SMALL-SCALE PRIVATIZATION IN RUSSIA:
The Nizhny Novgorod Model

A City Official's Guide

A Publication of

The Government of the Russian Federation

Prepared by

IFC
International Finance Corporation
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Foreword by Anatoly Chubais and Dimitri Vasilyev

The successful launch of the Nizhny Novgorod small-scale privatization program on April 4, 1992 marked a turning point in the Russian Federation’s privatization process. The auction-based program has firmly established the principles of competition, fairness, and openness, and has struck just the right balance between the interests of those who work in the small enterprises and those of the population at large.

Privatization of small state enterprises is part and parcel of the Russian Federation’s economic reform program. The use of competitive methods of privatization guarantees that new owners will make more efficient use of the resources now at their disposal. In Nizhny Novgorod, competitive auctions have allowed state property to be transferred to a new class of energetic entrepreneurs. In addition, the revenue from auction proceeds allows the city to take steps to ensure social security of its citizens.

Small-scale Privatization in Russia: The Nizhny Novgorod Model has two purposes. The first is to give the general reader an overview of “small-scale privatization” (i.e., the auctioning of small, state-owned enterprises) at both federal and city levels. The second purpose is to give to current and future practitioners of privatization the full benefit of the experience of those who designed and implemented the small-scale privatization program in Nizhny Novgorod. It is our hope that all readers of this manual, whatever their level of interest and involvement in the privatization process, will find it enlightening and useful.

We would like to express our sincere thanks to those who helped make the Nizhny Novgorod small-scale program Russia’s first successful privatization program, and also to those who prepared this manual. In particular we would like to thank the governor of the Oblast of Nizhny Novgorod, Mr. Boris Nemtsov; the mayor of Nizhny Novgorod, Mr. Dimitri Bednyakov; the chairman of the Oblast Council, Mr. Evgeni Krestyaninov; and the International Finance Corporation.

Anatoly Chubais
Chairman, Committee for the Management of State Property (GKI) of the Russian Federation

Dimitri Vasilyev
Deputy Chairman, GKI
Foreword by Boris Nemtsov

The privatization of small-scale municipal retail enterprises is now well underway in the city of Nizhny Novgorod. I am delighted with the results achieved so far and am confident that all municipal retail enterprises will be auctioned by the end of the year. The success of the municipal program was made possible by the collaboration of the International Finance Corporation.

The early positive results of the municipal program, which stem from the transparency, efficiency, and speed of the auction system, encouraged us to quickly introduce similar auction-based, small-scale privatization programs into other areas of the oblast. Auctions are taking place in locations throughout the region at the rate of one per month. These auctions are being enthusiastically supported by the oblast population, from the largest townships to the smallest villages. The next stage in my government’s regional privatization program is to privatize the transportation and wholesale distribution systems. This work is now in progress.

I hope that this manual on the Nizhny Novgorod small-scale privatization program will find widespread use throughout the Russian Federation.

Boris Nemtsov
Governor, Oblast of Nizhny Novgorod
Foreword by Dimitri Bednyakov

I consider the Nizhny Novgorod privatization program an important element in the normalization and revival of the Russian economy. It is not an experiment, but rather the beginning of a long process whose purpose is twofold: to transfer ownership and to maintain municipal infrastructure. We believe we have worked out a simple and reliable privatization plan, and the fact that cities all over Russia are ready to use the Nizhny Novgorod model only confirms that belief.

Dimitri Bednyakov
Mayor, City of Nizhny Novgorod
Preface

Privatization is under way in Russia: some 3,000 small businesses in the previously closed city of Nizhny Novgorod are being auctioned to Russian citizens under a plan devised and implemented by city officials in conjunction with IFC staff. The auctions have been witnessed by hundreds of local citizens and officials from Smolensk, Kursk, Perm, Ryazan, Volgograd, Ufa, and other cities throughout Russia. The Russian government has made public its hopes that Nizhny Novgorod will become a model for similar cities in the Russian Federation.

The attempt to privatize these “small-scale enterprises” in Russia began in January and February 1992 with initial meetings between IFC and Russia’s Goskomimuschestvo (GKI), the Committee for Management of State Property, which has assumed responsibility for privatization. During these meetings IFC staff worked with GKI officials to help draft the laws and regulations necessary to permit the auctions that eventually took place in Nizhny Novgorod.

The fundamental objective of these policy discussions and meetings was to draft the legislation governing the Russian Federation’s overall approach to privatization and to detail regulations guiding its implementation. An important part of the exercise was the drafting of the regulations governing privatization of small-scale enterprises in municipalities. Once this was completed, the stage was set for the auctions in Nizhny Novgorod.

The experiences of privatization in central and eastern Europe, particularly Poland and Czechoslovakia, demonstrated that privatization of small enterprises represented the logical and most efficient procedure with which to begin privatization in Russia. IFC drew upon the best of those experiences to help form the blueprint for Nizhny Novgorod.

Based on the principles and regulations established during the GKI-IFC meetings, GKI-IFC staff chose Nizhny Novgorod as the first target city for two reasons. First, it was felt that Nizhny Novgorod was a “typical” Russian city. The capital of the oblast (region), of the same name, the city has a population of 1.45 million. After its founding in 1221, its status as Russia’s main river port enabled it to become a major center of commerce before 1917. Success here, it was thought, would offer a model for privatization throughout the federation.

Second, Nizhny Novgorod officials of both legislative and executive branches have shown they are committed to the privatization process. Events in Czechoslovakia and Poland had demonstrated the importance of political commitment to this type of privatization.

With financial assistance from the World Bank, Switzerland, and Sweden, IFC assembled an international team of experts experienced in conducting privatizations through
auctions. These included senior government officials from Poland, auctioneers from Czechoslovakia, and lawyers from Sweden.

Working with a counterpart team of city officials, the GKI-IFC team put together a plan for the auctions; evaluations of small enterprises were begun; local auctioneers were trained; Russian personnel were sent to Prague to work with those who had participated in auctions; means of valuation, an auction format, and bidder qualifications were agreed upon; and incentives for current employees were put in place.

Prior to the first main auction scheduled for April 4, two trial runs were conducted on March 21 and 28. On Saturday, April 4, 1992, the auctions officially began in front of local, national and international press from a dozen countries. In attendance were the then First Deputy Prime Minister Yegor Gaidar, architect of the Russian reform program; Minister Anatoly Chubais, chief of the Russian Privatization program; Deputy Minister Dimitri Vasilyev; and IFC Vice President Wilfried Kaffenberger. For the next several hours Russian citizens bid against each other to purchase outlets including a cheese shop, an old books store, and a glass and crystal shop. Final selling prices ranged from 70,000 rubles to 10,000,000 rubles. More than a third of the shops were sold to the store employees themselves.

The process begun on April 4th has lived up to the expectations of both city and federal authorities. In selecting the auction method of privatization, primary emphasis was placed on maintaining the inherent transparency of the process. Any Russian citizen was allowed to participate and register as a bidder; steps were taken to eliminate as much as possible hidden deals and collusion; properties with fewer than two bidders were immediately removed from eligibility; safeguards were placed to protect the advantages of store employees; and transfer of ownership was immediate.

