

Sondhof, Harald W.

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Harald Sondhof\*

# Privatisation Policy in Russia

## From Ineffective Denationalisation to the Creation of Effective Ownership Structures

*Since Russia's process of privatisation got under way in 1992 a large proportion of the country's state-owned enterprises have been turned into private legal entities and have been transferred into private property. However, the desired economic success has so far largely remained elusive. What deficiencies in the privatisation policy have caused this? What can be done to solve the problems?*

The privatisation of the economy has been at the heart of Russia's reform policy from its outset. In 1992 a process of privatisation got under way which turned many Russian industrial enterprises into private legal entities, often with majority ownership passing to private individuals or companies. In addition, numerous businesses in the retail trade as well as parts of the infrastructure were privatised, e.g. a number of airports. The West, which had supported the privatisation policy both conceptually and by offering technical assistance, celebrated these outcomes as an example of successful support for the Russian transition process.<sup>1</sup> However, macroeconomic success has largely not materialised. Even before the crisis in August 1998, which signaled the failure of the Russian transition strategy, economic growth rates were modest at best. Economic stagnation is expected to continue for several more years, although the World Bank reports that more than 60% of Russia's economic output is now produced in the private sector.

Russia's unsatisfactory economic progress highlights the importance of creating a sound institutional framework to give a market economy the chance to function – and also to allow individual reform elements, such as privatisation, to be effective. Russia has not yet succeeded in creating a binding legal framework for its economic actors, and credible institutions to implement the law. Tax law, for example, is still fundamentally Soviet in character and is a veritable maze.<sup>2</sup> For large business enterprises tax payments are a matter of negotiation. On the other hand, the bankruptcy law, which was passed by the

Russian parliament in 1998 and on the whole provides a good basis for restructuring enterprises, is hardly ever applied due to lack of experience in enforcing rules of this kind. To this day the anti-trust authority has not asserted any control over monopolistic behaviour. In such an imperfect market environment the conceptual weaknesses of the Russian privatisation programme produce particularly negative results.

From the beginning the crucial weakness of Russia's privatisation policy was that it completely neglected the creation of efficient structures of ownership. Even after 1997, when the Russian parliament, the Duma, passed a new privatisation law replacing all the presidential decrees previously in force, it is not ensured that enterprises are sold to serious investors with long-term prospects. When the ownership rights of former state-owned enterprises are for sale, insiders from within the business's existing management structure or from the ministries responsible for these industries are as a rule favoured, while outsiders and foreign investors are systematically placed at a disadvantage. Mostly, therefore, privatisation has not helped businesses to acquire new management expertise, nor injected much fresh capital. As such, it has largely failed to produce the impetus for badly needed company restructuring which might otherwise have been provided by the change from state to private ownership. As experience has shown, the removal of incompetent owner-managers can take a long time if an effective

<sup>1</sup> See the critical analysis of US technical assistance by Janine Wedel: *Collision and Collusion, The Strange Case of Western Aid to Eastern Europe 1989-1998*, New York 1998, pp. 136 ff.

<sup>2</sup> One of the typical problems is that marketing and promotional expenses are only tax-deductible to a very limited extent because these activities are 'capitalist'.

\* Head of the German Ministry of Finance/GTZ Working Group, Moscow, Russia.

framework for a market economy does not exist. In the meantime, the formally privatised businesses suffer lasting damage, the workforce goes unpaid and the state cannot collect its taxes.

In order to achieve better results from future privatisation of the large number of assets which still remain state-owned, all the institutional elements of the market economy must be strengthened. But apart from that, the entire privatisation process needs to be fundamentally redesigned. A reorientation of this kind is now under discussion in Russia. From a German viewpoint it is worth noting that key decision-makers in Russia have now begun to assimilate the East German privatisation process. Hitherto the experience of the Treuhandanstalt (THA), the East German privatisation agency, has scarcely been known or drawn upon. Even the World Bank, which is heavily involved in Russia, only has a general idea of the THA's rules for privatisation.<sup>3</sup> However, the advantage of this delay in analysing the East German experience is that the positive outcomes of the THA privatisation can now be clearly recognised when compared with the approach pursued in Russia.

