



Review of Economies in Transition

Idäntalouksien katsauksia

1994 • No. 1

19.1.1994

Reprint in PDF format 2002

Pekka Sutela

Insider Privatization in Russia:
Speculations on Systemic Change

Bank of Finland
Institute for Economies in Transition, BOFIT

ISSN 1235-7405
Reprint in PDF format 2002

Bank of Finland
Institute for Economies in Transition (BOFIT)

PO Box 160
FIN-00101 Helsinki
Phone: +358 9 183 2268
Fax: +358 9 183 2294
bofit@bof.fi
www.bof.fi/bofit

The opinions expressed in this paper are those of the authors and do not necessarily reflect the views of the Bank of Finland.

Insider Privatization in Russia: Speculations on Systemic Change¹

As most textbooks will tell, an economic system is made up of structures of information, incentives and decision-making. Property rights, the relationships between claims or rights and the persons or institutions entitled to exercise them, form the locus of decision-making and are obviously at the heart of an economic system. For purposes of efficiency, they need to be well defined. With regard to equity, different property arrangements will have different implications. Furthermore, not all imaginable property arrangements are necessarily sustainable. Not much is however known about the exact outcome implications of most imaginable sets of property rights.

Such mainstream views have pride of place in the prevailing orthodoxy on economic transition from centrally managed systems to market economies. Together with stabilization, liberalization and structural change, privatization is seen as one of the core facets of transition. Though the widely accepted priority of privatization in transition process has been occasionally challenged, few would doubt that existing property arrangements have a crucial impact on the way in which an economy functions.

In Eastern Europe, privatization programmes have usually failed in reaching the goals of efficiency, equity, fiscal soundness and speed that may have been set for them. During the first years of programme implementation, only a relatively small proportion of state industries has been privatized, and that often amidst political controversy. Non-regulated, spontaneous privatization has been of more importance, but of great controversy as well. Perhaps surprisingly, Russia promises to be an exception in these respects. Though stabilization has failed, liberalization has still important imperfections and there is little evidence of structural change, in the summer of 1993 the government somewhat confidently forecast that perhaps as much as one half of former state industries would be privatized by the end of the year. Though exact percentages should be taken with a grain of salt, such speed contrasts with most of what has been seen in transition economies with a longer track record. Two questions have to be posed. What made fast privatization possible in Russia? What are the implications of Russian privatization for decision-making, enterprise behaviour and systemic change at large?

¹ This article is to appear in *Europe-Asia Studies* (former *Soviet Studies*) 1994:3.

An earlier version of this paper was presented at the 25th AAASS National Convention in Honolulu, 19–22 November 1993. The comments of panel participants, in particular Morris Bornstein, Richard Ericson, Gregory Grossman and Silvana Malle, are gratefully appreciated. The comments of Sergey Alexashenko, Laszlo Csaba, Yevgeny Gavrilentov and the Editor of this Journal have also been most useful. The usual caveat naturally applies. This paper was finalised after the basic outline of the December 1993 election results became evident but before any firm information was available concerning probable policy changes. The opinions expressed in this paper are those of the author and do not represent the views of the Bank of Finland.

This paper is divided into four sections. Section 1 summarizes available information on the speed and means of Russian privatization. Section 2 surveys available information on the impact of privatization – and inevitably of other transition policies as well – on enterprise behaviour in Russia. While these sections are basically surveys of existing literature, section 3 engages in theoretical and historical speculation on the significance of privatization for systemic change in Russia. Section 4 finally offers a conclusion. In particular, it attempts to evaluate the Russian case against "the two basic purposes defining the meaning of privatization in the East" as identified by Frydman and Rapaczynski²: the need to depolitize most economic decisions, and the need to create a new institutional structure of corporate governance. Because the "needs" identified by Frydman and Rapaczynski are normative, the paper inevitably also addressed the thorny question of the relationship between intentional policies and actual outcomes in the Russian case.

It is widely believed that the ongoing strengthening of the already existing tacit insider control is a crucial problem in privatization both in East Central Europe and especially in Russia³. Insider control is seen as an inappropriate corporate control solution, a danger to be avoided for reasons of both equity and efficiency. However many observers believe that some degree of insider privilege is not only inevitable but also beneficial. The consequences of insider privatization in Russia are the central perspective of this paper. In particular, this paper asks what would the future Russian market economy be like if the Russian case in fact proves to be one of insider privatization.

² Roman Frydman and Andrzej Rapaczynski, *Insiders and the state: overview of responses to agency problems in East European privatizations*, *Economics of Transition* 1, 1, 1993, pp. 39–59.

³ Edmund S. Phelps, Roman Frydman, Andrzej Rapaczynski and Andrei Shleifer, *Needed mechanisms of corporate governance and finance in Eastern Europe*, EBRD Working paper No 1, March 1993. This paper offers probably the best available discussion on corporate governance problems in East Central European and Russian privatization.

1 Russian Privatization: the Principles and Results

1.1 The Enigma of Russian Tempo

Only a few months after the principal issues of privatization had been competently discussed in Soviet press for the first time⁴, the Act on Privatization of State and Municipal Enterprises in the RSFSR was adopted in July 1991. As the proper framework for legislation and implementation was still missing and policy-makers were busy with other questions, regulated privatization did not begin until 1992. The relevant normative documents were approved in early 1992. In mid-1992 – following a schedule adopted in late 1991 – the government somewhat surprisingly announced that the first phase of Russian transition, that of liberalization and stabilization, had been successfully completed. The time had come for the second phase, that of privatization and structural change⁵.

This chronology is incomplete. Large-scale privatization by sale was already discussed in the 1990 Yavlinsky-Shatalin reform programme, and various legislation was also drafted at that time. After that, there were ambitious plans for give-away privatization under Mikhail Maley. Therefore, the process did not start from an absolute beginning in 1991, and there was a degree of organizational and practical continuity. Still, the change in privatization ideology and in the statehood of Russia in 1991 imply that this year does mark a new beginning.

Three things stand out in this chronology. First, by coming late, Russia was able to benefit from earlier Eastern European experience. In particular, this led to the acceptance of ample insider privileges so as to ensure speedy privatization. The authors of the Russian privatization programme evidently believed that breaking the ownership position of the branch ministries was the overwhelming priority if the irreversibility of transformation was to be ensured. Furthermore, as the political situation remained unsettled, such bastions of the ancien régime had to be abolished as fast as possible. Furthermore, Russian privatizers judged that the speed deemed necessary could not be attained without "bribing" the insiders⁶.

Several economic reasons for favouring insiders are often cited in the light of Eastern European experience. First, by their mere political weight, insiders are in a position to slow down or even prevent any privatization that they disapprove of. Therefore, insiders should be "bribed" to support privatization policies. Second, any lengthy and uncertain privatization procedure will as such reduce the motivation of insiders. Therefore, insiders have to be given privileges to make fast transfer of property rights possible. Third, even negative motivation may evolve.

⁴ Evgeny Yasin, *Razgosudarstvlenie i privatizatsiya*, *Kommunist* 5, 1991, pp. 99–111.

⁵ Seija Lainela and Pekka Sutela, Russian privatization policies, in P. Sutela, ed., *The Russian Economy in Crisis and Transition* (Helsinki, 1993), pp. 81–110.

⁶ Many of these issues are discussed in an informative way in Maxim Boycko and Andrei Shleifer, *The Politics of Russian Privatization*, Chapter 3 of Olivier Blanchard et al, *Post-Communist Reform, Pain and Progress*, United Nations University Press, Tokyo – The MIT Press, Cambridge, Mass. 1993.

Insiders may consciously wind an enterprise's operations down in order to secure a chance to acquire its property at a low price. This should be prevented by better incentives. Fourth, the lucrateness of private sector employment may attract insiders away from their present employment, leading to excessive state desertion. The possibility of insider privatization increases the net benefits available in state sector jobs. Fifth, in some cases insiders may see their position as an end game, pumping out all value from existing enterprises before finally abandoning the wreck. Insider privatization might prevent such behaviour.

Such reasons for insider privatization are basically defensive arguments for allowing managers and the workforce an explicit voice in enterprise decision-making. They do not really address the crucial problem of the degree of privileges needed to ensure insider support without ending up with the problems of corporate governance often identified with insider ownership⁷.

Overall, there are many arguments against insider control. Thus, there is no obvious reason for seeing insider control as being equitable. Most analysts would on the contrary argue that insider control is inherently unfair, as ensuing privileges will be very unevenly distributed among the population as a whole. There are also arguments of efficiency. Thus, given insider control, managerial interests may prevail over wider ones; short-term gains may prevail over long-term ones; and essential structural change may be prevented by a preference for the status quo. In this paper, these problems of insider control will be referred to as those of **equity, managerialism, short-termism** and **structural immobility**. Other problems, more peculiar to the Russian case, will also be described. Positive arguments for insider control have also been proposed, and they will be discussed later on.

The second peculiarity of the Russian privatization schedule is that in comparison with most other countries, the Russian legislative process was a fast one, surprisingly so if the peculiar circumstances of the country are taken into account. However, a price was paid for this legislative diligence, as – to put it mildly – not all the laws passed are necessarily enforced.

