29 December 1993), 2.

[4]There are several different definitions of the terms "privatized" and "privatizing," but that issue is not germane to this study.

[5]We were unable to secure the lists we needed from the property management committee in Ekaterinburg to be certain of the total number of privatized(ing) production enterprises there.

[6]From late June until early August 1993, we interviewed more than 5,000 respondents in the four cities. The subsample of enterprise executives we refer to in this paper includes 390 directors, vice-directors and privatization specialists in enterprises that had begun or completed privatization by June 1993. (We interviewed 229 directors, 106 vice-directors and 55 privatization specialists in these enterprises.) The 84 percent response rate for the directors' subsample included 209 executives of either nonproduction enterprises or enterprises that had not yet started privatization, in addition to the 390 studied in this report.

A Hard Sell among Enterprise Directors

Of the 390 production enterprises in the study that had undertaken privatization by June 1993, 164 had already distributed shares among either enterprise personnel or shareholders outside the enterprise or to a combination of these two categories of owners. We analyzed the percentage of shares in these enterprises that had been turned over to enterprise workers, the percentage distributed through voucher auction, and the percentage retained by the state. (The sale of shares to outsiders for money was also an option, but it was an insignificant factor among the enterprises in our study.[7]) Personnel in these 164 firms owned at least 50 percent of the total number of shares in 95 percent of the enterprises (n=156). In 85 of those enterprises, personnel owned 100 percent of the shares (54 percent of enterprises where personnel were majority shareholders). Among these enterprises, personnel accounted for an average of 80 percent of the enterprise shares. The state was the majority shareholder in only four enterprises (2.4 percent). In only 33 enterprises (20 percent) had any shares been distributed through voucher auctions, but in only five cases did the percentage of voucher-auctioned shares that were held outside the enterprise match or exceed the number of shares held by workers. Interestingly, the average number of personnel employed at these five enterprises was 287, while the average number of workers among worker-controlled enterprises was 1,248. Although the government had decided in 1992 that large production enterprises were to be prime candidates for voucher privatization, a year later it was clear that this expectation was not being realized.

Throughout Russia, among those enterprises that had been transformed into joint stock companies by the end of 1993, more than three-fourths had chosen the variant of privatization which allowed workers to own 51 percent of a company's shares from the start, with an

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[7]The property fund which has jurisdiction over the auctioning of an enterprise's shares has the option of deciding that a certain percentage of shares will be sold for money rather than being auctioned for vouchers. These proceeds are typically used to cover the cost of carrying out the voucher auction and to help the property fund meet its operating expenses. Yeltsin's July 6, 1993 decree On Additional Measures to Secure Rights of Russian Citizens Participating in Privatization emphasized that "not less than 80 percent of the total number of shares to be sold of every enterprise, or of the total value of the enterprise as an object of privatization to be sold through auction or competition, must be purchased with privatization checks [vouchers]." At least 29 percent of the shares of privatizing joint stock companies were to be offered through voucher auctions. ("O dopolnitel'nykh merakh po zashchite prava grazhdan Rossii na uchastie v privatizatsii," Ekonomika i zhizn', no. 31 [July 1993], 4).

opportunity to buy additional shares[8]--thus effectively precluding the possibility of "people's privatization" in those enterprises. Although this outcome was not in keeping with the government's plan, it was entirely consistent with the overall perspectives of the directors we interviewed. In his December 1993 press conference that we cited earlier, Chubais had been asked by a reporter to comment on the common perception that "there is opposition among the directors' corps to the current approach to privatization." Chubias's response was unequivocal: "All of the directors today are on our side," he insisted.[9] Our data, however, highlight the inaccuracy of Chubais's argument.

Chubais was not as incorrect in the abstract as when the subject was actual privatization of real enterprises. When asked whether they believed voucher privatization to be "a good idea or a bad idea," 38 percent of the directors in our 164 enterprises that had distributed shares answered that it was a good idea. Of course, even with that theoretical wording, 38-percent support hardly justifies Chubais's claim that "all of the directors today" support voucher privatization. And when we rephrased the question to elicit more specific behavioral preferences, the directors' initially-modest level of support for voucher privatizations nearly evaporated.