#### **The THA Privatisation Approach as a Reference Model**

Detailed knowledge of the eastern German privatisation experience can be useful for privatisation in Russia, because the two countries actually started from very similar positions: both economies had a large industrial sector, most of whose businesses could not survive under free-market conditions and were badly in need of restructuring. There were also parallels in the number of businesses to be privatised. Although the term 'mass privatisation' is only used in connection with the Russian privatisation process, the number of large and medium-sized industrial enterprises which have so far been transferred into private ownership is about the same in both countries.<sup>4</sup> The large number of privatisation cases which had to be undertaken meant that a more or less uniform approach was essential. In both countries the privatisation process was pushed through quickly (in Russia until 1995).

The main difference in the concept of privatisation between the two countries is that in the former East

Germany the immediate creation of effective structures of ownership was of primary importance. The rigorous pursuit of this objective was one of the main reasons why privatisation in the former GDR was successful. In the case of most larger enterprises in particular, external investors with new management and fresh capital had to be brought in to enable restructuring to be pushed through. Privatisation rules were hence geared towards attracting suitable investors.<sup>5</sup>

The legal basis for privatisation in eastern Germany was the Treuhand Act of 1990, which transferred all industrial holdings of the former East German state to the THA and made it responsible for privatising them, without specifying any details. The THA was thus able to regulate the privatisation process independently and, where need be, to adapt it to changing conditions. The THA was well equipped to deal with the task in both financial and personnel terms. The organisation had a staff of up to 6,000 employees and consultants; many of them, particularly in more senior positions, had been educated and trained in the West and had extensive professional experience in a market-economy environment.

For the privatisation of large businesses the THA developed a procedure which could be described as informal negotiations conforming to uniform principles. As a general rule the THA always aimed to sell the entire enterprise, that is, 100 per cent of the shares. In individual cases where investors insisted that the THA retained a minority share, a time-limit with a put option was regularly included in the contract. The eastern German privatisation process was generally characterised by the following stages or phases:

- As a first stage the THA actively advertised for investors. For larger enterprises or facilities, investment banks were called in to look for purchasers worldwide. Interested investors had to submit a business plan with their offer, which had to demonstrate how the investor envisaged the future development of the enterprise. These business plans formed the basis for intensive dialogue between the THA and investors.
- Investor quality was subject to systematic checks. First and foremost, the bidders' industrial compe-

<sup>3</sup> Indeed, the privatisation process in former East Germany has rarely been analysed in detail in the English-speaking world, or tends to be discussed without close knowledge of the THA's policies (see e.g. David Stark, Laslo Bruszt: *Postsocialist Pathways: Transforming Politics and Property in East Central Europe*, Cambridge 1998, pp. 88 ff.)

<sup>4</sup> This was termed the 'large' privatisation, of enterprises with more than 500 employees.

<sup>5</sup> A good, comprehensive account of the THA privatisation process is given by Herbert Brückner: *Privatisierung in Ostdeutschland: Eine institutionenökonomische Analyse*, Frankfurt am Main 1995.

tence and financial muscle were investigated. If an investor had not honoured its contractual obligations regarding a purchase made at an earlier privatisation, it was excluded from any further dealings.

□ The business plans submitted by the investors were assessed by a body of independent experts. The experts mostly came from international consultancy and auditing firms and were recognised authorities on the industry concerned, who would hence be able to assess the quality of an offer. The result of the assessment was a recommendation to begin negotiating the sale with one or more of the bidders.

□ The purchase contract included, among other things, conditions which the purchaser of the business had to satisfy. As a rule, in addition to paying the purchase price, the investor was bound to invest a certain sum of money over a specific period of time, and to guarantee an agreed number of jobs (although not for specific employees) for a period of up to five years.