Third, because stabilization failed, Russia had to privatize under very high and variable inflation and in general under much economic and political uncertainty. This obviously has an impact on the kinds of procedures available. In particular, the fiscal impact of privatization is bound to be of secondary importance compared with the rather ambitious original intentions⁸. But on the other hand – and this will be amply emphasized below – the peculiar path of Russian privatization may well also have an impact on the economic environment of the enterprises. This is noticed less often, but it may prove crucial.

⁷ See, for instance, Phelps and others, *Needed mechanisms...*

⁸ Anatoly Chubais, *Main issues of privatization in Russia*, in Richard Layard and Anders Åslund, eds., *Change of Economic System in Russia* (London, 1993), maintains that privatization was to have an important fiscal revenue impact.

1.2 The Programme and Outcomes

The Russian privatization programme was not surprisingly a compromise between conflicting goals. In words at least, the Russian government was and remains strongly opposed to any privatization procedures that would imply a give-away of enterprise shares to insiders. As Chubais explained it, give-away insider privatization would not create effective owners and might lead to short-termism, wage maximization and the neglect of investment with obvious consequences for restructuring and technical change⁹. As already noted, such views are in line with mainstream views on corporate control. Though such strong reservations against insider privatization should obviously be taken seriously, it might well be premature to jump into the conclusion that insider privatization originally was and still remains absolutely unacceptable to the government, especially now that it has proven to be the way in which the process actually moves.

At the same time as the government vocally disapproved of give-away insider privatization, this variant of privatization had a somewhat surprising collection of supporters ranging from liberals such as Piyasheva and Selyunin¹⁰ through the spokesmen of the industrialists¹¹ to various oppositional groups¹². This was an important debate in 1992, and remained so in early 1993, as the Parliament pushed for give-away insider privatization. The issue then seemed to have subsided until in Summer 1993 it became the object of another "war of laws" between the reformists and the Parliament.

As well known, the government privatization programme gives enterprises that have been turned into joint-stock companies a choice between three options for privatization. In Option 1, employees are given non-voting shares worth 25 per cent of the company's capital. They are able to buy a further 10 per cent of the shares for vouchers or cash at a 30 per cent discount. Top managers are able to buy 5 per cent. The controlling stake is sold in a single block to an investor or a consortium through a tender or auction. The remaining 10 per cent is auctioned to the public at large, who can pay with vouchers.

In Option 2, employees can buy up to 51 per cent of the shares, paying partly in vouchers, partly in money. The price paid is 1.7 times the book-value of the company. The money used by employees can be money accumulated in the enterprise's privatization fund. Originally, it was intended that a further 10 per cent would be sold to outsiders for vouchers, and the rest – 39 per cent – for cash. Actually, the State Property Fund has tended to keep 20 per cent of the shares for itself.

Option 3, based on restructuring tenders by insiders, is seldom used.

⁹ Chubais, Main issues.

¹⁰ See, for instance, *Literaturnaya Gazeta* 12 December 1990, *Izvestiya* 14 February 1992 and 22 September 1992, *Rossiyskaya Gazeta* 7 April 1992 and *Moskovskie Novosti* 2 February 1992.

¹¹ Volsky in *Izvestiya* 30 September 1992, Vladislavlev in *Nezavisimaya Gazeta* 25 September 1992.

¹² *Politicheskaya deklaratsiya levoy i pravoy oppozitsii*, *Sovetskaya Rossiya* 22 September 1992.

Option 2, that of "insider privatization by sale" has proved overwhelmingly the most popular one. This, it should be emphasized, was contrary to the expressed expectations of the government, which had seemingly believed that privatization Option 1, not Option 2, would be the most popular¹³. By summer 1993, some 70–80 per cent of enterprises to be privatized¹⁴ had actually opted for the second option, giving employees the right to buy a majority of shares at an advantageous price. Payment was in vouchers in up to 85 per cent of the cases¹⁵. On the average, only 22.5 per cent of the shares of a given enterprise were sold in voucher auctions¹⁶. The typical case thus left the state with a minority share of almost 30 per cent.

The use of vouchers for insider privatization, not in voucher auctions, has been much facilitated by the fact that in insider privatization vouchers are assigned a nominal value of 10000 roubles¹⁷. In auctions vouchers have actually the role of points, and their market value was until Autumn 1993 consistently below the nominal value.

As mentioned, the popularity of Option 2 was against the expressed expectations of the government. Still, the prevalence of this option is not difficult to explain. Employees easily see it as an employment guarantee, and the economically logical alternative of investing one's voucher in an outside enterprise is a distant one. Risk might be spread by doing that, but the degree of uncertainty involved is often overwhelming¹⁸. For managers, insider privatization is a way of maintaining existing control rights, as employees are much more probable to be in normal circumstances passive owners than outside investors would be. High inflation reduces accounting values close to zero, and insider purchasing power does not become a major problem. Finally, as will be seen below, certain government regulations – in particular the restrictions imposed on investment funds – have tended to make outside bids notably less probable.

Who are the people buying shares in voucher auctions? This is not actually known. The privatization authorities expected that the majority of voucher-owners would use them to acquire shares in their own company, and perhaps one third would immediately resell their vouchers after receiving them¹⁹. In voucher

¹³ Chubais, Pravda 30 June 1993.

¹⁴ It should be born in mind that according to Goskomstat, over 30 per cent of the industrial property is not to be privatized, privatization of 31 per cent will require a decision by the government and over 20 per cent a decision by the State Property Committee (Izvestiya 20 May 1993).

¹⁵ Ekonomika i zhizn 1993:36.

¹⁶ Izvestiya 21 August 1993.

¹⁷ Bozidar Djelic and Natalia Tsukanova, Voucher Auctions: A Crucial Step towards Privatization, RFE/RL Research Report 23 July 1993, pp. 10–18.

¹⁸ As a knowledgeable journalist explained it: Russian enterprises are offering shares on a basis which would not be acceptable in the West. There is no clear prospectus, no independent audit of the company's balance sheet and past performance, no statement of the company's obligations, and no legal guarantees of a prospective shareholder's rights". Jonathan Steele, Guardian 17 April 1993.

¹⁹ Chubais, Main issues.

auctions up to mid-1993, the average bid was 20 vouchers. At least some degree of ownership concentration has thus taken place. Though Russian law for some reason forbids investment funds from owning more than 10 per cent of the shares of any one company²⁰, there are at least a few well-publicized cases where a large part of the shares is held by an outside investor or group of investors. It also seems that in many cases enterprise employees do resell their shares, although usually to management. While some experts claim that employees have always been passive owners, others argue that this is certainly not the case. The authorities freely admit that they really do not have a clear picture of what is going on. Consequently, many of the shares traded at voucher auctions may also have ended up with enterprise insiders²¹.

Indeed one observer, basing her remarks on research done at Gaidar's Institute for Economic Problems of the Transition Period, informs us that a peculiar 'privatization racket' has come into being. Enterprise insiders may be so frightened about the prospect of outside investors that there is a business of buying company shares in auctions only to immediately resell them to insiders at a very high price. The threat used is that of otherwise becoming an active outside owner²².

Indeed, two authors who were advisors to these auctions state that 'after five voucher auctions in Yaroslavl Oblast it appeared that workers and managers had bought on average 80 per cent of the equity put up for sale. This is a salient feature of the Russian mass privatization program'²³. An extremely well-informed source concludes more generally that 'recently, the most prominent problem (in Russian privatization – P.S.) has become the one connected with the fact that up to 70 per cent of the assets of privatized enterprises are acquired practically free of charge by work collectives'²⁴. Though Yaroslavl Oblast may thus have been an extreme case, high percentages are not exceptional.

²⁰ This non-control rule – to use the terminology proposed by Morris Bornstein – seems to rule out an important class of potential outside core ownership. The rule is thus in blatant contradiction with the opposition to insider ownership professed by the government.

²¹ Much of the information in the last two paragraphs was taken from conference presentations by Maxim Boycko (Stockholm 14–15 June 1993), Andrei Shleifer and Dmitry Vasilyev (Repino, Leningradskaya oblast 26–27 June 1993) and Vladimir Palyutin (Helsinki 27–28 September 1993), all from the Russian State Committee for Privatization.

²² Larisa Gorbatova, *Moskovskye novosti Business* 12 December 1993.

²³ Djelic and Tsukanova, *Voucher Auctions*, p. 15.

²⁴ Evgeny Yasin, *Vybor puti, Delovoi mir* 7 September 1993.

1.3 A Continuing Struggle over Alternative Schemes

Though the extent of insider privatization may have come as a surprise to the government, it seemed in summer 1993 that the insider privatization train can no longer be stopped or even derailed²⁵. The attempt to block voucher privatization had failed both in Parliament and at the local level²⁶.

Still, the conservatives in Parliament continued to fight back. The crucial point of disagreement was still the position of vouchers in privatization, though the competing approaches had changed somewhat. Privatization authorities still wanted to emphasize vouchers, conservative deputies in Parliament and more recently some members of the Chernomyrdin cabinet as well wanted to scale down voucher privatization, both for their own reasons. The Government's draft privatization programme for 1993 argued that 5/6 of all privatization revenue should be in vouchers and less than ten per cent in money²⁷. Conservatives in the parliament demanded that most shares be distributed to employees at almost no cost²⁸. Most recently, a parliamentary specialist demanded the freezing of all large-scale privatization for a period of two to three years²⁹. Privatization was thus one of the crucial points conflict between the Government and Parliament during the running up to the October 1993 political crisis.