"Several ideas have been proposed for the privatization of large production enterprises," we began. "Of the following proposals, which one do you think has the most merit?" "Privatization through voucher auctions" was the choice of only 6.5 percent. Forty-two percent favored "privatization by turning ownership over to the personnel in an enterprise," and 16 percent favored "selling shares of enterprises to anyone who wants to buy them." Directors were four times more likely to respond that "large enterprises should not be privatized" (27 percent) than to say that they favored voucher privatization.[10] Significantly, none of the five directors favored voucher privatization who were themselves the most affected by voucher privatization and outside ownership. The preferences of these directors in the study were divided among the second, third and fourth alternatives named above.

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[8]"O sotsial'no-ekonomicheskom polozhenii Rossii v 1993 godu (po materialam Goskomstata Rossii)," Ekonomika i zhizn', no. 6 (February 1994), 8.

[9]Boris Krotkov, "Anatolii Chubais o perspektivakh privatizatsii--94."

[10]Eight percent were uncertain.

The Unsatisfied Need for Restructuring

A second inadequacy of the voucher program is that this approach does not clearly promote fundamental restructuring within enterprises. The most obvious internal transformation that has been effected through privatization has been change in formal ownership. Most management teams have remained intact. Most workers have kept their old jobs. At most plants, long-overdue modernization has not begun. Most privatized production enterprises have no foreign investment, and most have not sold shares for much-needed working capital. State ownership has declined, but because of marked inattention to such critical factors for economic development as the maintenance of supply and distribution networks during the transition, severe disruptions have resulted. The burden of coping with skyrocketing inflation has produced a nonpayment-for-goods epidemic and a severe shortage of working capital.

Voucher auctioning has not insured that outside owners would be brought in, because personnel were themselves free to purchase shares of their enterprises with vouchers. Among the 33 enterprises in our 1993 study which had been involved in voucher auctions, the utilization of vouchers for employee purchase of shares was the trend. Workers were majority shareholders in 76 percent of the cases where shares had been distributed through voucher auction (n=25).

Writing about this trend, Sergei Mikhailov, chair of the department for voucher utilization of the Property Fund of the Russian Federation, observes that "the majority of joint stock companies which are being formed count on purchasing as large a percentage of the shares of their own enterprises as possible. The reason is their unwillingness to give away a substantial proportion of their firm's profits, through dividends, to a number of small shareholders. They are also fearful of losing their jobs if any large investors should be interested in restructuring the enterprise."[11] Underscoring Mikhailov's assessment, the head of the Federation of Russia Stock Exchanges' information center, Lev Makarevich, notes that, in the process of distributing enterprise shares through voucher auction, most enterprises "very skillfully eject outsiders--ordinary citizens--from the stage."[12]

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[11]Sergei Mikhailov, "O nekotorykh itogakh privatizatsii v 1993 godu," Ekonomika i zhizn', no. 14 (April 1993), 15.

[12]Lev Makarevich, "Vauchery golosuiut za chetvertyi variant privatizatsii," Finansovye izvestiia, no. 14 (4-10 February 1993), 3.

The exclusion of outside investors might be seen as self-defeating for enterprises if outsiders were offering money in exchange for ownership of shares, but voucher auctions do not bring money to enterprises. Voucher privatization substitutes "worthless paper," as Nizhnii Novgorod's governor Boris Nemtsov put it, for real money in the purchase of enterprise shares. In the production sphere, the need for extensive modernization is acute, and lacking investment capital, any near-term profits that are earned will necessarily be used, in the large majority of enterprises, to improve production.

When we asked directors in our 1993 study about their most serious obstacles to increasing productivity and profits, the enormity of this problem became obvious. Directors' most pressing concerns centered around, not supply questions or work force deficiencies, but money. The director of Plastmass, a Voronezh firm which manufactures electrical supplies, told us, "I don't have any money to replace our obsolete and worn-out production equipment. When machines break down, if we can't repair them with parts that are on hand, we just have to stop using them. And selling what we make doesn't bring in much money, because our buyers often can't pay."