□ Once the contract had been signed the THA's contract-monitoring department took over. It required progress reports on the implementation of the privatisation contract to be submitted regularly. Particular attention was paid to investment conditions being satisfied and the commitments on jobs being met.

□ Where an investor failed to fulfil the conditions of the contract, the THA negotiated alternatives (e.g. extending deadlines). If no agreement could be reached with the investor, the THA demanded payment of the penalties which were set out in the contract.

Only in the case of real estate was the amount offered as the purchase price the deciding criterion for choosing an investor. For large enterprises, the investor's creditworthiness, the purchase price and the quality of the overall business plan all contributed to an all-round assessment. There was no discrimination against foreign bidders. In most cases the careful selection of investors by the THA guaranteed restructuring that made the businesses competitive. Since 1992 eastern German industry has recorded high growth rates. When the THA was dissolved at the end of 1994 it had privatised about 16,000 businesses

and had laid down about 500,000 specific conditions in the privatisation contracts. Contractual commitments to investments reached a level of about DM 210 billion, and the THA obtained long-term guarantees for the preservation of about 1.5 million jobs.<sup>6</sup> Approximately 10% of the privatisations with over 12% of the employees went to foreign investors.

### Russian Privatisation 1992-1997: Ineffective Denationalisation

The denationalisation of industry was at the forefront of Russia's privatisation policy, whereas economic goals were of secondary importance. The political change from a planned economy to a market economy was intended to quickly become irreversible. In addition, and most importantly, the influence of state bureaucracy on company decisions was to be restricted.<sup>7</sup> This process of denationalisation had basically started before the official privatisation policy began. Since at least 1989, when Gorbachev made a final attempt to save the rigid planned economy system by allowing greater flexibility at enterprise level, the management of the day has had practically unrestricted control over its own business. It was at this early juncture that the Soviet state lost control of its enterprises in a process often aptly described as 'spontaneous' privatisation. The *nomenclatura* took over state property by 'leasing' lucrative business operations or transferring them into private companies, whose formation had become possible in the final years of the USSR. Nothing changed at an operational level; the only difference was that the income generated no longer flowed into the state's coffers but into private bank accounts.

Voucher privatisation, begun in 1992 and ended in 1994, legalised 'spontaneous' privatisation *de facto*, but had no effect on the outcomes. As intended, however, privatisation accelerated considerably; within this period approximately 15,000 industrial enterprises were turned into joint-stock companies, and their equity transferred to private owners, mostly on a majority basis. It can be argued that, in order to make a return to a planned economy impossible, the government under the reformer Yegor Gaidar had no choice other than to give preferential treatment on a lavish scale to the former 'red' directors and high-

<sup>6</sup> Privatisation in East Germany cost the Federal Republic some DM 200 billion. This was one of the consequences of the currency conversion in June 1990 at par. When the old GDR mark was, *de facto*, revalued overnight, most enterprises lost any competitiveness they might have had relative to Western firms. In many cases therefore, because of their large hard-currency liabilities (e.g. welfare commitments, environmental clean-up costs) the enterprises up for privatisation had negative market values.

<sup>7</sup> Cf. Maxim Boycko, Andrei Shleifer, Robert Vishny: *Privatizing Russia*, Cambridge 1996, p. 65: 'In our view, controlling managers is not nearly as important as controlling politicians.' As assistants to Anatoly Chubais, the Minister of Privatisation at the time, the authors were directly involved in formulating the 1992 voucher privatisation programme. Shleifer and Vishny were working in Russia on behalf of USAID.

ranking officials in the Soviet ministries responsible for these industries, who were the mainstay of the planning bureaucracy.<sup>8</sup> At any rate, the reformers were perfectly aware of the problems involved with insider privatisation. They expected an external counterbalance to the owner-managers to emerge quickly from the creation of mutual or voucher funds to act as channels for capital investors, but these hopes were not realised.<sup>9</sup> The institutional conditions simply were not in place for a capital market to develop, where the controlling rights over businesses could have been traded. To this day only a few dozen companies are regularly traded on the stock market.