As was seen above, privatization has been mostly through vouchers, but not so much in open auctions as in closed insider privatization. So far, if the government originally really wanted to avoid insider control, its policies have failed. Though insider shares are usually purchased with vouchers, the proportion of shares sold through open voucher auctions is very low given the political importance attached to them.

The privatization authorities have attempted to remedy the situation by decreeing the minimum proportion of shares to be sold in auctions. First, there was a February 1993 instruction by the State Property Committee. It could not be implemented³⁰. In May, there was an attempt to fix by presidential decree the minimum proportion of shares in a company to be sold at voucher auctions within three months of registration as a joint stock company at 29 per cent³¹. Under this

²⁵ Chubais in *Nezavisimaya gazeta* 2 June 1993 and in *Izvestiya* 3 June 1993.

²⁶ The main exceptions, the slow movers in privatization, are said to be some politically unstable republics and the regions of Arkhangelsk and Tula (*Izvestiya* 21 August 1993).

²⁷ Proekt: Gosudarstvennaya programma privatizatsii gosudarstvennykh i munitsipalnykh predpriyatii v Rossiyskou Federatsii na 1993 god, *Rossiyskie vesti* 1993a:23.

²⁸ For expositions of this "fourth variant" of privatization see Klyuchnikov and Belkov in *Ekonomika i zhizn* 1993:1 and Klyuchnikov in *Rossiyskaya gazeta* 23 February 1993.

²⁹ Pavel Subbotin, a parliamentary economic advisor in *Rossiyskaya gazeta* 16 September 1993.

³⁰ Djelic and Tsukanova, *Voucher Auctions*.

³¹ *Kommersant* 1993:19, Anatoly Chubais and Maria Vishnevskaya, *Privatization in Russia: mid-1993*, mimeo, Stockholm Institute of East European Economics.

"forced voucherization" legislation, vouchers must thus also be used for buying shares in those companies that might otherwise have been sold totally for money.

In July another presidential decree³² not only repeated this minimum proportion – and shortened the period allowed to two months – but also demanded that vouchers must be used as payment for not less than 80 per cent of the total number of shares for sale in each company. Existing insider privileges were still to be maintained. Indeed, the decrees explicitly ordered that the price to be paid by employees for their proportion of shares should not be adjusted for inflation. Such indexing had been demanded by many, also – a leading privatizer complains – from within the Government³³. The State Property Committee strongly prefers privatization with almost no revenue to no privatization at all.

These decrees, however, fell victim of the political struggle. Instead, the Parliament passed laws making ministries again the owners of state property, thus bypassing the privatization agencies and quite possibly intending to prepare the way for all-round give-away insider privatization.

Later, a presidential decree basically to the same effect as the earlier ones but without any specifics was issued³⁴. The obligatory minimums were fixed in a prime ministerial decree³⁵. This did not prevent a key minister, that of the economy, from demanding that vouchers should be de-emphasized and sales for cash correspondingly increased so as to raise money for the budget³⁶. President Yeltsin first accepted a decree to this effect but then reconsidered³⁷.

Indeed, there seemed to be some need to strengthen the position of the vouchers. Too many of them threatened to be useless within the schedule originally set up. Slightly less than 24 million vouchers of the total of 146 million had been used by the end of July³⁸. It was expected that perhaps one-third of all vouchers distributed would still be in the hands of population at the end of 1993³⁹. This was the time originally set for their expiration. Given the prestige the Government has invested in voucher privatization, this could not be allowed, especially as elections are coming up. The validity of vouchers was duly continued until mid-1994.

Overall, in spite of the privatization programme being pursued, several policy lines have continued to be advocated. (1) Actually existing privatization overwhelmingly means insider privatization by sale, but cheaply. (2) The Government wants to enhance the position of vouchers in open auctions. (3) Many parliamentary deputies favoured give-away insider privatization and (4) the

³² Rossiyskie vesti 28 July 1993.

³³ Dimitry Vasilyev, Deputy Chairman of the State Property Committee in Izvestiya 20 May 1993.

³⁴ Rossiyskie vesti 12 August 1993.

³⁵ Ekonomika i zhizn 1993:34.

³⁶ Financial Times 4–5 September 1993, Nezavisimaya gazeta 9 September 1993.

³⁷ Izvestiya 14 September 1993.

³⁸ Izvestiya 21 August 1993, P. Filippov, Ekonomika i zhizn 1993:37.

³⁹ F. Tabeyev, Chairman of the Russian Federal Property Fund, Ekonomika i zhizn 1993:35.

Minister of the Economy emphasized privatization by sale to garner budget revenue.

Will Russian privatization in the end be of the open voucher type or of the insider privatization kind? Whatever the relevance of different legislation in the current climate, it does not seem improbable that the already well-established combination of insider privatization by sale and voucher auctions will continue in practice. The next most likely alternative may be the gradual abandonment of regulated privatization. That would surely imply much more unregulated privatization, most of which would be of the insider kind. Finally, implementation of the parliamentary concept would result in almost complete insider ownership. The differences between these three paths would perhaps not be all that fundamental. The privatization by sale alternative seems utterly unrealistical due to the lack of prospective bidders⁴⁰. Therefore, whatever the outcome of the political struggle, the implications of insider ownership in the Russian circumstances are surely worth speculating upon.

Though the decrees referred to above aimed at increasing the number of shares to be sold in voucher auctions, any change in this respect was at best slow. Among the 64 voucher auctions listed by *Ekonomika i zhizn* for September 1993⁴¹, only one enterprise was selling the majority of its shares. Only four enterprises were selling more than the 29 minimum decreed. In most cases, 23–29 per cent of the shares were to be sold. In some cases the proportion was less than ten per cent.

While discussing early Russian proposals for voucher privatization, Leonid Grigoryev and Evgeny Yasin wrote back in June 1991⁴² that one of the dangers inherent in the proposals was the birth of an employee-controlled economy: 'A question concerning the goal of privatization is raised: should it be market behaviour on the part of enterprises or the creation of a kind of corporatist system? ... The real question for Russian workers (is not whether to own property but whether – P.S.) ... the entire economy is efficient'. We now turn to evidence on the impact of privatization upon Russian enterprise behaviour.

⁴⁰ Delovoy mir 10 September 1993.

⁴¹ 1993:36.

⁴² Nezavisimaya Gazeta 1 June 1991.

2 The Impact of the Russian Transition of Enterprise Behaviour

2.1 Has the Tempo been too Fast?

Many observers, including the Expert Institute of the Russian Union of Industrialists⁴³, believe that Russian privatization, while aiming at maximum speed, has in fact been nominal. Therefore, they propose a slowing down of the privatization campaign so that enterprises could be better prepared for new circumstances. Enterprises should also be properly audited before privatization so that people could know exactly what they are buying. In short, this opinion argues for partial restructuring before privatization.

Another variation on the theme of speedy privatization is to say that Russian policies have so far resulted in only a large degree of decentralization of economic decision making, as the position of insiders has been strengthened while that of branch ministries has deteriorated⁴⁴. This, Frydman and Rapaczynski add, 'is certainly not equivalent to the introduction of a governance structure characteristic of modern capitalist economies.'

In principle, the whole operating environment of an enterprise – together with its internal structure and rules – changes during the transition. In particular, the incentives and information available for decision making will change even independently of property rights. Thus, both common sense and a comparison of the experiences of Central Eastern European countries would seem to imply that the more credibly the authorities are seen to be establishing hard budget constraints, the better state-owned enterprises adopt their behaviour to market conditions.

2.2 Privatization and the Enterprise Environment

The credibility of the Russian reform cannot be high on this account. On the contrary, Russian privatization is taking place in conditions of failed stabilization and very high inflation. The first bankruptcy procedures were not under way in obscure Russian enterprises until more than a year after the relevant presidential decree was signed and several months after the Act on Bankruptcy took effect on 1 March 1993⁴⁵. Indeed, the draft government economic programme for

⁴³ *Ekonomika i zhizn* 1993:29, *Nezavisimaya gazeta* 22 June 1993.

⁴⁴ Roman Frydman and Andrzej Rapaczynski, *Privatization in Eastern Europe*, *Finance & Development*, 6, 1993, pp. 10–13.

⁴⁵ Y. Tyunkov, *Rossiyskie vesti* 3 September 1993.

1993–1995 maintains that bankruptcy procedures must still be worked out⁴⁶. Both explicit subsidies and directed credits remain plentiful. Indeed, a presidential decree reportedly stipulates that privatized enterprises should not be discriminated against in the distribution of subsidized credits⁴⁷. There has been little change in enterprise managerial personnel. Existing interview evidence confirms the readily available macroeconomic and political evidence; as shown, for instance, by the arrears crisis, many enterprise directors have continued to behave as if the regime had not changed. Indeed, expectations of continued soft budget constraints have been self-fulfilling both because of the policy dilemmas created by enterprise behaviour and because of the use of the arrears crisis for political mobilisation⁴⁸. In this respect the regime has not changed.