Life goes on with a shortage of electrical supplies, but not without food. The director of "Pridonskii," a plant that produces canned goods, complained that his buyers, retail stores, have reduced their orders to a trickle. "Many aren't able to pay for even basic food items now," he said. And at the Moscow factory Rodina, where more than 1,000 workers make clothing for children and adults, the director noted, "We are working as well as we ever have, and our workers have always been capable, but most of what we make goes to pay taxes. We have no money to upgrade our old equipment or even repair our buildings, and we can't afford the high interest for loans."

One of the largest enterprises in Russia is Ekaterinburg's "Uralmash," which produces heavy machinery--a substantial percentage of which is designed for raw materials extraction. When we interviewed the firm's general director Viktor Korovin, he told us that he had originally supported voucher privatization, but he had learned, he said, that voucher distribution had done nothing to make his enterprise more effective. Because of its large size, "Uralmash" shares were available throughout Russia for vouchers, and 28.5 percent of the company's shares were claimed through voucher auction, mostly by outsiders. "But my most acute problem is lack of working capital," Korovkin added, "and vouchers haven't helped me at all in solving that problem, or in dealing with any of my company's other barriers to improved productivity." Although outside investors who claim enterprise shares for vouchers bring nothing to an enterprise that it needs, their investment represents a claim on the enterprise's profits. It should not be surprising, then, that enterprises resist such "investment," which they often predictably see as only unjustified intrusion. "Now," Korovkin continued in a different interview, "I am in no hurry to sell [through vouchers] the 20 percent of my company's shares which are owned by the state."[13] Andre Borodenkov summarized this point of view, which has been widely expressed among the directors of production enterprises. "We have nothing against the arrival of private capital, but we do not favor the arrival of owners who get their shares for a song" ("vauchernyi beztsenok").[14]

Sometimes, money does change hands through voucher auctioning. But ironically, the exchange does not benefit the enterprise whose shares are acquired in the process. "Uralmash" is an apt example. More than 18 percent of its shares were bought by Kakha Bendukidze, whose firm "Bioprotsess" paid the US dollar equivalent of about a million dollars for 130,000 vouchers. Bendukidze acknowledges that his expenditure was, indeed, "a song," relative to the value of the shares he bought. "Why shouldn't I buy," he asked, "if it is being offered for, actually, 'a ruble.'"[15] But none of Bendukidze's modest investment went to "Uralmash." It was paid to individual Russian citizens, who sold vouchers for enough to buy perhaps a bottle of vodka or three kilograms of butter, and to speculators, who trade in vouchers. The main beneficiaries in these exchanges were not the individual citizens, certainly. They had exchanged their share from Soviet collectivization for another "song." Those who gained the most in this activity were the voucher speculators and, if the investment achieves what Bendukidze hopes, "Bioprotsess"--which acquired, in this case, a substantial percentage of a solid enterprise's shares for a very small price. (Raw materials extraction is one of Russia's most notable growth areas for investment--the one which attracts a lion's share of the foreign investment in Russia today.) But enterprise personnel at "Uralmash" own 50 percent of the firm's shares and can still decide their company's policies. And Bendukidze will receive a substantial part of the profits of "Uralmash" without having been required to provide the firm with anything at all in return.

The "Uralmash" situation is actually an example of a favorable outcome for an enterprise, in the context of current voucher privatization arrangements. Although "Uralmash"

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[13] Andrei Borodenkov, "'Uralmash' poshel c molotka," Moskovskie novosti, no. 30 (25 July 93), 13.

[14] Ibid.

[15] Ibid.

received no benefit in exchange for the shares it turned over to "Bioprotsess," at least "Bioprotsess" now has a significant interest in the corporate well-being of "Uralmash" and may be willing to actually invest in modernization at "Uralmash" at some future time. There has been no such expenditure until now, and "Uralmash" has no means to insure that the company will actually invest in "Uralmash" at some later date. But the potential, at least, of significant outside interest is decidedly better for "Uralmash" than for other privatizing enterprises whose outside shareholders, each holding a very small percentage of a firm's stock, have no clear incentive for investing real money in the enterprise whose shares they have acquired with vouchers.