In the following pages IFC has compiled a “manual” showing what was necessary in order to realize Nizhny Novgorod’s privatization program. With its help, GKI, the U.S. Government and IFC are now exploring the possibility of using Nizhny Novgorod as a model for privatizing small-scale enterprises in other Russian cities.
Acknowledgments

IFC gratefully acknowledges the following contributions both to this manual and to the small-scale privatization program it documents:

As the chief visionaries and driving force behind the pilot Nizhny Novgorod privatization program, Boris Nemtsov, Governor, Oblast of Nizhny Novgorod; and Dimitri Bednyakov, Mayor, City of Nizhny Novgorod.

For their unfailing enthusiasm and steadfast support for the program at the level of the State Committee for the Management of State Property (GKI), Dimitri Vasilyev, Deputy Chairman; and Maxim Boycko and Jonathan Hay, Advisors.

For their skill and perseverance during the implementation and management of the program in Nizhny Novgorod, Alexander I. Lavrov, Chairman, City GKI; Valeri A. Remizov, Chairman, City Fund; Alexander N. Kosarikov, Chairman, City Council; and Evgeni V. Krestyaninov, Chairman, Oblast Council.

For volunteering to the program’s design his vast experience as Poland’s original minister of privatization, Krzysztof Lis.

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For generously financing both the planning and execution of the Nizhny Novgorod program, the World Bank Trust Fund and the Governments of Sweden and Switzerland.

For co-financing the production of this manual, the Government of the United States.


And finally, for helping to refine and produce the manual’s various volumes, Chris Marquardt, editor; Zhanna O’Clery, Sergey Zhukov, and Professor Yuri Olkhovsky, translators; Tamara Carless, production assistant; and Gibby Edwards, Mary Kilby, and the staff of J. Gibson & Company, design and production.
Abbreviated List of Annexes

For ease of reference, the following list of annexes has been abbreviated according to usage in the main text. A complete list can be found in the separate volume of Annexes.

1. Privatization Law
2. Fundamental Provisions and State Program
3. Provisional Regulations
4. Division of Property
5. City Regulations, March 6, 1992
6. City Regulations, April 22, 1992
7. City Fund
8. City Privatization Program
9. Leasing Regulations
10. Zoning Regulations
11. Public Notice
12. Purchase Contracts
13. Lease Contracts
14. Privatization Passports
15. Liquidation Laws
16. Power of Attorney
17. Pre-Registration Receipt
18. Application Forms
19. Participant’s Ticket
20. Auction Rules
21. Record of Purchase
22. Transfer and Acceptance
23. Receipt for Keys
24. Certificates of Ownership
25. Non-Payment Notice
26. Notice of Termination
Introduction: How To Use This Manual

This manual shows how Russian cities can “privatize”— transfer to the private sector—small, city-owned enterprises. It is not a theoretical work. Rather, it is based on the approach actually taken in privatizing small businesses in the city of Nizhny Novgorod, where the first privatization program in Russia is now underway.

For this reason, legislators, administrators, and others using the manual to help them privatize their cities are urged to adapt the approach to their particular needs while working within federal guidelines.

The manual has three volumes. The first, Guiding Principles, discusses privatization in its Russian context, then outlines the principles behind the auction approach used in Nizhny Novgorod. The second, A City Official’s Guide, in addition to containing the Guiding Principles, shows how these principles were translated into legislative, administrative, and procedural form, then discusses the corollary issues of financial management and employee participation in privatization. Copies of actual laws, regulations, decrees, resolutions, and other documents pertaining to the privatization process appear in a third volume of Annexes.

The first two volumes reflect IFC’s assumption of two types of readers. Those who have a general interest in privatization or in the changes taking place in the Russian Federation will find Guiding Principles useful and informative. Officials involved in privatization in other cities of the Russian Federation (or other republics) will use A City Official’s Guide and the Annexes — but will need to read Guiding Principles as a general introduction.

Both volumes contain glossaries explaining key legal documents, administrative bodies, and technical terms. Both are also available in Russian, as are the Annexes.
PART ONE:

GUIDING PRINCIPLES
1. Privatization

Privatization means involving the private sector in the ownership or operation of state-owned enterprises. This may include either (a) the purchase of all or part of an ongoing enterprise, or (b) the sale of a business following liquidation. It may also include the privatization of management through management contracts or the award of leases.

Thousands of large enterprises have been privatized worldwide since the early 1980s. Even more small enterprises have been privatized, particularly in eastern Europe. Privatization has occurred most frequently in such sectors as banking, power, telecommunications, steel, mining, airlines, pulp and paper, electrical equipment, petrochemicals and hotels.

The historic changes that began in 1989 in central and eastern Europe have cast the goals of privatization in a different, sharper light. The Governments of Poland, Hungary, and Czechoslovakia have announced intentions to privatize up to a half of their large state enterprises within the next three years. This could amount to more than the total number of large enterprises privatized throughout the world during all of the 1980s. Recent commitment to market reform among the former Soviet Republics has further increased the scale and importance of privatization.

Reasons for Privatizing

General benefits of privatization, when it is correctly conceived and implemented, include the following:

- Freeing public resources for investment in infrastructure and social programs
- Increasing the size and dynamism of the existing private sector
- Distributing ownership more widely
- Encouraging and facilitating private-sector investment from both domestic and foreign sources
- Generating revenues for the state and new jobs for workers
- Reducing the state’s administrative burden
- In the case of formerly socialist countries, launching and sustaining the transformation from a command to a market economy
- In the main, consumers have also benefitted from privatization.
Enterprise-specific benefits may include:

- Increased productivity
- Expansion of production capability
- Increased profits for new owners and other shareholders
- Higher profits, faster growth, and greater cost containment.

Privatization has, in some cases, led to the closure of non-viable firms previously kept alive by government protection and subsidies. Bankruptcies, closures, and liquidations do not indicate that the privatization was misguided. The closure of loss-making firms, public or private, can free assets for more productive use, eliminate a burden on the economy and allow more productive investment—and job creation—elsewhere.

2. Privatization in Russia

Privatization in Russia is a more complex and massive undertaking than anywhere else in the world. Large enterprises number in the tens of thousands. Even at their peak, state-owned sectors in industrialized and mixed-economies paled in size and number compared to those in Russia. Indeed, state-owned enterprises do not comprise a sector in Russia per se. Rather, they are the economy. A private sector has not existed in Russia for over 70 years. Privatization is considered the most effective way to put under-utilized and wasted assets to use. In Russia, privatizations must carry the additional burden of transforming the country and its society from a command system to a market economy.

For such a transformation to succeed with so large a number of enterprises and with such high political and social risks, privatization must be massive and rapid. Obstacles to the process—including uncertainty regarding methods of privatization—are correspondingly daunting. However, delaying privatization would weaken or even block the entire transformation process. At the moment, hundreds of thousands of Russian enterprises, large and small, receive neither central commands nor adequate market signals. Recognizing that this situation serves neither present nor future generations, the Russian government is actively promoting privatization programs around the country.
**Government Objectives**

The Russian government’s stated objectives for privatization in 1992 are:

- To encourage private ownership and create a platform for a market economy
- To raise the efficiency of former state- and city-owned enterprises
- To establish a social “safety net” and to develop social infrastructure using auction proceeds
- To provide the environment and institutional structure necessary to expand the scale of privatization
- To contribute to financial stability
- To promote competition and de-monopolization
- To attract foreign investments.