The authorities have not only failed to signal their commitment to imposing financial discipline on enterprises. The problem goes deeper. Ickes and Ryterman⁴⁹ argue that given the uncertainty surrounding both the liquidity and solvency of enterprises, radical change in economic incentives could only be accomplished at the risk of serious economic and social dislocation. Without appropriate enterprise-level information, tight policies might cause a huge market failure. Therefore, enterprise managers deliberately suspend payments even when enterprises have sufficient funds, trusting that a general bailing out will be forthcoming. Their expectations were proved correct in summer 1992.

Ickes and Ryterman are also worried about the incentive effects of Russian privatization. Inter-enterprise arrears combine with general economic uncertainty to produce a situation where the viability of enterprises is impossible to judge. For managers, this creates career uncertainty which helps to produce survival-oriented enterprises. Many authorities keen to accelerate privatization will support policies that effectively reduce the liabilities of enterprises because they appear to facilitate the process of privatization. Therefore, debt cancellation and the extension of credit will be favoured not only by industrialists but also by many privatizers even if such policy measures imply the expected continuation of soft budget constraints and various inefficiencies.

Indeed, the existence of a divergence of interests between "stabilizers" and "privatizers" among reformist Russian authorities is a fact. One can go further than Ickes and Ryterman by pointing out at least three additional sources of such conflict. First, for insider privatization by sale, enterprises will be priced on the basis of 1992 book values, which have been decimated by high inflation. As noted above, Russian privatization authorities have succeeded in blocking proposals –

⁴⁶ Proekt: Rabochaya programma Soveta Ministrov – Pravitelstva Rossiyskoy Federatsii na 1993–1995 gody: Razvitie reform i stabilizatsii rossiyskoy ekonomiki, Delovoy mir 13 August 1993.

⁴⁷ D. Nikologorskiy and A. Neshadin, Rossiyskaya gazeta 14 April 1993.

⁴⁸ Barry W. Ickes and Randi Ryterman, The Interenterprise Arrears Crisis in Russia, *Post-Soviet Affairs* 4, 1992, pp. 331–361; David Bigman and Sérgio Pereira Leite, Enterprise Arrears in Russia: Causes and Policy Options, IMF Working Paper WP/93/61, August 1993.

⁴⁹ Barry W. Ickes and Randi Ryterman, Roadblock to Economic Reform: Inter-Enterprise Debt and the Transition to Markets, mimeo, forthcoming in *Post-Soviet Affairs*.

also from within the Government – to adjust these prices for inflation. They want cheap transfers of property titles. As higher property prices would imply more government revenue, they would be preferred from the point of view of fiscal stabilization – and from that of industrial policies.

However, if one accepts that the fiscal revenue impact of privatization will in any case be small, the policy of selling cheaply can be defended. If any price set is largely arbitrary due to the existence of fundamental uncertainty, setting a low price may well be a reasonable policy to follow. At least in that case, nobody should feel that serious amounts of money have been used to buy worthless shares.

The second implied conflict of interest between Russian privatizers and stabilizers is probably more important. Enterprise acquisitions will usually be financed – in addition to vouchers and the enterprise privatization fund available to insiders – by credit. Usually any outside investor will presumably depend on credit. Therefore, it is in the most direct interests of the clients of privatization authorities that inflation will continue to make real interest rates negative. As the current privatization authorities would also like to have responsibility for the financing and guidance of post-privatization structural change, one can assume a coincidence of interests between the privatizers and the enterprise insiders who might not only be their clients but also a potential political power base. This would much strengthen the signal – rightly emphasized by Ickes and Ryterman – that inter-enterprise debt and other implications of soft budget constraints might well continue even after an enterprise has been privatized. Governments can indeed 'remain a hostage to any large group of important enterprises, even if they are privately owned'⁵⁰.

Finally, as Heinrich points out⁵¹, the privatizers have vested much of their political credibility in the process of property transfer. It may simply be infeasible to impose hard budget constraints on enterprises that have been privatized in an environment characterized by so much political fighting. In a situation familiar from many other industrial support cases, the privatization agencies may become prisoners of enterprises all too willing to continue receiving subsidies.

Thus, Russian privatization does not only take place under failed stabilization. Its peculiarities may actually contribute to soft budget constraints, subsidies and high inflation.

2.3 Surveys of Enterprise Behaviour

Various Russian research institutes and other bodies conduct surveys among enterprise managers and employees. Thus, IMEMO, the Institute of World Economy and International Relations, regularly surveys a group of 140–180 industrial enterprises. These surveys are published in various issues of **The**

⁵⁰ Ickes and Ryterman, Roadblocks, pp. 21–22, emphasis deleted.

⁵¹ Ralph Heinrich, The Merits of Insider Privatization, Kieler Diskussionsbeiträge 201, März 1993.

Russian Economic Barometer, and a summary has been published separately⁵². In 1992, most of the enterprises surveyed were in favour of privatization. The relative interest of managers tended to increase during the year, while that of employees declined somewhat. Interestingly, in February 1992 most (58 per cent) surveyed enterprise directors wanted to transfer property totally to workers' collectives. By May, the popularity of this alternative had clearly declined.

A December 1992 IMEMO survey found that about one third of the directors found it difficult to state what consequences they expected from privatization. Those who answered most often expected positive change in labour productivity, profits and wages. Only after that came technical progress, decreased employment and increased production. Short-termism seems to prevail.

The same general thrust is visible in other surveys as well. Boeva and Dolgopiatova of the Reform Centre of the Russian Government report that in their survey – in-depth non-formalized interviews conducted in early 1993 in ten relatively small Russian enterprises – the usual strategy met with was survival, understood as maintaining the existing labour collective⁵³. For this purpose managers still use the well-tested methods of wage maximization and housing construction. Compared with a similar survey conducted a year earlier, priorities seem to have shifted toward small-scale investment for the short-term changing the output mix. This is evidence that enterprises are starting to adjust to market signals.

In the Boeva and Dolgopiatova survey, most managers see privatization primarily as a way of escaping bureaucratic tutelage, especially as state enterprises are no longer expected to receive resources from the state more easily than privatized ones. The state is accused of having abandoned these relatively small enterprises. The managers interviewed do not expect better employee motivation as a consequence of privatization. They are instead concerned about possible wage pressure and general short-termism. However, these managers often foresee the possibility of a future redistribution of ownership away from employees through secondary markets of securities so that more effective governance structures would appear.

Overall, these enterprises are becoming more sensitive to money and prices. This does not, however, imply financial responsibility. These managers still pin their hopes on softer financial constraints, the state, privileges and subsidies. In short, they already know the uses of money, but want to use the old ways to obtain it. To conclude, Boeva and Dolgopiatova characterize the state enterprises interviewed as "a special form of 'partial labour property'" oriented to state paternalism.

Alexashenko and Nabiullina⁵⁴ offer, on the basis of a series of surveys conducted by the Expert Institute of the Russian Union of Industrialists, a classifica-

⁵² Vladislav Belyanov, *Rossiyskie predpriyatiya v usloviyakh krizisa*, *Delovoy mir* 25 March 1993.

⁵³ Irina Boeva and Tatiana Dolgopiatova, *State enterprises during transition: forming of survival strategies*, mimeo, IIASA 1993; Tatiana Dolgopiatova, *Enterprises relations*, mimeo, IIASA 1993.

⁵⁴ Sergey Alexashenko and Elvira Nabiullina, *Enterprises in transition: new models of behavior*, mimeo, IIASA, 1993; Elvira Nabiullina, *Predpriyatie delaet vybor*, *Rossiyskiy soyuz promyshlennikov i predprinimateley*, *Ekspertnyi Institut*, *Diskussionnyi material*, *Vypusk N 7*, Moskva, *Fevral* 1993, pp. 21–39.

tion of the survival strategies of Russian industrial enterprises⁵⁵. Some of the enterprises try to survive by following traditional mores of behaviour, while others have adopted market-oriented behaviour. The majority of enterprises have not yet made their choice.

According to Alexashenko and Nabiullina, the probability of choosing market-orientation increases if enterprises face competition – though only a few do –, produce consumer goods, export their products or import their inputs, produce a large mix of products and have a small burden of non-productive expenses. Such enterprises whose traditional markets have been upset by conversion or the collapse of traditional links with other former Soviet Union enterprises have also been forced to reorient. However, the most important factor in deciding which model of behaviour will be chosen is the personality of the manager.

Alexashenko and Nabiullina conclude that it is not yet possible to judge the impact of privatization on enterprise behaviour. They note that many researchers conclude that privatized enterprises have above-average financial results. This, Alexashenko and Nabiullina point out, does not amount to conclusive proof as the best enterprises have typically been the first ones to be privatized.

Such findings can be interpreted in two divergent ways. It is possible that the effects of privatization have not yet been felt. If this were the case, a 'wait and see' attitude would be the proper one. But it may also be the case that consistent differences in the performance of state-owned and privatized enterprises should not be expected. In the studies summarized by Alexashenko and Nabiullina, the decisive factors for enterprise behaviour were the characteristics of the manager on one hand and the severity of the shocks encountered on the other. Therefore, the crucial change would have to take place in the internal and external environment of enterprise decision-making⁵⁶.