"Uralmash" did not retain control over its affairs at no cost. Ironically, the firm spent the US dollar equivalent of $500,000 to purchase the 65,000 vouchers which insured that half of the stock would be company-owned.[16] None of this money was reverted to "Uralmash." Most of it, as with Bendukidze's $1,000,000, went to voucher speculators.

The Equity Issue

Third, voucher privatization has failed to deliver on its promise of equity. For most Russian citizens, an amount of investment in Russian enterprises that could be meaningful in even a symbolic sense--prominently hailed by Yeltsin and his ministers as voucher privatization's chief feature--is as elusive today as it was under Communist rule. With the new privatization, there is not even a pretense of broad social equity.

Back when voucher privatization was still an idea being discussed by Gaidar's planning team, it was first met with skepticism. Finally, though, they decided that a substantial part, at least, of "the people's property" should be distributed to citizens free of charge. This was a critical development which had broad implications for the way the privatization effort evolved in 1992 and early 1993. There was also a practical consideration here. With the liberalization of prices in January 1992, savings were largely wiped out, and most people did not have enough money to buy property while at the same time adjusting to rapidly rising prices for necessary expenses. Thus, the Russian reformers ultimately incorporated the concept of free

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[16]Vladimir San'ko, "Ne promahknemsia li my?" Delovoi mir, no. 145 (3 August 1993), 3.

distribution of property to citizens as a keystone of their program,[17] and equity considerations were showcased as one of the voucher program's key strengths.[18]

In this way, the architects of Russian privatization took the side of those radical democrats whose chief objective was relatively equal distribution of property, and against those who believed that the primary goal of privatization should be to increase productivity and efficiency. The radical democrats did not often speak about efficiency. They instead assumed that productivity would not suffer if owners were able to acquire enterprises without competition from other would-be buyers and if they were not required to invest real, preexisting assets into their enterprises.

But public confidence in the voucher program has been seriously weakened by special regulations which benefit those enterprise personnel who work in the relatively small number of enterprises that are seen as particularly desirable. People who are not employees of those unusually-successful firms are disadvantaged in some conspicuous ways. Securing useful information about the financial prospects of privatizing enterprises has proven to be virtually impossible for the average person, and that problem has nagged potential investors since the beginning of the program. Yeltsin has consistently argued that the principal objective of the voucher program was to divide state property among the citizens, and in this way to give all people an opportunity to be active participants in the transformation to a market economy.[19] "We don't need a few millionaires," he maintained at the outset of the voucher privatization initiative. "We need millions of owners."[20]

Yet many citizens have concluded, not without cause, that they have been given the unenviable opportunity to own enterprises which are, in a large number of cases, on the brink of bankruptcy. When asked about this problem in August 1992, Chubais responded, "We are dealing here with a closed circle. Of course, before privatization would be the best time to

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[17]See Oleg Bogomolov, "Razdaetsia nicheinoe bogatstvo," Nezavisimaia gazeta, no. 13 (23 January 1993), 4.

[18]See, for example, World Bank, Russian Economic Reform: Crossing the Threshold of Structural Change (Washington, D.C.: The International Bank for Reconstruction and Development/The World Bank, 1992), 88-89.

[19]See "Programma uglubleniia reform," Izvestiia, no. 224 (9 October, 1992): 2.

[20]Aleksandr Borisov, ". . . plius sploshnaia vaucherizatsiia vsei strany," Megalolis-Express, no. 35 (2 September 1992), 3.

revitalize our industries, but it is clear already that without the first step, privatization, the second won't happen."[21] But what Chubais neglected to emphasize in public was that many of those industries would never be revitalized, and as we note below, he was fully aware of that undesirable feature of voucher privatization.