In the cash privatisation programme which began in 1995, investor quality was again only a minor consideration. The main concern of the privatisation policy was not the choice of competent investors, but rather how to cover budget deficits. As a rule stakes in state-owned enterprises were sold at auctions to the highest bidder. Investors with a long-term interest in the development of their capital investment and who also had the competence needed to adapt their businesses to market conditions only rarely got a look-in. In the lucrative natural resources industries, which would have been of special interest to foreign investors, the auctions were often fixed in advance by those taking part, i.e. the successful bidder had already been decided in the run-up to the auction. According to World Bank calculations, the proceeds which the Russian state made from the sale of the country's largest oil companies, which on a conservative estimate had a market value of \$150 billion, only came to about \$1.5 billion.<sup>10</sup>

Prior to 1997 privatisation policy was largely determined by presidential decrees because the Russian parliament could not agree on privatisation legislation. In July 1997 the Duma passed its first-ever privatisation law, which was supposed to replace the old decrees and create a stable basis for future privatisation.<sup>11</sup> Following on from the voucher and cash privatisation phases, this law marks the beginning of a third phase in Russian privatisation policy. It does not so much introduce a change in the privatisation process as such, but rather leads to stricter parliamentary supervision of the process.

The law prescribes, in part in great detail, how the Ministry for the Management of State Property (the MGI, previously the GKI) must organise the privatisation process. Tightening procedures by law in this way need not be a bad thing in principle; the Russian Legislature really intended to curb the decision-

making powers of the Executive, in an attempt to reduce abuse of office and corruption. On the other hand it has proven very difficult in Russian politics to improve legal regulations or to adapt them to a changing environment, because parliament, which is dominated by Communists, is often unwilling to enter into constructive dialogue with the government. Larger enterprises now have to be registered individually in a privatisation programme requiring annual approval and the passage of a new law by the Duma. No such programme has been passed by the parliament since 1997, with the result that privatisation cases currently being carried out are politically controversial.<sup>12</sup>

### Russia's Present-day Privatisation Procedure

Although the law provides for seven different methods of privatisation (also including the possibility of distributing shares to the workforce), in practice one of two routes is normally chosen, namely an auction or a 'commercial tender with investment and social conditions'. When an auction is held, potential purchasers are called upon to submit sealed bids above an officially predefined minimum by a fixed final date. Once the sealed bids have all been opened, the enterprise is sold to the highest bidder. In the tendering procedure, compulsory for all enterprises above a certain size, the MGI sets out conditions in advance applying to future investments and the welfare of employees (the 'social' conditions); these form part of the minimum required bid. Any successful bidder is required to meet these obligations within a set time period, and only then will the transfer of title to the enterprise take place. One aspect this procedure has in common with the THA's privatisation model is that it endeavours to ensure that some funds are injected into the newly privatised enterprise for

<sup>8</sup> Gaidar notes in his autobiography, published in 1997, that the government faced the choice between insisting rigidly on implementing pure principles and running the risk of retarding the whole process of redistributing rights of ownership, or entering into unfavourable compromises in the knowledge that the resulting profile of ownership would be far from optimal: Yegor Gaidar: *Dni poroshenii i poped*, Moscow 1997, p. 200.

<sup>9</sup> Cf. Maxim Boycko, Andrei Shleifer, Robert Vishny, *op. cit.*, pp. 62 ff. In the view of the authors the problem of inefficient corporate governance would resolve itself if the stakes held by outside shareholders steadily increased.

<sup>10</sup> Cf. Dale Gray: *Energy Tax Reform in Russia and Other Former Soviet Union Countries*, in: *Finance and Development*, September 1998, p. 31.