### 3. The Legal Basis for Privatization in Russia

The legal basis for privatization in Russia was established on July 3, 1991 with the passing of the Law on Privatization of State and Municipal Enterprises in the RSFSR, commonly known as the *Privatization Law*. (This law was amended on June, 1992.)

Stating the goal of setting up an effective market economy, the law established the organizational and legislative framework for privatizing state and municipal enterprises.

The goals, objectives, targets, procedures and restrictions for privatization in 1992 were then set out in December 1991 in the *Fundamental Provisions* of the Program for Privatization of State and Municipal Enterprises in the Russian Federation, dated December 29, 1991. The *Fundamental Provisions* were then amended and elaborated upon in the *State Program* for Privatizing state and municipally Enterprises of the Russian Federation for 1992.

The *State Program*, adopted by the Supreme Soviet on June 11, is of seminal importance. Among other things, it:

- Determines which objects and enterprises will and will not be privatized and at whose discretion
- Allocated privatization proceeds
Sets privatization targets for state authorities

Categorizes all state- and city-owned property according to size and sets out methods of privatization

 Sets out privatization benefits for management and employees of enterprises for privatized enterprises

 Details preparation of issuance and use of personal privatization accounts in 1992

 Outlines uses and restrictions on foreign investment

 Sets out requirements for local privatization programs and outlines the uses of privatization proceeds allocated to local authorities

 Defines relationships between government bodies involved in privatization.

A third important set of documents is the Provisional Regulations concerning the Privatization of State and Municipal Enterprises, dated January 29, 1992. The Provisional Regulations set out methods and procedures for:

 Applications for privatization

 Valuation of enterprises

 Transformation of enterprises into open joint-stock companies

 Privatization through auctions and competitions

 Use of economic incentive funds

 Formation and conduct of commissions of privatization.

Under the Privatization Law, the State Committee for Management of State Property (Goskomimuschestvo, or GKI) is charged with (a) preparing the privatization policy framework and implementation program and (b) preparing enterprises for privatization. The State Property Fund (referred to hereafter as the Fund) is the sole seller of state- and city-owned property.
4. Small-scale Privatization

Small-scale privatization is generally accepted to mean the privatization of small shops, stores, retail outlets and commercial services. Privatization of small-scale enterprises has accounted for almost all the early successes of privatization programs throughout central and eastern Europe.

Privatization of small enterprises in central and eastern Europe has largely occurred by means of sale to the general public in open, competitive auctions. Ownership of the enterprise or, in some cases, the right to lease the premises and facilities for a fixed period, is awarded to the highest bidder. Typically, mass small-scale privatization has been carried out by local/regional authorities under the general direction and guidance of the national privatization agency. This decentralized approach has resulted in the rapid privatization of small enterprises.

In little over a year Poland has sold a large percentage of its small enterprises; as a result, most retail trade and services are now in private hands. In about a year, Czechoslovakia, too, has sold thousands of small businesses, and Germany has also had considerable success with its small-scale privatization.

These experiences show that small-scale privatization:

- Can be done quickly
- Demonstrates early in the reform process the benefits of privatization (because of the improved service offered by privately owned shops and stores compared to state establishments)
- Has not hindered the supply of basic food stuffs and other necessities
- Has resulted in a wide variety of individuals buying the enterprises, avoiding concentrated ownership by such groups as former managers or foreign investors
- Has avoided charges of corruption or favoritism because the process is open and transparent and ownership is granted to the investor willing to pay the highest price rather than the one with political connections or influence
- Has generated substantial revenues for local and national governments.
5. Small-scale Privatization in Russia

Small-scale Enterprises

The State Program divides state and city-owned enterprises into three categories (small, medium, and large) according to size and method of privatization. Small-scale enterprises are defined as enterprises with under 200 employees and a book value of less than 1,000,000 rubles of fixed capital as of January 1, 1992. Between 150,000 and 200,000 such small-scale enterprises are estimated to exist.

Privatization Schedule

The State Program also classifies state-and city-owned enterprises into five categories depending on their preparedness for privatization in 1992:

1. Privatization not allowed in 1992
2. Privatization only at the decision of the Russian government
3. Privatization at the discretion of the GKI
4. Privatization exclusively under local privatization programs

It is expected that most small-scale enterprises will fall into the last category, for which privatization is mandatory in 1992. The State Program classifies enterprises in this category as those most influencing the emergence and operation of a market infrastructure in the Russian economy and those inefficient operations that impede the development of the national economy and the emergency of a market. Such enterprises include:

- Wholesale and retail enterprises, including those involved in the marketing of industrial goods, catering facilities, and consumer services
- Construction and enterprises producing construction materials
- Food and light industry
- Trucking
- State agricultural enterprises, including poultry farms (except sovkhozes), enterprises processing agricultural produce, servicing agriculture and producing industrial goods for agriculture
Uncompleted projects and unfinished construction

 Enterprises that operate at a loss, except those whose privatization is banned in 1992.

**Administration**

The Privatization Law establishes the GKI as the agency responsible for preparing enterprises for privatization and the Fund as the seller of state-owned property. The law also provides for the devolution of GKI and Fund responsibilities to the region and/or city level through the formation of regional and/or municipal GKI and Fund bodies. The State Program places responsibility for achieving mandatory targets for 1992 with the relevant local bodies.

**6. Small-scale Privatization in Nizhny Novgorod**

Nizhny Novgorod was chosen as the site of Russia's first privatization program for two reasons. First, it was felt to be a relatively typical Russian city in size and economic composition. Second, Nizhny Novgorod officials were committed to the privatization process.

**Background**

**Enterprises to Be Privatized**

Privatization in Nizhny Novgorod has to date been confined to three groups of small-scale municipal enterprises:

- Retail shops
- Consumer Services
- Catering facilities, including restaurants.

Consistent with the State Program, these businesses have fewer than 200 employees and book value of less than 1,000,000 rubles. About 3,000 small-scale enterprises fall into this category.

**Dissolving Wholesale Networks**

Several major steps had to be taken to bring state-owned enterprises under city control and to establish clear municipal property rights. The key step was to dissolve the network of
wholesale trade distribution networks, or torgs, controlling retail trade. Retail stores were not separate legal entities so much as simple outlets for the wholesale networks.

On November 25, 1991 President Yeltsin signed a Decree On the Commercialization of the Activity of Trade Enterprises in the RSFSR directing local officials to reorganize retail trade establishments by separating them from their existing structures and registering them as separate entities. In accordance with this legislation, on December 25, 1990 the Nizhny Novgorod City Council passed a resolution mandating that all retail shops, catering facilities and consumer services be registered as legally independent “municipal enterprises.” Each shop was given responsibility for its own business activities, including supply and transport contracts and financial and legal arrangements.

The same resolution mandated that, as of February 1, 1992, the old wholesale networks cease to exist as legal entities and be reorganized into intermediary organizations (“commercial centers”) with no right to interfere in the activities of the above-mentioned, newly established retail enterprises.

These two steps were critical to introducing competition into the sources of supply for the retail trade sector. By initiating the commercialization of both wholesale trade and administrative/financial responsibility for retail trade, the December resolutions laid the foundation for the small-scale privatization to follow.

**Local Enabling Legislation**

With the devolution to the regional and city level of responsibility for preparing and implementing small-scale privatization, it was necessary for the regional and city authorities to set out an overall framework for small-scale privatization and to establish administrative bodies to implement the privatization process.