Information about the competitive potential of privatizing enterprises is not completely lacking. Rather, the kind of information that investors might find useful has not been made public. Many state employees who are involved in privatization have solid data about enterprises which could serve as a basis for judging their relative merits. Those employees are prohibited by law from investing directly in enterprises. They know too much. Unfortunately for the privatization program, a large number of citizens are keenly aware that they know too little about how to successfully navigate the uncharted waters of Russian privatization. Nor does the opportunity to exchange personal vouchers for shares in investment funds offer a promising solution for most of the millions who have chosen that option. By the end of 1993 more than 600 voucher investment funds were registered in Russia. Together, these funds had attracted more than 51 percent of all the vouchers that had been issued. Fewer than half of these vouchers were invested in privatizing enterprises, however. The others were being held at year's end because of a shortage of investment opportunities that were considered attractive by the funds' managers.[22]

Most investment funds are not paying dividends, because of the difficulties faced by the enterprises where funds have invested the vouchers they purchased. Large numbers of private investors in these funds have become impatient with the funds' inability to pay the expected dividends. By now, many funds have either stopped functioning or are selling large numbers of vouchers at stock exchanges in the hope of being able to make at least a one-time payment to investors. This disappointing outcome was not what voucher recipients had anticipated.[23]

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[21]Vladimir Kucherenko, "Massovaia privatizatsiia: led eshche ne tronulsia, no uzhe tresnul," Megapolis-Express, no. 34 (26 August 1992), 3.

[22]See Elena Kotel'nikova, "Goskomimushchestvo stimuliruet chekovye fondy," Kommersant-daily, no. 237 (9 December 1993), 3.

[23]See, for example, Viktor Smirnov and Viktor Ivanov, "Provintsial'nye chekovye fondy ispytyvaiut krizic," Kommersant-Daily, no. 7 (19 January 1994), 2.

The State Program for Privatization for 1992 stated that "enterprises whose activity is not efficient" were expressly targeted, among others, for "obligatory privatization."[24] The State Property Management Committee complied with this instruction in developing its list of large and middle-sized enterprises slated for obligatory privatization.[25] Speaking about this "obligatory privatization" list, Dmitrii Vasil'ev, vice-chair of the State Property Management Committee, observed, "According to our estimate, the properties of the 4,500 enterprises which are to be privatized in the 'obligatory' category are enough to bring in all the vouchers that have been allocated."[26] (This is not to say that all enterprises on the 'obligatory' list are bad investments. A number of enterprises in several categories included in this list are promising by any measure. Also, enterprises are allowed to voluntarily opt for privatization, except for those in categories that were explicitly or implicitly excluded;[27] and many have.)

Not surprisingly, then, when our 1993 general population sample[28] were asked how much the public was benefiting from the voucher program, only 20 percent said "a great deal" or even "somewhat." An overwhelming 82 percent thought that mafia and crime groups were benefiting, however; and 76 percent believed that current officials were. Only 34 percent of these respondents were even "somewhat satisfied" with the results of privatization in the retail and consumer services spheres, which, at that time, were more than 50 percent privatized.

A further disadvantage accrues to those who are not employed by the more successful enterprises when they invest their voucher. Because of the manner through which vouchers are distributed at auction, in firms where shares are in high demand among outside investors, a voucher will buy less; because the purchasing power of vouchers is dependent on demand. But the purchasing power of vouchers used by an enterprise's workers is not subject to the

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[24]"Gosydarstvennaia programma privatizatsii gosudarstvennykh i munitsipal'nykh predpriiatii v Rossiiskoi Federatsii na 1992 god," Ekonomika i zhizn', no. 29 (July 1992), 15.

[25]Dmitrii Vasil'ev, "1 oktiabria--nachalo privatizatsii v Rossii. Dlia kogo? Chto nuzhno sdelat' k etomu sroku?" Izvestiia, no. 214 (25 September 1992), 2.

[26]Dmitrii Vasil'ev, "Privatizatsiia: voprosy i otvety," Izvestiia, no. 224 (9 October 1992), 2.

[27]In some categories, enterprises needed to apply for permission to privatize.