This view is supported strongly by Sergey Vasiliev, the head of the Russian Government Centre for Economic Reform⁵⁷. At first sight somewhat surprisingly, he cites the facts of continuing investment and low unemployment as indications of the 'remarkably high adjustment capacity of Russian enterprises'. Though such adjustment has a passive, adaptive character, it does not depend on privatization. Some state enterprises have been successful, others have tended to fail after privatization. To shift from passive to active restructuring, additional conditions are needed. Vasiliev enumerates clarification of property rights,

⁵⁵ In a recent paper Ickes and Ryterman develop a theory of "Survival-Oriented Enterprises" during the Russian transition. The discussion in this paper can be seen to complement their analysis. See Barry W. Ickes and Randi Ryterman, *From Enterprise to Firm: Notes for a Theory of the Enterprise in Transition*, mimeo, 1993.

⁵⁶ A careful World Bank survey on the adaptation of 41 Russian industrial enterprises in 1992 concludes that the prevailing behavioural rules, namely "rapid adjustment to product prices and a stable pricing rule, combined with a strong acceleration in nominal wage claims and an accommodating monetary policy, are key ingredients for high and sustained inflation". Simon Commander, Leonid Liberman, Cecilia Ugaz and Ruslan Yemtsov, *The Behavior of Russian Firms in 1992*, Policy Research Working Papers WPS 1166, Economic Development Institute, The World Bank, August 1993.

⁵⁷ Sergey A. Vasiliev, *Environmental vs. Institutional Factors of Restructuring*, mimeo, IIASA, Vienna 1993.

creation of a proper financial environment and development of an adequate system of price signals as the most urgent changes.

Such interpretations are in line with traditional orthodoxy on privatization. Not the transfer of property rights as such, but the complex and necessarily evolutionary change of incentives, decision making capacity and information is the mainspring of efficiency. In Russia as elsewhere, the separation of political and economic decisions, together with the emergence of competition⁵⁸, would thus seem to be the real tasks ahead⁵⁹. Even the former cannot be equated with privatization, as the preceding discussion should have shown.

An influential Western study of the Russian privatization process, based on interviews at 27 enterprises in three localities, seems to reach even more pessimistic results than Russian researchers⁶⁰. In this sample, where privatization had been forced upon the enterprises and not selected as a strategy of transformation, privatization was not usually seen as a move towards commercialization, but as a defensive step to preserve the status quo. The primary objective of most managements and workforces in the privatization process, the study concludes, is to retain control of the enterprise. The main advantage seen in privatization was to be relieved of government controls. Most enterprises had opted for the insider majority option, and almost half of the privatized enterprises had consequently made no changes in the way in which they operated. Indeed, only one of the enterprises had anything which approached the Western conception of a business plan. When change had taken place, it was usually in response to external pressures. In no enterprise had incumbent management changed. In summary: 'Living off the past allows the system to continue but there is little evidence of enterprises building a foundation for the future'⁶¹.

⁵⁸ Brown, Ickes and Ryterman argue on the basis of industrial census statistics that the Russian problem of competition is not in industrial concentration but in market segmentation, the lack of a proper distribution system and the absence of entry of new firms. See Annette N. Brown, Barry Ickes, and Randi Ryterman, *The Myth of Monopoly: A New View of Industrial Structure in Russia*, mimeo, IIASA, Vienna 1993.

⁵⁹ An important example is the continuing provision of social security benefits by enterprises. Alexander Telyukov cites five reasons for this: the legacy of paternalism, the politics of survival in privatization, the lack of a procedure for transferring such benefits to be provided by the authorities, taxation-related tactics and the need to secure enterprise finance from pension funds. Naturally, the lack of state and municipal finance could be added to this list. See Alexander Telyukov, *Social Welfare and the Enterprise*, mimeo, IIASA, Vienna 1993.

⁶⁰ KPMG Management Consulting, *A Study of the Russian Privatisation Process: Changing Enterprise Behaviour*, (London, 1993).

⁶¹ KPMG Management Consulting, *A Study*, p. 3.

3 The Impact of Privatization on Russian Systemic Change

3.1 Depolitization of Economic Decision-making

The surveys outlined above have tended to emphasize the impact of change in enterprise environment on the behaviour of privatized enterprises. There are extremely good reasons for doing so, although one should remember that there is also a crucial impact in the opposite direction. Enterprise elites are among those interest groups that may also have an indirect impact on their own environment via economic policies adopted by state authorities.

The possibility of emergence of a corporatist state of peculiar character in Russia is real⁶². Traditionally, Russia has been a society of strong interest groups and a weak state. Currently the state has grown weaker. There are many reasons for that. Among them are the general goal of transition to a market economy and the immense difficulty of transiting from Soviet institutions to Russian ones. A persistent and fundamental uncertainty concerning Russian statehood still remains. There is a seemingly endemic political conflict at the Moscow centre with its consequent struggles over budgets and laws. Warring authorities in Moscow use policy decentralization as a political bait to lure regional support. There is also spontaneous demand for more autonomy in several regions and, ensuingly, spontaneous decentralization of Russia. There is also widely-spread corruption and other reasons for the continuing weakening of the Russian state. But whatever the reasons for weak state, this fact itself is under no doubt. It has been similarly diagnosed by liberals such as Vitaly Naishul⁶³, by centrists such as the Expert Institute of the Russian Union of Industrialist⁶⁴ and naturally by conservatives and reactionaries of different kinds. The policy conclusions presented naturally differ.

One important consequence of a weak state is the regional differentiation of privatization procedures. This is important, as it will tend to create segmented property structures and therefore contribute to the dissolution of the Russian economic area. This, however, is not the whole story. The insider privatization option evolving in Russia also implies a strengthening of existing industrial elites within enterprises. Due to the weak organizational capacity that these interest groups seem to have – as evidenced by the collapse of the Civic Union – the de facto power vacuum left by the central state will not necessarily be filled by the usual corporatist organs. But if one assumes that Russia will not lapse into total anarchy, the state will maintain the capacity to collect revenue and regulate

⁶² Pekka Sutela, Overview, in Pekka Sutela, ed., *The Russian Economy in Crisis and Transition*, (Helsinki, 1993), pp. 9–23.

⁶³ Vitaly Naishul', *Liberalism, Customary Rights and Economic Reforms*, *Communist Economics & Economic Transformation* 1, 1993, pp. 29–44.

⁶⁴ *Edinstvo reformy i reforma edinstva (doklad Ekspertnogo instituta Rossiyskogo soyuza promyshlennikov i predprinimateley)*, *Obshchestvo i ekonomika* 1, 1993, pp. 34–55.

society. Therefore, the industrial lobbies will remain interested in influencing state policies, in particular as far as taxation, subsidies, competition policy, public procurement, foreign trade and investment regulation and other similar measures with an immediate bearing upon the well-being of enterprises are concerned. As the strengthening of the state will be necessarily a difficult and lengthy process – if it were attempted seriously – the state will sooner become an arena for vested interests than an activist agent for industrial policies.

In short, this would be the corporatism of a weak state in the Latin American mode, not corporatism of a strong state in the mode of certain small European nations. There would be no fundamental separation of the economy from political decisions.

3.2 Corporate Governance

In addition to depolitization, the other goal often set for privatization is 'the creation of a new institutional structure of corporate governance which would not favour a policy of massive state support, but would rather give rise to powerful new interests opposed to state intervention'⁶⁵. As Frydman and Rapaczynski add, such corporate governance is not the inevitable result of privatization. 'If the state withdraws from its ownership position and leaves in its place a structure in which the insiders remain in effective control of the formally privatized enterprises, while at the same time their incentives are not radically altered, it is very likely that they will continue to pursue policies and strategies designed to force the government into a new system of **political** enterprise governance. ... The effect might very well turn out to be a crystallization of the now still inchoate entitlements into formal ownership...'

The Russian mass privatization programme was intended to avoid these problems. It offered unlimited consumer choice so that voucher holders could use their vouchers either to buy shares in a company of their choice or invest them in one of the intermediaries. The free development of secondary markets was foreseen as vouchers and shares are immediately transferable. The programme also provided for free entry of intermediaries and the state is precommitted to non-intervention. There has also been important practical progress in these respects. As noted above, voucher auctions have spread fast. There is also a degree of voucher ownership concentration, as evidenced by the above-cited average auction bid of twenty vouchers. Still, secondary markets remain rudimentary. An infrastructure of nation-wide auctions to complement the prevailing regional auctions is developing, though the voucher auction market still remains segmented⁶⁶. The number of intermediaries, i.e. investment funds, has grown fast, from about one hundred in February 1993 to 550 in August 1993. By that time, they seemed to

⁶⁵ Frydman and Rapaczynski, *Insiders and the state*, p. 40.

⁶⁶ P. Filippov, *Ekonomika i zhizn* 1993:37.

have acquired 25 million vouchers – one sixth of the total issued⁶⁷. Other sources even claimed that the funds have as many as one third of all vouchers⁶⁸.