<sup>11</sup> 'Law on Privatising State Property and on the Principles of Privatising Municipal Property in the Russian Federation', 21st July 1997, No. 123-FS.

<sup>12</sup> The privatisation of small stakes in large state-owned monopolies such as Gazprom is intended solely to plug gaps in the budget.

investment. Responsibility for the privatisation procedure is shared between the MGI and the Russian Federal Property Fund RFFI (see Table 1).<sup>13</sup>

As the law is formulated, the initiative for privatising an enterprise may come either from the MGI or from interested parties. In practice, the driving force behind privatisation normally comes from the enterprise's own management. Usually the management or its partners succeed in gaining control of the enterprise. The key deficiency in Russia's privatisation procedure, which the new law in 1997 has done nothing to resolve, is that there is no provision for any independent research which might come remotely near establishing the fair market value of an enterprise due for privatisation, or might be able to produce a list of other potential purchasers.<sup>14</sup> Privatisation plans are normally drawn up directly by the enterprises concerned; these plans, which set out not only the proposed profile of shareholders but also determine what investments should be made, are normally based on the (often limited) knowledge of the existing management and reflect only the interests of the management and their backers. To keep the capital sum needed to acquire an enterprise's assets as low as possible and reduce the business's attraction to potential external investors, it is usually proposed that the equity should be divided among the enterprise's employees, management and other interested groups (e.g. the local property committee). The dispersal of the equity among a number of parties simultaneously prevents any external investor gaining majority control in one single step.

The privatisation commissions, which are appointed by the MGI, are decision-making bodies without the resources to develop plans and concepts of their own or to negotiate with potential investors. Consequently, on matters of determining what investment and social conditions to impose they have to substantially rely on the information and proposals offered to them by an enterprise's management. They do not usually commission independent expert reports so as to save costs. Although any would-be

external investor is free to draw up and present a business plan for a privatised enterprise, the decision-makers are not in a position to require all interested bidders to submit one. On the other hand, potential investors have few means available to them for obtaining information on specific productive properties. Even though a 1992 presidential decree called for an information centre for investors, no such organisation has been established to this day.

Investment plans are prescribed by the MGI (the privatisation commission) as part of the conditions of the tender. The conditions usually go into quite detailed specifics (e.g. purchasing machine x to produce y). A monetary value is placed on them and they form part of the minimum bid price. The Privatisation Law stipulates that the bid must be the only criterion on which the selection of purchaser should be based, the fulfilment of the investment conditions laid down in the privatisation plan being an unalterable supplementary condition.

The actual organisation of the tender is the responsibility of the Federal Property Fund (RFFI). The RFFI has to take the privatisation plan as given and cannot change its conditions. Cases have come before the Russian courts in which investors have been rejected who were prepared to spend larger capital sums than the privatisation plan required, but not in the same field of business. It goes without saying that, if they are interpreted in this way, the investment conditions act as a substantial potential deterrent to external investors.

**Table 1**  
**Division of Responsibilities between the MGI and RFFI in Privatisation**

Procedural stages	Institution responsible	
	MGI	RFFI
Formal decision to privatise	X	
Appointment of a privatisation commission	X	
Development of a privatisation plan	X	
Acceptance of the privatisation plan (incl. investment and social conditions)	X	
Transfer of the state's ownership title to the RFFI	X	
Preparation and conduct of the auction or tendering process		X
Conclusion of a purchase agreement with the highest bidder		X
Monitoring of compliance with conditions (commercial tendering process only)		X
Transfer of ownership title to the acquiring investor		X

Source: German Ministry of Finance/GTZ Working Group.

<sup>13</sup> The RFFI is organisationally separate from the MGI, though the two are linked via some of their personnel. The present Chairman of the RFFI is a former Deputy Minister at the MGI. The Fund's tasks in the 'commercial tender with investment and/or social conditions' procedure have been prescribed in detail in a governmental decree: 'On the Approval of the Regulations on the Sale of State and Municipal Property at a Commercial Tender with Investment and (or) Social Conditions', Russian Federation Government Decree 1311, 9th November 1998.