[28]Comprising 4,000 respondents randomly selected from address bureau lists (Moscow and Ekaterinburg) and voucher lists (Voronezh and Smolensk)--1,000 in each city.

fluctuating value of vouchers for other investors. Enterprise assessments which determine the price of shares to enterprise personnel are based on January 1992 prices.[29] The result is that outside investors who want to purchase shares of an attractive privatizing enterprise have to pay the much higher market prices--even as much as 1,000 times more--for shares that are in high demand. "To each according to his employment," thus has become an operative principle in the new Russia. But only 12 percent of the population work in large industrial enterprises, and only a few of those are considered good investments--perhaps only about one-tenth.[30]

Even those enterprises that survive privatization and the difficulties of establishing market relations in a chaotic economic environment will not, for the most part, soon be able to pay any dividends to outside shareholders. There are additional reasons why most shareholders should not expect any return on their investment in the foreseeable future. Privatized Russian enterprises do not face the constraint of shareholder discontent that typifies public companies in the West. Because voucher privatization gives no working capital to enterprises, privatized firms neither have a financial obligation to shareholders nor an incentive to provide dividends to stimulate further investment.

Politics in the Name of Economic Reform

A fourth conspicuous flaw of the voucher program should have been obvious, and its inevitably negative consequences recognized, from its inception. There is a fundamental contradiction between the program's underlying political objectives and its stated economic ones. It was only a matter of time until this contradiction created both a crisis of production and a crisis of political legitimacy.

Although the second aim listed in the 1992 State Program for Privatization was "to increase the productivity of enterprises,"[31] it was clear by the time the Congress approved the

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[29]Enterprises have been reassessed since January 1992, but Yeltsin's July 6, 1993 decree On Additional Measures to Secure Rights of Russian Citizens Participating in Privatization (see fn. 7) guaranteed that enterprise reassessment after January 1992 would not affect the prices of enterprise shares in voucher privatization.

[30]Vasilii Seliunin, "Tret'ia popytka," Izvestiia, no. 211 (22 September 1992), 1, 3.

[31]"Gosudarstvennaia programma privatizatsii gosudarstvennykh i munitsipal'nykh predpriiatii v Rossiiskoi Federatsii na 1992 god," 15-18.

program that the primary focus of privatization had changed. The government's chief concern had shifted to dismantling the state control system as quickly as possible. Along the way, and in spite of a chorus of warnings and cautions by analysts outside the Yeltsin government's circle of privatization planners, questions about efficiency were largely ignored. The possibility of disruptions during the rapid shift to decentralized planning was now seen as less sinister than the fear that opposition forces might halt the process entirely if given enough time.

In nearly every important detail, the Yeltsin government's privatization program is intended to promote the realization of political more than economic goals. On that point Chubais is clear. When we interviewed him in August 1993, he told us unhesitatingly, "This is not an economics program; it is a political program. It is five percent economics and 95 percent politics." Nor does Chubais hesitate, in addressing colleagues, to make gloomy long-range predictions for the prospects of a very large number of privatizing enterprises. In a July 1993 speech he warned, "The biggest price that we will pay will come tomorrow. The main danger to the whole privatization program is the risk that it will face when some of the privatized enterprises, or probably most of them, become bankrupt."[32] Before 1993 ended, Chubais's State Property Management Committee was estimating that more than half of all federal property was on the brink of bankruptcy.[33]

Fifth, and another problem that should have been obvious from the beginning, is that the voucher privatization in Russia is flawed by the usual defects of massive top-down economic transformation compounded by the hazards of fashioning a program with motives that sharply diverged from the stated objectives of Russia's privatization planners and promoters in the Yeltsin government. "We are ready to unveil Big Privatization," Chubais declared with the beginning of price liberalization in January 1992. "We have worked out the required tasks for privatization in regions, oblasts, Moscow and St. Petersburg."[34] According to Chubais's estimate, more than 50,000 government personnel would be required to implement the privatization program. In January 1992 Chubais said that the government had applied to the Central Bank for five hundred million rubles (R500,000,000) just to purchase office equipment

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[32]Anatolii Chubais, "Remarks Delivered by Vice-Premier Anatolii Chubais at the International Institute for Applied Systems Analysis, July 9, 1993" (mimeo).