The key legislative document was a Decree of the Head of Administration (dated March 6, 1992) setting out the small-scale privatization procedures and regulations to be adopted by the City. On April 22, 1992, after the first trial auctions, these “City Regulations” were amended to improve upon administration and process.

The most important aspect of the City Regulations was the creation of a central **Standing Commission on Privatization** of the City GKI to assume the responsibilities of the privatization committees mandated for each enterprise under the Privatization Law. This constituted a major simplification of the law and prevented the creation of 3,000 separate standing commissions.
Other provisions of the City Regulations address the following:

- Methods for gathering and publishing information on each enterprise for privatization
- Preparation of enterprises for privatization, including the method for calculating the opening bid price
- Determining sellers and qualifying buyers
- Establishing what is being privatized
- Conditions of sale of fixed assets, inventory and equipment
- Methods of privatization (auctions and conditional auctions)
- Liquidation procedure for enterprises scheduled for privatization
- Labor collective participation in the privatization process
- Payment for the privatized property
- Forms of payment, including an installment plan for labor
- Penalty for refusal to pay
- Responsibility of parties
- Necessary documentation to conclude privatization transactions
- Distribution of auction proceeds
- Rules governing the re-sale and inheritance of leaseholds.

**The Approach**

Nizhny Novgorod’s current auction program is based on two fundamental concepts; selling leasing rights; and liquidating businesses before selling them.

**Sale of Leasing Rights**

Most retail enterprises in Nizhny Novgorod share building space with other small businesses. It was decided that, at this early stage in privatization, outright sale to different owners would unnecessarily complicate the privatization process and lead to problems in reaching agreement between multiple owners. It was judged preferable for the city to lease space in the building for at least five years, after which time the city will sell the entire building. In this case, bidders are in effect bidding on the right to lease
physical property. Only when an enterprise occupies an entire, stand-alone structure is the entire building sold.

**Enterprise Liquidation**

Instead of selling enterprises as ongoing concerns, the city first liquidates them, then sells their assets. Liquidation means that, after employees are notified, a business’s financial operations are concluded, its bank accounts blocked, and its operations closed down. The city assumes all liabilities, including any debt and/or obligations to existing employees.

In addition to simplifying and streamlining the mass small-scale privatization process, liquidation frees new owners to operate the privatized enterprise in more productive, efficient, and innovative ways. Only in a few limited cases are new owners required to resume an enterprise’s pre-auction activities; this is discussed below.

**The Guiding Principles**

These fundamental concepts were incorporated into an overall set of principles guiding the design of the mass small-scale privatization program in Nizhny Novgorod. The principles were formulated on the basis of (a) the requirements of the *Privatization Law* and the *Provisional Regulations*; (b) the particular needs of the municipality of Nizhny Novgorod; and (c) the experiences of IFC in central and eastern Europe and elsewhere.

**PRINCIPLE 1: A single privatization method should be chosen.**

The *State Program* lays out two relevant methods of privatization for small enterprises. The first is the *auction*, in which businesses are sold unconditionally in open bidding to buyers who may be either legal entities or private individuals. The second is the *tender*, or “conditional” auction, in which the buyer is obligated to meet certain conditions of sale. These conditions may include continuing the sale of certain products, preserving the historical status of a building, and the future investment plans. Conditional auctions may be held through open or closed bidding procedures.

The city should choose a single, generalized method for privatization of small-scale retail businesses. This will eliminate the need for separate privatization commissions at the municipal level, and will diminish administrative and bureaucratic discretion in the auction process.
The Guiding Principles

PRINCIPLE 1: A single privatization method should be chosen.
PRINCIPLE 2: Only the right to physical property should be sold.
PRINCIPLE 3: Enterprises should first be liquidated so that buyers do not assume liabilities or obligations.
PRINCIPLE 4: Decision-making authority should be consolidated.
PRINCIPLE 5: Concentration of ownership should be avoided.
PRINCIPLE 6: Russian citizens should receive preference in the first round of auctions.
PRINCIPLE 7: Starting bids at auctions should be based on balance-sheet values.
PRINCIPLE 8: Valuation of inventory and equipment should be set equal to balance-sheet values.
PRINCIPLE 9: Auction participants should pre-register to establish good faith.
PRINCIPLE 10: The city should provide incentives for investments in and physical improvements of privatized retail outlets.
PRINCIPLE 11: Zoning should determine lease payments.
PRINCIPLE 12: Labor collectives should be allowed to pay in periodic installments.
PRINCIPLE 13: Existing employees should be able to buy their enterprises at a discount.
PRINCIPLE 14: Measures should be taken to help employees displaced by privatization.
PRINCIPLE 15: Auction proceeds should be distributed in accordance with the laws and regulations of the Russian Federation.
PRINCIPLE 16: Consideration should be given to taxing future sales of auctioned property.
PRINCIPLE 17: Leased property should eventually be sold.
PRINCIPLE 18: Privatization of wholesale distribution and transport distribution networks should follow the first auctions.
PRINCIPLE 19: Security of food supply is imperative.
PRINCIPLE 20: Political commitment is essential.
In Nizhny Novgorod, public auctions are the method of privatization. City-owned businesses are sold to bidders offering the highest price during open bidding. In rare cases the city may resort to a conditional auction in which buyers agree in writing to observe certain conditions of sale.

Other methods of privatization have by and large proven unsatisfactory. Most conditional auctions, for instance, require government commissions to decide outcomes using such potentially subjective criteria as the bidder’s experience, qualifications, or plans for the business. While the aims may be admirable, experience shows that these discretion-based systems lead to slowness and corruption. Each of these issues can be resolved by well-conceived, general guidelines for an auction privatization process.

**Principle 2:** Only the right to physical property should be sold.

To facilitate the privatization process, buyers do not assume debts and obligations incurred by the enterprises scheduled to be sold. Instead, the city takes on the debt and obligations of each business through the process of liquidation, described below in Principle 3. Because they have been liquidated, enterprises are not sold as going concerns. As mentioned above, if an enterprise occupies an entire, “stand-alone” building (“commercial property”), then only that property is sold, along with any fixed assets and inventory on the premises. If an enterprise shares a building with other enterprises, equipment and inventory are sold, but the city retains ownership of the building, selling instead the right to lease the property for a five-year term. This five-year lease period was chosen by Nizhny Novgorod officials. Current minimum and maximum allowable lease periods should be determined in accordance with the State Program.

Once the building (or leasehold in a shared building) is bought, purchases of equipment and inventory located on the premises is obligatory. From information provided in the press release and auction program, bidders at each auction know the additional price they will be required to pay for these assets. The buyer meets with the City Fund immediately after the auction to confirm that value of the property’s inventory and equipment, if any, was accurately described before the auction.

Recognizing that is preferable to have private owners for all buildings, the Nizhny Novgorod authorities have committed to auctioning shared (“multi-purpose”) buildings in five years. However, the privatization program should also create an incentive for cooperative arrangements among leaseholders to evolve over time. This can be done by granting leaseholders who share a building the option to purchase the building at a predetermined discount. In Nizhny Novgorod this discount was set at 30 percent and allows bidders to bid more for a particular structure than competing bidders without additional cash outlay. This creates a strong financial incentive for leaseholders to prepare effective cooperative arrangements in anticipation of a joint auction bid, making
them more credible participants in future sales of commercial property. This option will also help reduce leaseholder uncertainty over the right of continued use of leased space when ownership rights are eventually sold by the city.