<sup>14</sup> The law stipulates that an enterprise's sale value should be determined on the basis of its book value, which is often higher than its fair market value.

Once an agreement with the winning bidder has been signed, a special-purpose commission monitors the fulfilment of the contractual conditions; however, this contract-monitoring body within the RFFI so far exists only in rudimentary form. Disputes that have occasionally arisen in recent years between the RFFI and the purchaser(s) of an enterprise have normally been politically motivated and have not been triggered off by contractual problems but by conflicts within the purchasing consortia made up of managers and associated groupings.<sup>15</sup>

The normal course of privatisation in practice today suffers from the same drawbacks as the voucher privatisation system did. It is still the case that the ownership of assets is normally transferred to insiders who have little incentive or competence to engage in any restructuring. Thus the change in the form of ownership is an opportunity left untaken. At the same time, the punitive mechanisms of the marketplace are not yet sufficiently developed to spur these formally privatised enterprises into any change of policy. It takes time for ineffective proprietors to lose their controlling grip on productive assets. A state-owned sector that has been privatised in this way fails to provide any growth impetus to the economy as a whole.

The Russian government has recognised the problems inherent in privatisation procedures as they currently stand. In particular, the MGI has now set itself the task of making appropriate changes, for there are still a large number of enterprises operating under state ownership, both federal and regional.<sup>16</sup> According to the MGI, at the start of 1999 there were just under 4,000 joint-stock companies with equity owned by the federal government (see Table 2). Then there are some 14,000 unitarian enterprises, as they

are known, which are constituted in their own special form and are entirely state-owned. The Russian Federation also owns commercially used real-estate sites and buildings with a total area of approximately 214 million square metres.

In the face of statistics such as these, privatisation will remain an important task in Russia's economic policy-making for the foreseeable future. Moreover, we are quite likely to see enterprises that have already been privatised returning to state ownership in the years ahead, perhaps as part of an agreement to reduce their tax liabilities. A number of the 'oligarchs' have now lost interest in their industrial holdings, and would be glad of the chance to return them voluntarily to state ownership. If the government really wants to establish the conditions for successful privatisation – and economic growth – the procedures involved must take better account of the interests of serious investors, and must stop giving preferential treatment to insiders as they have in the past.

#### Approaches towards Improving Russia's Privatisation Procedure

In the light of the THA's experience in eastern Germany, the most desirable course would be to thoroughly rewrite Russia's 1997 Privatisation Law. The Law ought to treat privatisation as an opportunity to reform the economy as a whole. Budgetary considerations should take a back seat, while priority should be given to creating effective structures of ownership. With that in mind, procedures that fail to take account of the quality of investors ought to be renounced in future. In addition, a new privatisation law ought to strengthen the MGI's position *vis-à-vis* branch ministries, which in the past have usually tended to back special interests. Finally, the conditions under which majority stakes can be sold need to be improved. Indeed, apart from the fact that outside investors' interests are neglected, one of the greatest obstacles to the development of effective structures of ownership has been the practice of distributing ownership rights among several interest groups. However, given that any new legislative initiative to this effect is unlikely to be made in the near future, some fresh approaches that stress quality in privatisation should be looked for within the framework of current privatisation legislation.

**Table 2**  
**Stakes in Companies Held by the Russian Federation (start of 1999)**

Size of government holding (%)	Number of companies (joint-stock or limited liability)
100	382
> 50	470
25–50	1,601
< 25	863
'Golden share' <sup>1</sup>	580
<b>Total</b>	<b>3,896</b>

<sup>1</sup> Granting the state special voting rights.

Source: MGI.

<sup>15</sup> Cf. Gary Peach: Past Privatization Misdeeds Surface to Haunt Russia, in: Moscow Times, 6th April 1999.