Very little is known of the incipient Russian investment funds. Their numbers and voucher ownership are extremely large, but the legal provisions limiting these funds to owning not more than ten per cent of the shares of any one company confine them to a subsidiary role in the governance of the privatized enterprises⁶⁹. The possibility that funds might in some cases not be genuine outsiders but might also be used as vehicles by insiders, can certainly not be excluded⁷⁰.

Curiously enough, Russian banks do not currently face ownership limitations similar to those of investment funds⁷¹. Though short-term activities are currently more profitable than long-term investment in securities, Russian banks thus might in principle develop into German type universal banks with extensive equity portfolios. Possible restriction to bank ownership are however currently debated in Russia, and it thus seems that the final choice concerning the possible role of banks as outside core investors has not yet been made⁷².

The Russian authorities obviously believe that the secondary markets for shares will be activated as employees soon start cashing in their substantial capital gains. They also seem to believe that employees will in any case remain passive owners. Insider ownership would thus imply control by managers, not actual employee ownership. Neither of these beliefs can be invalidated or substantiated for the time being, but it is certainly not easy to trust in the relevance of the Coase theorem in Russia. As Phelps and others⁷³ note, there are serious grounds for concern about the development of secondary share markets in Russia.

In general, one should ask whether governance structures can be imposed by the state. In Poland and Hungary insider interests have to a large degree been

⁶⁷ Delovoy mir 17 August 1993.

⁶⁸ A. Abramov of the State Property Committee, *Ekonomika i zhizn* 1993:36.

⁶⁹ This is the non-control rule already mentioned. There is also – to continue using terminology proposed by Morris Bornstein – a diversification rule: funds are legally limited to investing no more than 5 per cent of assets in securities of any one enterprise. For a fuller discussion of the varieties of Russian funds see Silvana Malle, *Entrepreneurship and Privatization on The Enterprise Level: Russia 1993*, forthcoming in *Journal of International and Comparative Economics*, 1994.

⁷⁰ Possibly for this reason, no investment fund can invest more than 5 per cent of its net assets in the securities of any one enterprise. This also implies that funds have to spread their probably extremely scarce control, analytical and governance resources over at least a score of enterprises.

⁷¹ At least St. Petersburg banks were in autumn 1993 ignorant of any such limitations. Inkeri Hirvensalo, Bank of Finland, interview material.

⁷² Banks and other financial institutions would clearly be the only potential Russian buyers with money. Russian central bank statistics show that of the approximately 5.6 trillion SUR non-cash balances held, industry had in 1 September 1993 less than 19 per cent – and agriculture a meagre 3.1 per cent – while "other branches" had accumulated a whopping 56.5 per cent. *Tsentralnyi Bank Rossiyskoy Federatsii, Byulleten bankovskoy statistiki* 1993:4, p. 28. In addition to banks and other financial institutions, "other branches" presumably includes extra-budgetary funds.

⁷³ Phelps and others, *Needed mechanisms*. One of the authors, Shleifer, is an adviser to the Russian privatization authorities. For his cogent comments on Russian corruption see Andrei Shleifer and Robert W. Vishny, *Corruption*, NBER Working Paper No 4372, May 1993.

involved in successful privatization even when this was not the goal of explicit state policies. In the Czech Republic, mass privatization led to dominance by investment funds and perhaps – but just perhaps – to an efficient governance structure. But even in this case one may well ask whether the original intention was that banks would have such a crucial role as they now have, as they own all but one of the dominant investment fund⁷⁴.

The Russian case would seem to be one in which, for the initial period at least, insider interests have prevailed over declared government policies that intended to create a different distribution of property rights. The Government more or less announced that it was investing its credibility in voucher privatization⁷⁵. In fact, privatization was taken over by insiders. Still, as was amply emphasised above, the Government may well feel obliged to bail out failing privatized enterprises precisely because so much political prestige and power is at stake in privatization. In any case Russian privatizers must by now have accepted the fact – whether they originally liked it or not – that Russian privatization is either of the insider kind or nonexistent.

3.3 Towards a New Economic System in Russia?

As has been seen above, there are many arguments against insider control of enterprises. Above, they were compressed under the terms of equity, managerialism, short-termism and structural immobility. In the Russian case in particular, as pointed out above, insider control may well enforce the existing tendencies of state intervention, corporatism, favouritism, corruption, paternalism and protectionism. In short, insider control should be condemned on grounds of both equity and efficiency.

Not surprisingly, outside analysts, including the international financial institutions, tend to be quite concerned about the extent of insider control in Russian privatization⁷⁶.

A totally different perspective also exists. A number of economists have argued in a Hayekian vein that insider control is nothing more than the natural

⁷⁴ Such a position of banks leads to three questions. First, how will the banks, which are still state-owned, be themselves privatized? Second, what is the probability of these institutional investors being active owners? Third, if the banking system is to be concentrated, how probable is it that the state will really impose hard budget constraints on them and not bail them out in the event of a banking crisis, when the credibility of the whole financial system may be at stake?

⁷⁵ It has been pointed out that the official Russian emphasis on vouchers may have been little more than a smokescreen behind which the government in fact furthered insider privatization. The restrictions on investment funds mentioned above would surely support this interpretation, but at the same time all the political infighting around alternative privatization schemes would amount to a relatively complex smokescreen.

⁷⁶ EBRD, *Privatisation in Russia*, A Discussion Paper for the Consultative Group in Paris, 8 and 9 June, 1993; IBRD, *Privatization and Restructuring of Enterprises in Russia: A Revised Approach*, mimeo, June 14 1993.

consequence of the way in which Russia has developed in recent decades⁷⁷. According to Heinrich, Russia would be well advised to enhance the preferential conditions for insiders even further and scale down the scope of its voucher program. Naishul goes further and argues that "privatization is unnecessary and harmful" because a naturally developed distribution of property rights already exists.

Heinrich argues that insider control is not only inevitable but also economically more efficient than generally conceded. His arguments are not convincing as they neglect to consider the issue which was deemed crucial above: the possible impact of insider privatization upon the market environment through state policies.

⁷⁷ Heinrich, *The Merits*; Naishul, *Liberalism*.

4 Concluding Remarks

It is naturally too early to judge the final consequences of Russian privatization policies for systemic change. Still, the main conclusion should be clear. Contrary to what the position of vouchers as the central issue of Russian privatization debates might seem to imply, Russian privatization is overwhelmingly creating insider control, not corporate governance by strong outside owners. Most analysts do not think this will be good for the future efficiency of the Russian economy.

Naturally, if one were to take the Coasian parables of economics seriously, this might not have all that much importance. Current privatization might just be the period of handing out initial endowments, and ensuing market processes would eventually secure the emergence of effective property relations. In this view, the current process would be one of defining existing property relations, to be followed by true privatization sometime in the future. There is much circumstantial evidence that this is exactly how many within the Russian government have tended to see the current phase of Russian privatization.

This is not an argument that should be overlooked, and the empirical issues of retrading shares and distinguishing between active and passive owners will be important and interesting to follow. Still, ownership gives power which helps to preserve any property constellations that have originally emerged. A possible redistribution of property titles does not take place outside historical time. It is a path-dependent process of production, investment and structural change. The chance that original distribution might lock historical developments into a pattern should not be excluded. If this perspective should prove relevant, a peculiar economic system may be developing in Russia.

Important issues still remain to be followed and analysed. First of all, this paper has concentrated on insider control without generally distinguishing between decision making by managers and employees. The actual division of power with its ensuing implications for structure and performance remains to be seen, but the general thrust of evidence presented above points in the direction of decision making by managers with somewhat strong constraints set by employees.

Secondly, this paper by no means claims to amount to an economic analysis of the long-term feasibility and performance of the peculiar economic system speculated upon. This work – if it is deemed worthwhile – is remains to be done.