In addition, the city guarantees leaseholders the reasonable use of their business space over the five years lease period, independent of the ownership of the building.

**PRINCIPLE 3: Enterprises should first be liquidated so that buyers do not assume liabilities or obligations.**

The Nizhny Novgorod privatization program involves only the sale of the assets of liquidated municipal enterprises. The buyer assumes none of the liabilities of the enterprise, including obligations to existing employees and management. Liabilities remain with the municipality and are financed by auction proceeds. By avoiding the need for time-consuming pre-auction assessment of existing liabilities, this expedites and simplifies the process considerably. It also greatly increases the flexibility of new owners to operate the privatized enterprise in more productive, efficient, and innovative ways.

The publication of the list of enterprises proposed for privatization is considered both (a) formal notification of the decision to liquidate the enterprises and (b) the beginning of an enterprise’s formal liquidation process. Creditors are given two months to submit claims against the enterprise. A city Liquidation Commission assumes all creditors’ claims. An enterprise is considered formally liquidated at the moment it is excluded from the state register.

Managers of enterprises are responsible for informing employees of the liquidation order. Monies are transferred for the payment of severance pay to workers dismissed as a result of privatization. Initially, this payment was equivalent to three months’ salary. The State Program now requires that up to 30 percent of the purchase price be paid to former employees, as long as this payment does not exceed twenty months’ salary of the national minimum wage.

**PRINCIPLE 4: Decision-making authority should be consolidated.**

Clear authority should be consolidated in one decision-making structure at the beginning of the privatization program. This should occur with the mutual consent of the City Council and the Head of Administration.

Under the privatization law, federal Fund and GKI responsibilities were devolved to the regional level through the formation of regional Fund and GKI bodies. In turn, the Nizhny Novgorod authorities established a City Fund, a City GKI, and district privatization commissions working under the City GKI. The Fund thus became the owner of
municipal property with the responsibility for actual sale of each enterprise. The City GKI's responsibility is to prepare and manage the privatization process.

As mentioned above, Nizhny Novgorod authorities established a single Standing Commission on Privatization under the auspices of the City GKI. This represented a significant simplification of the requirements of the Privatization Law, which otherwise requires that a separate privatization commission be formed for each enterprise.

**Principle 5: Concentration of ownership should be avoided.**

Widespread ownership is key to successful small-scale privatization. Ideally, the auction system will quickly foster the emergence of a free and open market system that will encourage the private distribution of capital.

If ownership of enterprises becomes concentrated in the hands of a few, limits may need to be placed on the number of businesses which can be leased/purchased by any one individual in the auctions. Even then, after a predetermined period of time, such limits should not constrain the right of leaseholders/owners to sub-lease or sell their businesses to any individual in private transactions. Nizhny Novgorod authorities considered limiting the number of enterprises an individual can buy, but decided instead to monitor auctions and act to restrain concentration of ownership only if absolutely necessary.

**Principle 6: Russian citizens should receive preference in the first round of auctions.**

In Nizhny Novgorod, participation in the first round of auction has been limited to Russian citizens. Foreign investors, including those from former Soviet Republics, are excluded unless there is no domestic interest in a certain piece of property. Non-Russians will be able to participate in subsequent private market transactions. The State Program gives local authorities discretion on this matter.

In Nizhny Novgorod both “natural persons” (i.e. individuals) and legal entities (e.g., companies and labor collectives) may participate in the auctions. The latter, however, must be privately owned; no state- or city-owned enterprises are allowed to participate.

**Principle 7: Starting bids at auctions should be based on balance-sheet values.**

For each liquidated enterprise to be sold, a minimum bid is necessary to start the auction process. For leaseholds in shared buildings, the minimum bid is one month’s lease payment. For stand-alone structures, the starting price is the sum of the balance-
sheet (or residual book) value of the property and the value of the inventory and equipment on that property.¹

Should these minimum prices hinder the auction process (if they are too high, for instance), another simple rule for minimum bid prices can be chosen.

**PRINCIPLE 8: Valuation of inventory and equipment should be set equal to balance-sheet values.**

Inventory and equipment are not sold at the auction. Instead, the buyer commits to buying them at an additional price determined itself from existing balance-sheet values. Although these values tend to be very low, they are the only consistent values available and are the simplest reference point for valuation. (The amount of inventory and equipment is often negligible.)

In Nizhny Novgorod, the buyer of the leasehold is obligated to purchase the property’s equipment (not its inventory) at residual (i.e., depreciated) book value. Inventory is purchased at current book value because it is not depreciated.

**PRINCIPLE 9: Auction participants should pre-register to establish good faith.**

Some form of good-faith deposit should be required to discourage spurious participation in the auction process. In Nizhny Novgorod there are different applications for individuals ("natural persons") and legal entities such as labor collectives or private companies. Each application contains information identifying the bidder, the item for which the bidder is bidding, and—if the bidder is a legal entity—information on ownership so that eligibility can be verified. If the entity is more than 25 percent state-owned it is not eligible to bid.

**PRINCIPLE 10: The city should provide incentives for investments in and physical improvements of privatized enterprises.**

Incentives should be provided to shop owners during the first year after privatization to encourage capital investment in retail business operations. In Nizhny Novgorod this incentive is a reduction in second-year lease payments. This reduction is equivalent to the amount spent to improve the physical condition of the property during the first twelve months after its purchase at auction.

¹The latter are not sold at auction, however. Rather, the buyer commits to buying equipment and inventory later at a known price. This is not a significant point where setting the starting price is concerned; the starting price is simply a way of beginning the bidding process.
**PRINCIPLE 11: Zoning should determine lease payments.**

Two criteria determine lease payments for small enterprises located in shared buildings in Nizhny Novgorod. The first is the building’s historical importance, if any.

The second, and chief, criterion revolves around a simple system of zoning. The city was divided into three zones depending on the location of main transport and shopping thoroughfares, centrality of location, and density of pedestrian and vehicular traffic. The building’s zone location determines the coefficients applied to base lease payments already determined by the City Council.

The resulting lease payments are adjusted for inflation at the end of each year for the five-year lease term.

**PRINCIPLE 12: Labor collectives should be allowed to pay in periodic installments.**

Ideally, auction bids should be financed by conventional mortgage loans from commercial banks. However, most banks in Nizhny Novgorod were unprepared to finance bids (i.e., make mortgage loans) in the auction process. Installment payments were seen as an alternative way to induce and finance auction bids in the absence of conventional financing structures. The installment-payment mechanism would also strengthen the incentive for owners/leaseholders to make productive use of commercial property, rather than leaving it idle and holding it solely for speculative purposes.

In Nizhny Novgorod, installment payments were restricted to labor collectives. The first installment of 30 percent must be paid within 30 days after the auction; the second installment of 30 percent, within six months; and the third installment of 40 percent, within 12 months. The current State Program, meanwhile, allows installment payments by labor collectives to extend for a period of up to three years. In both cases, the right of ownership begins with the first payment.

Auction winners who do not represent labor collectives must pay in full within 30 days of the auction.

**PRINCIPLE 13: Existing employees should be able to buy their enterprises at a discount.**

Some form of preference for existing employees is both politically indispensable and economically logical. Experience elsewhere demonstrates that employees who buy their enterprises often make excellent managers, particularly as individual owners.
The privatization program offers existing employees a 30 percent discount in the auction bidding process. This allows them to bid more for a particular business than competing bidders without additional cash outlay. This system also creates a financial incentive for outside bidders to arrive at some form of accommodation with existing employees that takes into consideration employee interests while allowing outside bidders to take advantage of the employees' discount.