<sup>16</sup> Cf., e.g., remarks made by the MGI's First Deputy Minister, Alexander Braverman, in the Financial Times on 21st December 1998.

A first attempt to attain better results from privatisation was the 'case-by-case' privatisation programme initiated by the World Bank in 1997.<sup>17</sup> By deploying a 'financial advisor' and a 'sales agent', the idea was to improve the process of seeking out suitable external investors and to generally enhance the transparency of the proceedings. In particular, this external support was intended to achieve three things, namely:

- The proposed future structure of an enterprise's equity was to be established on the basis of an analysis of potential investors. Implicitly, a further intention here was to resolve the governance problem by selling a majority stake to an outside investor. Thus the privatisation plan would no longer be based on the interests of the existing management.
- To offer potential investors greater insights into the financial situation of enterprises undergoing privatisation, the financial advisor was intended to conduct a form of due diligence review. He or she was also to draw up a value report based on specific asset values, to gain an idea of what sale price might be attainable.
- On the basis of his or her judgement of the market, the financial advisor was called upon to establish how much new capital, of what nature, an external investor ought to inject into the enterprise to make it competitive. This evaluation would have included a broader look at industry prospects.

By engaging an independent third party, the idea was to cut down the amount of influence insiders might exert on the privatisation plan. The formulation of a well-founded privatisation plan was also intended to boost the proceeds of the privatisation process. Last but not least, it was hoped this would establish the right conditions to appeal to foreign investors by improving transparency.

Despite the benefits of this new procedure – the main weakness of the privatisation procedure in the past, namely the poor attempts to research markets and potential investors, is indeed alleviated – the World Bank's bid to make the privatisation process in Russia more efficient has actually yielded little success in practice.<sup>18</sup> There is just one case in which the true privatisation is scheduled to occur in mid-1999, after drawing up a proper privatisation plan, but no other projects are currently envisaged. One of the

reasons for the limited success of the case-by-case model is quite likely to be that it tends to be extravagant in its resource inputs. It is difficult to find the funding for the external specialists, as the privatisation proceeds are distributed according to a pattern laid down by law, which does not include adequate provision for meeting the costs of the privatisation itself and the preparations needed. However, the crucial disadvantage of the World Bank model was probably that it almost totally excluded the privatisation bureaucracy from the process. So while the World Bank model has a number of advantages in terms of transparency, it offers no help to Russia's authorities in developing the institutional capability to carry out quality privatisation on their own.

Since the start of 1999, a so-called 'improved privatisation model (IPM)' has been under discussion, which endeavours to avoid the disadvantages of the World Bank model and takes a greater lead from the THA approach. The more welcoming approach within the procedure itself towards outside investors will be retained in the new model. However, the intention is to make the procedure as a whole more flexible and to step up the MGI's role in drawing up privatisation plans. Under the new procedure, the privatisation commissions will receive their decision-making briefs from the MGI instead of from external consultants. In contrast to the World Bank's case-by-case model, the recommendations for the IPM work on the assumption that the MGI will be actively involved in the preparations for privatisation.

The informal soundings in the marketplace that take place before a privatisation process is formally launched, beginning with a public announcement of the intention to privatise in due course, are intended in this model to be the task of a new MGI department created for the purpose. One alternative to the development of a privatisation department within the MGI is instead to improve the personnel resources of the privatisation commissions. They might, for example, be provided with their own staff team to coordinate market research and to engage in dialogue with investors.

Improvements are also intended in the provision of information on enterprises to potential investors, including those from abroad. On the other hand, the task of the team researching the market is to assess the value of the business due for privatisation and its

<sup>17</sup> In September 1997, Maxim Boyko, then Minister of Privatisation, also suggested that the sealed envelopes containing investors' bids ought to be opened in the presence of journalists. This plan was not implemented, and Mr. Boyko himself was forced to resign after four months in office, following corruption allegations.