[33]Elena Kotel'nikova, "Viktor Chernomyrdin sdelal stavku na Goskomimushchestvo," Kommersant-Daily, no. 185 (28 September 1993), 2.

[34]Vladimir Orlov, "Gosudarstvo idet s molotka," Moskovskie novosti, no. 2 (12 January 1992), 14.

and supplies for work related to privatization. Most of the employees Chubais was seeking to fill the new jobs for privatization would, in his words, come from "branches where there massive staff reductions are now going on."[35] That is, he was hiring seasoned veterans of the state system to staff yet another bureaucratic machine.

Chubais and other members of the Yeltsin government were successful through 1993 in their campaign to convince the public that a slower rate of privatization would produce even more problems than rapid privatization. Chubais has frequently warned of uncontrolled nomenklatura and mafia involvement if privatization should be pursued more gradually, and of a "narrow window of opportunity," for privatization because of an increasingly resistant legislature. "After mid-1992," Chubais stated this past July, "it became impossible to get any kind of positive or even reasonable decision about privatization from the Parliament."[36] Whereas in the previous winter Chubais was concerned that "what blows in with the wind" may depart just as effortlessly, now he defended the government's new position by suggesting, "The politics of the State Property Management Committee is not to further the stratification of society but to let everyone take part in people-oriented privatization."[37]

Of the 62 large production enterprises (with at least one thousand workers) in our study which had completed privatization, vouchers had been distributed for only nine (15 percent), and those voucher distributions averaged just 24 percent of the enterprises' shares.

Russia's privatization planners inherited a faltering production system, certainly. Their mistake was in not seriously addressing problems of industrial performance and misplaced incentives. The Gaidar-Chubais team established other priorities. Their energies were focused more on destroying the existing command system than on building an improved production system.

The Russian government's privatization program established a process for divesting the state of property without first developing procedures for facilitating the survival of those newly-privatized enterprises in an alien economic environment. Divestment was the simpler of the two tasks, by far. And the second need was not adequately, or even seriously, addressed by

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[35]Ibid.

[36]Ibid.

[37]Anatolii Velednitskii, "Priblizhaetsia delezhka. Gosimushchestva," Delovoi mir, no. 110 (10 June 1992), 1.

the privatization planners. This has been the privatization program's most costly defect, whose negative consequences have already been enormous and threaten to accelerate even further in both the economic and political spheres. The inadequate preparation of Russian enterprises to operate in a market economy--indeed, the manifest inattention to that vital aspect of privatization by the Yeltsin government--may insure, if uncorrected, that Russia's production system will not recover from its recent precipitous decline in the foreseeable future, and that the Russian political system will not soon establish a stable democratic legislative structure which could check excesses of executive power.

It may not be too late to reverse this mistaken course, and to attend to the requirements of creating a favorable interorganizational context for market relations, but it is almost too late. Too many enterprises have already been privatized and left, predictably, to flounder, and the economy has already been seriously weakened because of the misplaced priorities of privatization planners. And with the revitalization of nationalist and Communist opposition movements in Russia, Chubais's "tomorrow" has already arrived.

This subject requires detailed elaboration and additional proof, and it will be the explicit focus of a subsequent paper.

Conclusion

The initial idea of privatization in the Soviet Union and in Russia was to revitalize the economy and improve the efficiency of enterprises. It was with that objective in mind that on July 1, 1991 the USSR Supreme Soviet approved the law On the Basic Principles of the Destatization and Privatization of Enterprises, which specified target dates for removing enterprises from state control, some of which would initially be leased and others converted into joint stock companies.[38] According to the plan, about half of the fixed production assets of state enterprises would be shifted outside the sphere of direct state management by the end of 1992; and this sector of the economy was expected to grow substantially by 1995.[39] But history took a decidedly different turn.

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[38]"Ob osnovnykh nachalakh razgosudarstvleniia i privatizatsii predpriiatii," Izvestiia, no. 188 (8 August 1991), 3.