The labor collective's final bill can be further reduced by the amount invested by the collective in the enterprise itself during the previous two-year period (1989-1991). In order for collectives to qualify for this additional discount, these investments are required to have been financed from enterprise profits left at the disposal of the labor collective.

As mentioned previously, only labor collectives are allowed to pay in installments. The privatization program specifies that the installment period is for one year, with a downpayment of not less than 30 percent of the purchase price. (See Principle 12.)

**PRINCIPLE 14: Measures should be taken to help employees displaced by privatization.**

Privatization necessarily entails relocation of both capital and labor to more efficient uses. Such a relocation can be extremely difficult from a social standpoint, however, and measures should be taken to ease the transition to a market economy. In accordance with the Privatization Law, the State Program, and other legislation, the city of Nizhny Novgorod provides certain “measures of social security” to protect workers affected by privatization.

For employees dismissed as a result of liquidation and auction, these include job and salary protection before auction; prompt notice of planned dismissal; a collective payment of a certain percentage of the auction purchase price (see Principle 15); registration with an employment agency; and severance pay.

**PRINCIPLE 15: Auction proceeds should be distributed in accordance with the laws and regulations of the Russian Federation.**

Proceeds from the privatization of objects are transferred to a special account and distributed in accordance with the laws and regulations of the Russian Federation. A certain percentage must first be paid to employees dismissed as a result of privatization. In Nizhny Novgorod this figure was initially ten percent. Now, in accordance with the State Program, the city must pay 30 percent of the proceeds, an amount not to exceed twenty monthly minimum wages.
The remaining funds are distributed as follows:

- City Budget ............................................. 45%
- Regional Budget ........................................... 25%
- Federal Budget ........................................... 20%
- City GKI .................................................... 4.5%
- City Fund .................................................. 4.5%
- Federal GKI ............................................. 0.5%
- Federal Fund .............................................. 0.5%

Lease payments will be transferred to the city budget.

**Principle 16: Consideration should be given to taxing future sales of auctioned property.**

Should the winning bidder choose to sell the property/leasehold at a profit within five years of the auction, he or she must pay the city a percentage of the profit. This tax is really a form of delayed payment for commercial property sold by the city in auctions. If commercial property prices rise in the future, the revenue proceeds from such a tax will help deflect criticism that the city sold this property at unreasonably low prices. If these payments cannot be structured as taxes, then some form of contractual fee to be paid upon transfer of commercial property must be designed that preserves the economic essence of a capital gains tax.

In Nizhny Novgorod, to capitalize on the anticipated long-term rise in the value of commercial property, the city established a system of “transfer fees.” For up to sixty months after commercial property is auctioned, if the buyer wishes to resell the property, he must pay the city 30 percent of the difference between the sale price and the original auction price. The monetary value of documented physical improvements to the structure can be subtracted from the sale price when calculating the fee.

The same fee is applied in the same manner if a leasehold is sold during a 60-month period after privatization. The sale or transfer of commercial property and leaseholds is prohibited during the 12 months after privatization of an enterprise. This is intended to lend stability to the process, to encourage proper management and maintenance, and to avoid speculative bidding.
**PRINCIPLE 17: Leased property should eventually be sold.**

The Nizhny Novgorod authorities decided to commit to sell by auction, within five years, the shared buildings housing restaurants and retail and service outlets. During these auctions leaseholders, like labor collectives during the current auctions, will receive a 30 percent discount on the auction sale price. The price will be further reduced by the monetary value of the physical investments they have made to the building over the five-year leasehold.

**PRINCIPLE 18: Privatization of wholesale distribution and transport distribution networks should follow the first auctions.**

The city must support its privatized retail sector by privatizing wholesale trade and transport networks. In Nizhny Novgorod this was scheduled to occur shortly after privatization of restaurants and retail and service outlets was initiated. Simultaneous privatization of retail, wholesale, and transport was avoided so that supply networks for retail trade businesses would not be unduly disrupted.

**PRINCIPLE 19: Security of food supply is imperative.**

Nizhny Novgorod officials implementing the privatization program were concerned that the supply of such dietary staples as milk and bread not be interrupted. It was decided that enterprises currently selling bread and milk be required to continue selling such items for one year after the auction. Buyers sign a binding agreement to this effect, as they do when a building is deemed of historic significance and its upkeep must be assured. However, enterprises are allowed to sell other products, and newly privatized shops not previously selling bread and milk are allowed to begin doing so.

**PRINCIPLE 20: Political commitment is essential.**

From the very start of the small-scale privatization process it was clear that there is a need for close cooperation between the city administration and the city council on all issues concerning the small-scale privatization process. This also implies close cooperation between the City GKI and City Fund.

Even more than the need for close cooperation, the presence of dedicated, reform-minded officials at the city level is critical. Small-scale privatization is a highly charged socio-political process. Strong and committed leadership is needed to win over the variety of groups involved. The city of Nizhny Novgorod was fortunate to have a strong and dedicated leadership. At both city and regional levels, leaders recognized the importance of early success in small-scale privatization.
PART TWO:

A CITY OFFICIAL’S GUIDE
This part of the manual describes in detail the design and implementation of a small-scale privatization program in Nizhny Novgorod, Russia. It is divided into two sections:

**Section One**

Section One discusses the five successive stages of the program:

- **STAGE 1: Legislative Framework**
- **STAGE 2: Administration**
- **STAGE 3: Data Collection**
- **STAGE 4: Enterprise Liquidation**
- **STAGE 5: Auction Procedure**

**Section Two**

Section Two then discusses the related issues of (a) employee participation in the privatization process and (b) financial management. Where relevant, sidebars refer the reader to annexes containing copies of pertinent legislation and other documentation. These annexes appear in a separate volume.

Practitioners should be aware that, although the framework described below represents a potential model for other cities in the Russian Federation, it is derived in part from circumstances peculiar to Nizhny Novgorod. Although they must work within federal legal and administrative guidelines, city officials should be careful to tailor their own small-scale privatization programs accordingly.
THE FIVE STAGES OF PRIVATIZATION
The Legislative Framework

Because privatization involves the transfer of ownership, it is a legal process. Russia now has the federal laws and regulations required to implement a privatization program in any municipality. Before implementation can occur, however, city officials must work within federal law to adapt two things to their particular needs:

- City regulations governing the operational details of small-scale privatization
- Standardized documents pertaining to individual auction transactions.

This section of the manual summarizes the legislative framework in effect at the time that the Nizhny Novgorod small-scale privatization program was first implemented. Discussion is divided between:

- Federal legislation
- City legislation
- Legal documentation governing individual transactions.

Additional legislation concerning enterprise liquidation is discussed below in Stage Four; and Stage Five will address additional legal documents required during the auction process.

Applicable laws and regulations continue to evolve, and it is safe to assume that they will do so for some time. Nevertheless, the Nizhny Novgorod small-scale privatization program is currently the most advanced and comprehensive model in Russia.

Federal Legislation

Four major laws and regulations establish the basis for small-scale privatization at the federal level:


2. The Fundamental Provisions of the Program for Privatization of State Municipal Enterprises in the Russian Federation for 1992, hereafter referred to as the
**Fundamental Provisions**; and its successor, the State Program of Privatization of State and Municipal Enterprises, hereafter referred to as the **State Program**.