REVIEW OF ECONOMIES IN TRANSITION

from number 4 ISSN 1235-7405

- 1/92 Pekka Sutela: **Neuvostoliiton hajoamisen taloudelliset aspektit.** 24 s.
Jouko Rautava: **Suomen ja Venäjän taloussuhteet Suomen EY-jäsenyyden valossa.** 12 s.
- 2/92 Seija Lainela - Jouko Rautava **Neuvostoliiton talouskehitys vuonna 1991.** 15 s.
Seija Lainela **Viron taloudellisen kehityksen lähtökohdat.** 9 s.
Merja Tekoniemi **Yksityistäminen itäisen Euroopan maissa ja Baltiassa.** 7 s.
- 3/92 Kamil Janáček **Transformation of Czechoslovakia's Economy: Results, Prospects, Open Issues.** 20 p.
Sergey Alexashenko **General Remarks on the Speed of Transformation in the Socialist Countries.** 25 p.
Sergey Alexashenko **The Free Exchange Rate in Russia: Policy, Dynamics, and Projections for the Future.** 19 p.
Jouko Rautava **Liikaraha, inflaatio ja vakauttaminen.** 16 s.
- 4/92 Stanislava Janáčková - Kamil Janáček **Privatization in Czechoslovakia.** 8 p.
Sergey Alexashenko **The Collapse of the Soviet Fiscal System: What Should Be Done?** 45 p.
Juhani Laurila **Neuvostoliiton ja Venäjän velka.** 23 s.
Jukka Kero **Neuvostoliiton ja Venäjän ulkomaankauppa.** 24 s.
- 5/92 Pekka Sutela **Clearing, Money and Investment: The Finnish Perspective on Trading with the USSR.** 26 p.
Petri Matikainen **"Suuri pamaus" - Puolan taloussuudistus 1990.** 22 s.
- 6/92 Miroslav Hrnčíř **Foreign Trade and Exchange Rate in Czechoslovakia: Challenges of the Transition and Economic Recovery.** 39 p.
Terhi Kivilahti - Jukka Kero - Merja Tekoniemi **Venäjän rahoitus- ja pankkijärjestelmä.** 37 s.
- 7/92 Seija Lainela **Baltian maiden rahauudistukset.** 23 s.
Seija Lainela - Jouko Rautava **Baltian maiden poliittisen ja taloudellisen kehityksen taustat ja nykytilanne.** 14 s.
Sergei Alexashenko **Verojen ja tulonsiirtojen jakautuminen entisessä Neuvostoliitossa.** 17 s.
- 1/93 Pekka Sutela **Taloudellinen transitio Venäjällä.** 11 s.
Pekka Sutela **Venäjän taloudellinen voima 2000-luvulla.** 9 s.
Pekka Sutela **Itäinen Eurooppa integraatiossa: ottopoikia, sisarpuolia vai ...** 11 s.
- 2/93 Inkeri Hirvensalo **Changes in the Competitive Advantages of Finnish Exporters in the Former USSR after the Abolition of the Clearing Payment System.** 35 p.
Miroslav Hrnčíř **The Exchange Rate Regime and Economic Recovery.** 17 p.
Gábor Oblath **Real Exchange Rate Changes and Exchange Rate Policy under Economic Transformation in Hungary and Central-Eastern Europe.** 31 p.
Gábor Oblath **Interpreting and Implementing Currency Convertibility in Central and Eastern Europe: a Hungarian Perspective.** 19 p.
- 3/93 Jouko Rautava **Venäjän järjestelmämuutos ja talouskehitys 1992.** 19 s.
Seija Lainela **Baltian maiden talous vuonna 1992.** 25 s.
Pekka Sutela **Itäinen Eurooppa vuonna 1992.** 14 s.
- 4/93 Jouko Rautava **Monetary Overhang, Inflation and Stabilization in the Economies in Transition.** 17 p.
Jarmo Eronen **Manufacturing Industries before and after the Collapse of Soviet Markets: a Comparison of Finnish and Czechoslovak Experience.** 19 p.

- 5/93 Pekka Sutela **Uusi hanke entisen rupla-alueen kaupankäynnin monenkeskeistämiseksi.** 8 s.
Juhani Laurila **Venäjän velkakriisin kehitys ja nykytilanne.** 10 s.
- 6/93 Jouko Rautava **Yritystuesta sosiaaliturvaan: Julkisen tuen muutospaineet Venäjällä.** 7 s.
Jarmo Eronen **Venäjän uusi hallinnollinen aluejako.** 7 s.
Aleksei Tkatchenko **Pienyrittäjäisyys Venäjällä: Nykytilanne ja kehitysnäkymät.** 35 s.
- 7/93 Tuula Ryttilä **Russian Monetary Policy Since January 1992.** 20 p.
Inkeri Hirvensalo **Developments in the Russian Banking Sector in 1992-1993.** 22 p.
- 8/93 Seija Lainela - Pekka Sutela **Introducing New Currencies in the Baltic Countries.** 26 p.
Inna Shteinbuka **The Baltics' ways: Intentions, Scenarios, Prospects.** 27 p.
Inna Shteinbuka **Latvia in Transition: First Challenges and First Results.** 33 p.
Inna Shteinbuka **Industry Policy in Transition: the Case of Latvia.** 30 p.
- 9/93 Jouko Rautava **Venäjän keskeiset taloustapahtumat heinä- syyskuussa 1993.** 10 s.
Merja Tekoniemi **Venäjän parlamenttivaalien poliittiset ryhmittymät.** 3 s.
Jarmo Eronen **Venäläinen ja suomalainen periferia: Permin Komin ja Kainuun luetaloudellista vertailua.** 29 s.
- 10/93 Seija Lainela **Venäjän federatiivisen rakenteen muotoutuminen ja taloudellinen päätöksenteko; Pietarin asema.** 14 s.
Inkeri Hirvensalo **Pankkitoimintaa Pietarissa.** 14 s.
Juhani Laurila **Suoran sijoitustoiminnan kehittyminen Venäjällä ja Suomen lähialueella.** 29 s.
Juhani Laurila **Suomen saamiset Venäjältä. Valuuttakurssimuutosten ja vakautusten vaikutukset.** 8 s.
- 1/94 Pekka Sutela **Insider Privatization in Russia: Speculations on Systemic Change.** 22 p.
Inkeri Hirvensalo **Banking in St.Petersburg.** 18 p.
- 2/94 Aleksei Tkatchenko **Pienyritysten yksityistäminen Venäjällä.** 23 s.
Jarmo Eronen **Konversio Venäjällä: tulosten tarkastelua.** 10 s.
- 3/94 Juhani Laurila **Direct Investment from Finland to Russia, Baltic and Central Eastern European Countries: Results of a Survey by the Bank of Finland.** 14 p.
Juhani Laurila **Finland's Changing Economic Relations with Russia and the Baltic States.** 11 p.
Jouko Rautava **EC Integration: Does It Mean East-West Disintegration.** 8 p.
Eugene Gavrilenkov **Macroeconomic Crisis and Price Distortions in Russia.** 20 p.
Eugene Gavrilenkov **Russia: Out of the Post-Soviet Macroeconomic Deadlock through a Labyrinth of Reforms.** 22 p.
- 4/94 Jouko Rautava **Venäjän järjestelmämuutos ja talouskehitys 1993.** 16 s.
Seija Lainela **Baltian maat vuonna 1993.** 19 s.
Jouko Rautava **Suomen idänkauppa 1990-93.** 7 s.
- 5/94 Pekka Sutela **Production, Employment and Inflation in the Baltic Countries.** 22 p.
Seija Lainela **Private Sector Development and Liberalization in the Baltics.** 14 p.
Seija Lainela **Small Countries Establishing Their Own Independent Monetary Systems: the Case of the Baltics.** 17 p.
- 6/94 Merja Tekoniemi **Työttömyys ja sosiaaliturva Venäjällä.** 31 s.
- 7/94 Pekka Sutela **Fiscal Federalism in Russia.** 23 p.
Jouko Rautava **Interdependence of Politics and Economic Development: Financial Stabilization in Russia.** 12 p.
Eugene Gavrilenkov **"Monetarism" and Monetary Policy in Russia.** 8 p.

- 8/94 Pekka Sutela **The Instability of Political Regimes, Prices and Enterprise Financing and Their Impact on the External Activities of the Russian Enterprises.** 31 p.
 Juhani Laurila **The Republic of Karelia: Its Economy and Financial Administration.** 37 p.
 Inkeri Hirvensalo **Banking Reform in Estonia.** 21 p.
- 9/94 Jouko Rautava **Euroopan unionin ja Venäjän välinen kumppanuus- ja yhteistyösopimus - näkökohtia Suomen kannalta.** 7 s.
- 10/94 Seija Lainela - Pekka Sutela **The Comparative Efficiency of Baltic Monetary Reforms.** 22 p.
 Tuula Ryttilä **Monetary Policy in Russia.** 22 p.
- 11/94 Merja Tekoniemi **Miksi Venäjän virallinen työttömyysaste on säilynyt alhaisena?** 19 s.
- 1/95 Jouko Rautava **Venäjän järjestelmämuutos ja talouskehitys 1994.** 19 s.
 Seija Lainela **Baltian maat vuonna 1994.** 21 s.
 Vesa Korhonen **Itäisen Euroopan talouskehitys 1994.** 19 s.
- 2/95 Urmas Sepp **Inflation in Estonia: the Effect of Transition.** 27 p.
 Urmas Sepp **Financial Intermediation in Estonia.** 32 p.
- 3/95 Vesa Korhonen **EU:n ja Venäjän kumppanuus- ja yhteistyösopimus.** 31 s.
 Jouko Rautava **Taloussintegraatio ja Suomen turvallisuus - Suomi Euroopan unionin idän taloussuhteissa.** 21 s.
 Jouko Rautava **Suomen idänkauppa 1985-94.** 10 s.
- 4/95 Nina Oding **Evolution of the Budgeting Process in St. Petersburg.** 29 p.
 Urmas Sepp **A Note on Inflation under the Estonian Currency Board.** 12 p.
 Pekka Sutela **But ... Does Mr. Coase Go to Russia?** 14 p.
- 5/95 Urmas Sepp **Estonia's Transition to a Market Economy 1995.** 57 p.
- 6/95 Niina Pautola **The New Trade Theory and the Pattern of East-West Trade in the New Europe.** 21 p.
 Nina Oding **Investment needs of the St.Petersburg Economy and the Possibilities to meeting them.** 20 p.
 Panu Kalmi **Evolution of Ownership Change and Corporate Control in Poland.** 21 p.
- 7/95 Vesa Korhonen **Venäjän IMF-vakauttamisohjelma 1995 ja Venäjän talouden tilanne.** 37 s.
 Inkeri Hirvensalo **Maksurästit Venäjän transitiotaloudessa.** 30 s.
 Seija Lainela **Baltian maiden omat valuutat ja talouden vakautus - pienten maiden suuri menestys.** 14 s.
- 8/95 Pekka Sutela **Economies Under Socialism: the Russian Case.** 17 p.
 Vladimir Mau **Searching for Economic Reforms: Soviet Economists on the Road to Perestroika.** 19 p.
- 9/95 Niina Pautola **East-West Integration.** 33 p.
 Panu Kalmi **Insider-Led Privatization in Poland, Russia and Lithuania: a Comparison.** 16 p.
 Iikka Korhonen **Equity Markets in Russia.** 14 p.
 Jury V. Mishalchenko - Niina Pautola **The Taxation of Banks in Russia.** 5 p.
- 1/96 Juhani Laurila **Payment Arrangements among Economies in Transition: the Case of the CIS.** 23 p.
 Sergei Sutyryn **Problems and Prospects of Economic Reintegration within the CIS.** 17 p.
 Viktor V. Zakharov - Sergei F. Sutyryn **Manager Training - Another Emerging Market in Russian Educational Services.** 9 p.