[39]See A. Stepovoi and S. Chugaev, "Konets monopolii gossobstvennosti," Izvestiia, no. 156 (2 July 1991), 1-2; and "Ob osnovnykh nachalakh razgosudarstvleniia i privatizatsii predpriiatiy," Izvestiia, no. 188 (8 August 1991), 3.

It is probably true that Soviet and Russian legislators were too optimistic in the early 1990s about the readiness with which the production system's sluggishness could be transcended through "destatization." The optimistic objectives they established for 1995 were not likely to have been achieved. But it is clearly arguable that the emphasis of their programs was correct. Their approach was to overcome defects through systematic improvement, not through hasty restructuring that would impair directors' ability to establish new markets and develop dependable supply sources.

On July 3, 1991 the RSFSR Supreme Soviet passed the law On Privatization of State and Municipal Enterprises.[40] According to this legislation, enterprises could be privatized in several ways. An entire enterprise could be sold through auction or competition. It could be transformed into a joint stock company and its shares sold. Finally, leased enterprises could be redeemed by their management and workers for a predetermined price, without auction or competition. Leased enterprises could be made into joint stock companies if the option of buying the leased enterprise were not exercised; and in this case, employees could buy as many shares as they could afford, selling the remaining shares.

The same day another law was passed in the RSFSR, On Personal Privatization Checks and Accounts,[41] which suggested that privatization "investment accounts" could be established in state banks for all citizens. With these accounts, citizens could buy property from the state. Over the summer, the Russian legislature issued a series of normative documents outlining privatization plans of different departments. The principal objective of these measures that were crafted in the parliaments of both the USSR and the RSFSR in 1991 was to, above all, increase the efficiency of production and the viability of the economy.

The economic program which eventually emerged under Gaidar's leadership was quite different. In the early days of the Yeltsin reforms, equity considerations came to predominate over concern about efficiency and productivity as the voucher idea gained increasing support among the Gaidar team. Later, equity was also sacrificed in a conscious rush to decisively bury the discredited command system. Yeltsin's reformers were more determined to demolish

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[40] "O privatizatsii gosudarstvennykh i munitsipal'nykh predpriiatii v RSFSR," Zakony RSFSR o privatizatsii gosudarstvennykh i munitsipal'nykh predpriiatii, zhil'ia (Moscow: Sovetskaia Rossiia, 1991), 3-36.

[41] "Annotatsiia," Delovoi mir, no. 131 (10 July 1992), 5.

than to build. As a political more than an economic program, voucher privatization has been directed against a haunting past more than toward a more productive future.

Significance for United States Government Policy

The principal policy implication of this analysis for the government of the United States is that Western policy-makers who study Russian privatization should quickly move beyond a simplistic emphasis on the pace of privatization, to the neglect of both political and organizational factors that could create a stable foundation for market relations among newly privatized enterprises. Only thus can the unprecedented opportunity which has been presented in Russia for both economic and political development be effectively realized. If United States policy-makers, following Yeltsin and Chubais's lead, continue to emphasize quantitative aspects of Russian privatization over its more sobering qualitative features, initiatives which could improve the chances for success in Russian economic and political reform will be forgone.

A critical point in this regard, notwithstanding the monetarism-based arguments of prominent foreign advisers, is that there is no compelling evidence from any country--Russia, Eastern Europe, or elsewhere--that constructive economic reform had to trigger the precipitous declines in production, research and development support, and economic well-being among the population that Russian has known since the onset of the Yeltsin-Gaidar economic reforms. Arguments to the contrary by such advisors as Anders Aslund and Jeffrey Sachs are entirely speculative, and we are confident that they will be judged by future analysts as having been profoundly deficient.[38] But now, Russia must cope, not with the interpretations of history about the country's ill-fated monetarist experiment,[39] but with the privatization program's crippling results. Russian leaders must account to the many citizens who were sold privatization as payment for the privation brought on by Communism, and who are now questioning their country's faulty approach to economic reform. The United States, having unhesitatingly supported some of the most flawed elements of the Yeltsin government's economic program, is now implicated in the reform initiative's negative economic and political impact. A decision to quickly abandon this ineffectual policy course is overdue.