<sup>18</sup> The Bank put up funding under the terms of the Structural Adjustment Loan (SAL) agreements concluded with the Russian government.



chances of future development. During this phase, the idea is that potential investors should be called upon to express their future ideas with no obligation, and without it being compulsory for them to present a firm business plan. As in the case-by-case model, the opportunity provided within the existing law should be taken when necessary, to engage the services of outside experts to assess the privatisation requirements. However, the proposal is that these experts should be deployed in a much more focused and more closely defined manner, to keep a lid on the costs of the procedure (for large projects, it will still be necessary to take on external specialists).

The set of instruments already in the making to screen potential investors for serious intentions is to be extended, and their use will be compulsory in all privatisation cases. This means that the MGI and RFI need to establish new internal administrative arrangements and regulations. Other measures to improve the outcome of privatisation will be applied to the later phase after the investor has been chosen. Under existing legislation, provision has been made for a standard agreement on the privatisation of state-owned enterprises; the MGI will be called upon to issue general requirements for the various elements of a privatisation procedure which need to be incorporated into every such agreement (e.g. guarantees on jobs), but without making the web of requirements too dense and thus deterring potential bidders. Once a privatisation agreement has been concluded, organisational measures should be taken to ensure that investors are strictly monitored as to their proper fulfilment of the conditions attached to privatisation. In projects involving relatively large enterprises and extensive conditions, auditors will need to be employed, at the investor's expense, to do these checks.

### Summary and Outlook

The transfer of government ownership of productive assets into the private sector is an absolutely essential prerequisite for positive economic development. Russia's reform policies have also been guided by this principle. However, the experience of the last few years has shown that formal privatisation is not sufficient in itself to guarantee economic success. In the way it has been conducted in Russia, the privatisation process has essentially been a denationalisation without any rapid move in the direction of effective structures of private-sector ownership. Policy-makers have failed to establish the necessary market framework to ensure that privati-

sation is a success, including such features as an operable bankruptcy law. Because little attention was paid to the quality of the first private owners, it will now take a long time before enterprises are taken over by more effective proprietors who are willing and able to tackle the task of restructuring.

In the prevailing unstable environment, many of the first generation of private owners have tended to have a 'hit-and-run' mentality (known in Russian as '*chwatai i begi*'): if economic actors do not see any prospect of repeatedly making profitable transactions, they are likely to go for one 'big one' and then clear out. They are then quite prepared for the fact that they will no longer be able to conduct future transactions, whether because they have lost the confidence of their business associates or because the very basis of the transactions has eroded away (if the proverbial cake has been eaten).

Even though it may take several years to build up a market-based institutional framework that will lessen the incentive to 'hit and run', it is still by all means possible to attain short-term improvements in Russia's privatisation procedures. The prime objectives, as incorporated in the IPM, need to be to improve the process of selecting investors, to demand stricter requirements from potential purchasers, and to improve the monitoring of how the conditions attached to privatisation are actually met. For these changes to be implemented, the ministry responsible for privatisation needs to be strengthened in organisational terms. Whatever the political difficulties involved, the prospects of achieving this are not bad. Once the Duma elections have been completed in December 1999, proposals to improve upon the present privatisation legislation will hopefully have a greater chance of succeeding. That in turn would make life easier for the government and the MGI.

Western nations ought to have an interest in developing a spirit of partnership in the field of privatisation policy. The task is to facilitate an exchange of expertise between equal partners, e.g. between the MGI and Western ministries with experience in the privatisation area. Only with this institutional backing will it be possible to gain acceptance in Russia for 'Western models'. Finally, the increasing awareness in the West of the failure of the Russian privatisation policy ought not to create a general mood of resignation. The deficiencies of the methods and procedures used so far – some with western assistance – are all too plain to see. There is no need to use magic to achieve better outcomes from the privatisation of state-owned assets.