3. The **Provisional Regulations**, a series of regulations giving operational guidance on different aspects of privatization.

4. The Resolution Concerning the Division of State Property in the RSFSR, hereafter referred to as the **Division of Property** law.

These federal laws offer a broad framework within which regional, city, and district officials may work to create a privatization program that best suits their own needs.

1. **The Privatization Law**

Dated July 3, 1991, the **Privatization Law** sets forth the overall legislative framework for privatization in the Russian Republic. Major features include:

- Establishment of the Committee for Management of State Property (Goskomimuschestvo, or GKI), including oblast and city GKIs, responsible for preparing enterprises for privatization under their respective jurisdictions.

- Establishment of the **State Property Fund** (the Fund) including regional and city funds responsible for conducting the *actual auctions* of enterprises being privatized.

- Provision that privatization plans are to be developed by **standing committees on privatization** and approved by the City GKI. (With federal sanction, the Nizhny Novgorod authorities simplified this provision to require only one municipal **Standing Commission on Privatization**.)

- Provision that enterprises be prepared for sale by open auction or closed conditional auction.

2. **The Fundamental Provisions and State Program**

The **Fundamental Provisions**, confirmed by decree on December 29, 1991, were further developed by the **State Program**. The provisions build on the **Privatization Law** by establishing the goals, procedures, and restrictions of the national privatization program.
It was the **Fundamental Provisions** that guided Nizhny Novgorod officials in their efforts to design a program of their own. In brief, they:

- State that enterprises in retail trade, food services and communal services must be privatized in 1992
- Delineate the division of proceeds from privatization between federal, regional, and municipal levels of government
- Limit to labor collectives the right to pay for auctioned properties in periodic installments
- Grant employees a 30 percent discount when bidding at auctions.

### 3. The Provisional Regulations

The **Provisional Regulations** comprise several documents specifying operational guidelines for various facets of privatization. On January 29, 1992 they were collectively endorsed by a “Decree on the Measures to Accelerate Privatization of State and Municipal Enterprises.” The **Provisional Regulations** specify methods and procedures for:

- Applications for privatization and valuation of enterprises to be privatized
- Transforming enterprises into joint-stock companies
- Conducting auctions and tenders, including the content of both public announcements and applications to participate in such auctions and tenders.

### 4. Division of State Property

The December 27, 1991 Resolution of the Supreme Soviet on the Division of State Property takes the crucial step of relinquishing to municipalities certain categories of enterprises, i.e., retail shops, catering facilities, and consumer services. The resolution further stipulates that each **City GKI** should establish lists of enterprises to be transferred to the city, and that these lists are to be confirmed by the local City Council, then registered with the **Oblast** or **Federal GKI**. Property is legally transferred to the municipality two months after such registration.²

² A Presidential Decree of March 18, 1992 establishes further procedures for implementing the division of property.
City Legislation

Decrees and regulations issued at the city level address the framework for small-scale privatization with greater specificity. In addition to further defining the types of businesses to be auctioned, they establish:

- The city entities responsible for implementing the privatization process
- The zoning and leasing laws necessary to auction leaseholds of property located in shared (or “multi-purpose”) buildings
- Legislation to do with individual auction transactions.

The discussion below focuses on two sets of documents: (a) general regulations and (b) regulations to do with leasing and zoning.

1. General Regulations

The driving force behind the Nizhny Novgorod auction program is the body of City Regulations of March 6, 1992. These set forth the administrative procedures for small-scale privatization in the city. On April 22 they were slightly amended to incorporate the results both of pilot auctions and of proposals by the permanent commissions of the city council. The City Regulations currently provide for the following:

- A single Standing Commission on Privatization to coordinate privatization under the City GKI. The Commission assumes responsibilities of the privatization committees that, under the federal Privatization Law, would normally be established for each enterprise. This simplification has been endorsed by the Federal GKI.

- Methods for gathering and publishing information about each enterprise to be privatized. These include the requirement that the date of the press release announcing enterprises to be privatized also marks the date on which enterprises will begin to be liquidated.

- Means of calculating initial bidding prices.

- Details on payment for privatized enterprises, including (a) a 30 percent discount accorded to labor collectives and (b) the right of labor collectives to pay in periodic installments.
Other important city regulations governing small-scale privatization include:

- The Resolution No. 7/8 of the Nizhny Novgorod City Council of November 14, 1991, “Concerning the Property Fund of the City of Nizhny Novgorod,” which adopts the Regulations on the Property Fund of the City of Nizhny Novgorod, thereby establishing a City Fund.

- Resolution No. 7/9 of the Nizhny Novgorod City Council of November 14, 1991, “Concerning the Program of Urgent Measures for the Privatization of Municipal Property,” which defines the city’s privatization program.

2. Zoning and Lease Regulations

Nizhny Novgorod authorities have established a simple zoning system to determine lease payments for businesses located in shared buildings. The city was divided into three zones according to the location of main transport and shopping thoroughfares, centrality of location, and density of pedestrian and vehicular traffic. Based on the zoning, a coefficient is applied to the base lease payments determined by the City Council. The Council then applies a further coefficient based on the building’s historical value, if any. The resulting lease payments are to be adjusted for inflation at the end of each year in the five-year lease term.

Two city council resolutions regulate leaseholds stemming from auctions. The first was a February 26, 1992 resolution addressing leasing agreements generally and establishing base rental rates. The second, passed on March 9, 1992, provides for adjustment of these base rental rates upwards according to the zoning coefficients just described.

Implementing Documents: Individual Transactions

Finally, as with the transfer of property in any country, legal and other documentation is necessary to implement individual privatization transactions. In Nizhny Novgorod these include both contracts and requirements of “public notice.” Additional documentation is discussed in the context of auction procedure in Stage Five.

1. Public Notice

Under federal law the city must notify the public when it plans to privatize enterprises. This public notice has two parts: a press release and explanatory notes.
Press Release

The City Fund must publish a press release in local newspapers three weeks before each auction. The release contains practical information necessary for potential buyers to participate in the auctions. This includes type, date, time, and place of auction, a list of all enterprises (with addresses) for sale, starting prices, and whether each sale will involve the purchase of a stand-alone building or the right to lease space in a shared building. (The city gathers this and other information by means of a privatization passport described below in Stage Three.)

The press release should also contain regulations defining auction procedure, the method of payment, and the amount of pre-registration deposit.

Explanatory Notes

Before the first auctions in Nizhny Novgorod, city officials published a form of explanatory notice in the local press. These explanatory notes explained the overall approach and operating procedures of the city privatization program.

2. Contracts

To allow for different types of lease and/or sales agreements, a total of three types of contracts pertain to the small-scale privatization program in Nizhny Novgorod.

Contracts of Purchase and Sale

The new private owner is buying either (a) the right to own a free-standing building or (b) the right to lease space in a shared building. In either case a contract of purchase and sale is required.

Two types of purchase contracts exist. The first finalizes the purchase of the right to own both a stand-alone building and its equipment and inventory; the second, the purchase of the right to lease space while owning the assets in that space.