- 2/96 Jouko Rautava **Venäjän järjestelmämuutos ja talouskehitys vuonna 1995.** 12 s.
 Juhani Laurila **Katsaus lähialueisiin.** 28 s.
 Iikka Korhonen **Baltian vuosikatsaus.** 10 s.
 Pekka Sutela **Ukrainan ja Valkovenäjän taloudet vuonna 1995.** 10 s.
 Vesa Korhonen **Itäisen Euroopan siirtymätalouksien kehitys 1995.** 17 s.
- 3/96 Niina Pautola **Intra-Baltic Trade and Baltic Integration.** 12 p.
 Vesa Korhonen **The Baltic Countries - Changing Foreign Trade Patterns and the Nordic Connection.** 16 p.
 Iikka Korhonen **Banking Sectors in Baltic Countries.** 22 p.
- 4/96 Niina Pautola **Trends in EU-Russia Trade, Aid and Cooperation.** 16 p.
 Niina Pautola **The Baltic States and the European Union - on the Road to Membership.** 20 p.
 Elena G. Efimova - Sergei F. Sutyryn **The Transport Network Structure of the St.Petersburg Region and its Impact on Russian-Finnish Economic Cooperation.** 11 p.
 Iikka Korhonen **An Error Correction Model for Russian Inflation.** 10 p.
- 5/96 Juhani Laurila - Inkeri Hirvensalo **Direct Investment from Finland to Eastern Europe; Results of the 1995 Bank of Finland Survey.** 21 p.
 Tatiana Popova - Merja Tekoniemi **Social Consequences of Economic Reform in Russia.** 26 p.
 Iikka Korhonen **Dollarization in Lithuania.** 7 p.
- 6/96 Juhani Laurila - Inkeri Hirvensalo **Suorat sijoitukset Suomesta Itä-Eurooppaan; Suomen Pankin vuonna 1995 tekemän kyselyn tulokset.** 20 s.
 Jouko Rautava **Suomi, Euroopan Unioni ja Venäjä.** 6 s.
 Niina Pautola **Baltian maiden talouskatsaus 1996.** 12 s.
- 1/97 Panu Kalmi **Ownership Change in Employee-Owned Enterprises in Poland and Russia.** 51 p.
- 2/97 Niina Pautola **Fiscal Transition in the Baltics.** 23 p.
 Peter Backé **Interlinkages Between European Monetary Union and a Future EU Enlargement to Central and Eastern Europe.** 19 p.
- 3/97 Iikka Korhonen **A Few Observations on the Monetary and Exchange Rate Policies of Transition Economies.** 8 p.
 Iikka Korhonen **A Brief Assessment of Russia's Treasury Bill Market.** 8 p.
 Rasa Dale **Currency Boards.** 14 p.
- 4/97 Sergei F. Sutyryn **Russia's International Economic Strategy: A General Assessment.** 17 p.
 Tatiana Popova **The Cultural Consequences of Russian Reform.** 17 p.
 Ludmilla V. Popova - Sergei F. Sutyryn **Trends and Perspectives in Sino-Russian Trade.** 11 p.
- 5/97 Jouko Rautava **Venäjän järjestelmämuutos ja talouskehitys vuonna 1996.** 10 s.
 Iikka Korhonen - Niina Pautola **Baltian talouskatsaus 1996.** 12 s.
 Merja Tekoniemi **Katsaus lähialueisiin 1996.** 11 s.
 Merja Tekoniemi **Ukrainan talouskatsaus 1996.** 10 s.
 Kari Pekonen **Valko-Venäjän talous vuonna 1996.** 6 s.
 Katri Lehtonen **Keski- ja Itä-Euroopan talouskehitys vuonna 1996.** 13 s.
- 6/97 Niina Pautola **Towards European Union Eastern Enlargement - Progress and Problems in Pre-Accession.** 17 p.
 Katri Lehtonen **Theory of Economic Reform and the Case of Poland.** 26 p.
 Boris Brodsky **Dollarization and Monetary Policy in Russia.** 14 p.
- 7/97 Toivo Kuus **Estonia and EMU Prospect.** 24 p.
 Olga Luššik **The Anatomy of the Tallinn Stock Exchange.** 23 p.
 Riia Arukaevu **Estonian Money Market.** 20 p.

- 1/98 Iikka Korhonen **The Sustainability of Russian Fiscal Policy.** 8 p.
Tatiana Popova - Merja Tekoniemi **Challenges to Reforming Russia's Tax System.** 18 p.
Niina Pautola **Optimal Currency Areas, EMU and the Outlook for Eastern Europe.** 25 p.
- 2/98 Peter Westin **Comparative Advantage and Characteristics of Russia's Trade with the European Union.** 26 p.
Urszula Kosterna **On the Road to the European Union - Some Remarks on Budgetary Performance in Transition Economies.** 31 p.
- 3/98 Jouko Rautava **Venäjän järjestelmämuutos ja talouskehitys vuonna 1997.** 11 s.
Merja Tekoniemi **Keskuksen ja alueiden välisten suhteiden kehitys Venäjällä 1992-1997.** 10 s.
Niina Pautola **Baltian talouskatsaus 1997.** 11 s.
Merja Tekoniemi **Katsaus Suomen kauppaan IVY-maiden ja Baltian maiden kanssa 1990-1997.** 11 s.
Tom Nordman **Kiinan talouden tila ja ongelmat.** 11 s.
Merja Tekoniemi **Ukrainan talouskatsaus 1997.** 10 s.
Iikka Korhonen **Keski- ja Itä-Euroopan talouskehitys 1997.** 12 s.
- 4/98 Kustaa Äimä **Central Bank Independence in the Baltic Policy.** 30 p.
Iikka Korhonen – Hanna Pesonen **The Short and Variable Lags of Russian Monetary Policy.** 11p.
Hanna Pesonen **Assessing Causal Linkages between the Emerging Stock Markets of Asia and Russia.** 10 p.
- 5/98 Laura Solanko **Issues in Intergovernmental Fiscal Relations – Possible Lessons for Economies in Transition.** 19 p.
Iikka Korhonen **Preliminary Tests on Price Formation and Weak-form Efficiency in Baltic Stock Exchanges.** 7 p.
Iikka Korhonen **A Vector Error Correction Model for Prices, Money, Output, and Interest Rate in Russia.** 12 p.
Tom Nordman **Will China catch the Asian Flu?** 14 p.
- 6/98 Saga Holmberg **Recent Reforms in Information Disclosure and Shareholders' Rights in Russia.** 17 p.
Vladimir R. Evstigneev **Estimating the Opening-Up Shock: an Optimal Portfolio Approach to Would-Be Integration of the C.I.S. Financial Markets.** 39 p.
Laura Solanko – Merja Tekoniemi **Novgorod and Pskov – Examples of How Economic Policy Can Influence Economic Development.** 14 p.
Ülle Lõhmus - Dimitri G. Demekas **An Index of Coincident Economic Indicators for Estonia.** 12p.
- 7/98 Tatyana Popova **Financial-Industrial Groups (FIGs) and Their Roles in the Russian Economy.** 24p.
Mikhail Dmitriyev – Mikhail Matovnikov – Leonid Mikhailov – Lyudmila Sycheva **Russian Stabilization Policy and the Banking Sector, as Reflected in the Portfolios of Moscow Banks in 1995–97.** 29 p.
- 1/99 Jouko Rautava **Venäjän järjestelmämuutos ja talouskehitys vuonna 1998.** 10 s.
Iikka Korhonen – Seija Lainela **Baltian maat vuonna 1998.** 10 s.
Tom Nordman **Kiinan talouden tila ja näkymät.** 13 s.
Pekka Sutela **Ukrainan talouskatsaus 1998.** 14 s.
Iikka Korhonen **Keski- ja Itä-Euroopan talouskehitys vuonna 1998.** 10 s.