At the time the contract is executed (i.e., at the auction immediately following the sale), the buyer and a City Fund representative agree on a time at which they will meet at the shop on the first business day following the auction. At that time the new buyer receives the keys and signs the Act of Transfer and Acceptance, thus taking official possession of the property.
Finally, after stock-taking to verify the existence of assets (if any) listed before the auction, the buyer purchases (a) equipment at residual book value and (b) inventory (which does not depreciate) at book value.

**Contract of Lease**

Owning the right to lease space does not mean that the space has yet been leased. Buyers who have purchased the right to lease a space in a shared building need to take the additional step of signing a *lease contract*. In Nizhny Novgorod, on the day of the auction, buyers are given a certificate giving them the right to sign such a contract. On the next working day the buyer, having taken possession of the property, brings the certificate to the City Fund, or the real estate agency that owns the building. This body then completes and executes the Contract of Lease.
STAGE TWO

Administration

With the legislative framework in place, the city can concentrate on adapting its administration to the special needs of privatization. As mentioned above, the two main administrative organs of privatization at the city level are the City GKI and the City Fund. The City GKI, tied to the City Administration via its chairman, handles all matters prior to the actual sale of municipal property, including enterprise liquidation (see Stage Four). Responsibility for actual sale and individual auctions rests with the City Fund, whose chairman is elected by the City Council. Representatives of both City GKI and City Fund sit, with other officials, on a central Standing Commission on Privatization.

The City GKI

The chairman of the City GKI, nominated by the mayor, is formally also deputy mayor. The City GKI deals with both management and privatization of municipal property. This involves cultural centers (such as theaters) and utilities as well as retail businesses, and the City GKI has a department for each category. However, as only retail (including catering and communal services) businesses are currently scheduled for privatization, only that department will be discussed here.

Relevant departments of the City GKI are:

- Retail Trade and Catering
- Inventory
- Valuation
- Social Security
- Information
- Law
- Financial and Economic
- Registration
- Administration.

1. The Department of Retail Trade and Catering

This is the main department dealing with the privatization of municipal shops and restaurants. Among its most important functions is the pre-auction clarification of
ownership. The department has achieved this mostly by reorganizing the retail outlets of the wholesale networks into separate municipal enterprises. The department’s other functions include:

- Executing the decrees concerning small-scale privatization
- Preparing preliminary lists of municipal enterprises to be sold
- Certifying balance sheets for each such enterprise
- Preparing the required privatization documents
- Advising the public on issues concerning privatization.

2. The Department of Inventory

This department maintains a data bank on the city’s physical assets, culling information from city and district agencies. It also registers documents concerning ownership rights.

3. The Valuation Department

The valuation department determines the value of enterprises scheduled for auction. For stand-alone structures the balance-sheet value of property (including assets and inventory) becomes the starting price; for space in a shared building, the equivalent of one month’s lease is used.

4. The Department of Social Security for Employees of Privatized Enterprises

This department deals with social security issues concerning employees of privatized businesses.

5. The Information Department

This department’s chief role is to prepare a privatization passport for each enterprise on the privatization list. This process is described in Stage Three below.

6. The Legal Department

This department collects and processes applications for privatization and provides general information on legal issues concerning privatization. Most important, however, is its role in establishing clear title to each property to be sold.
7. The Financial and Economic Department

The privatization process is based on liquidation and asset sale, with the city assuming all liabilities associated with liquidated enterprises. This department deals with these liabilities, settling accounts with creditors and transferring the funds according to the data submitted by the social security department. (The liquidation process is described more fully below in Stage Four.)

8. The Registration Department

The speedy registration of new businesses allows new owners to operate immediately. This department:

- Prepares documents and materials concerning the registration of the new enterprises and companies
- Receives applications for privatization
- Transfers to the City Fund the certificate and shareholding structure of each enterprise
- Registers labor collectives as “limited liability companies” so that they may register for auctions (see Section Two, “Employee Participation in the Privatization Process,” below).

9. Administration Department

No less important than the other departments, this department provides office equipment, deals with personal documents, and maintains the City GKI archive.

The District Privatization Commissions

Subdivisions of the City GKI have been established in each of Nizhny Novgorod’s eight districts and are called district privatization commissions. Each privatization commission is subordinated to the City GKI as well as to the relevant district administration. Members include:

- A representative of the City GKI who chairs the commission
- A representative of the district council
- A representative of the district Financial Department
A representative of the district Department of Inventory.

The district privatization commissions work with the City GKI to gather data and compile lists of municipal properties to be prepared for auction.

**District Privatization Commissions and the City GKI: Administrative Procedure**

As the grassroots arm of the City GKI, the district privatization commissions are initially responsible for gathering and preparing the information essential to the auction process. The City GKI finalizes the list of enterprises to be auctioned and initiates the actual auction process. Their collective duties can be summarized as follows:

**District Level**

1. **Step 1** Prepare all information required by the law by completing privatization passports
2. **Step 2** Determine the starting price and method of privatization (i.e., auction or conditional auction) for each enterprise
3. **Step 3** Prepare monthly, quarterly, and annual lists of enterprises to be privatized
4. **Step 4** Discuss each enterprise on the privatization list with the appropriate labor collective
5. **Step 5** Submit privatization lists for approval to the chairman of the district Council and the district head of Administration
6. **Step 6** Submit the privatization list to the City GKI

**City Level**

7. **Step 7** Collect the privatization list from each district
8. **Step 8** Review the information and approve the starting price for each enterprise
9. **Step 9** Prepare the city privatization list
10. **Step 10** Submit the city privatization list to the Standing Commission on Privatization for approval
Step 11 Submit the city privatization list to the mayor and City Council chairman

Step 12 Transfer the final privatization list to the City Fund for publication.

The City Fund

The City Property Fund, or City Fund, is the municipal arm of the State Property Fund and is responsible for administering each individual auction. It operates independently of the City Administration; the chairman, being elected (and dismissed) by the City Council, is responsible only thereto.

As a legal entity, the City Fund has all the associated attributes of such an entity, including signatory seal and stamp. When a final list of businesses to be sold is approved, the City GKI transfers to the City Fund all pertinent documentation and data, including certificates of ownership. In this way, although the City Fund does not have the right to actually manage an enterprise, it assumes the responsibilities of the owner and the risks of the enterprise.

Immediately after the property is sold, the City Fund transfers to the buyer the certificate of ownership or, in the case of shared buildings, the right to a five-year lease. Finally, after each auction it receives and distributes the proceeds, retaining 4.5 percent in order to finance its future activities.

A full description of City Fund activities before, during, and after each auction appears in Stage Five below.

Organization

Overseeing the City Fund is a four-member board including the chairman of the City Fund, a deputy chairman, and two members of the City Fund, who work on a contract basis. As mentioned above, the chairman of the City Fund is appointed and dismissed by the City Council.

In Nizhny Novgorod the City Fund employs 25 people. Its six departments are Commercial, Information, Legal, Accounting, Securities, and Auction. After the City
Fund receives the proper documentation from the City GKI, it publishes a press release announcing that an auction will be held in three weeks. For those three weeks the City Fund's departments devote their full attention to the enterprises scheduled to be sold.

1. Commercial Department

The main functions of this department are as follows:

<table>
<thead>
<tr>
<th>TIMING</th>
<th>ACTIVITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before auction</td>
<td>Analyze privatization lists prepared by the district privatization commissions and the City GKI</td>
</tr>
<tr>
<td>Before auction</td>
<td>Analyze the implementation of the city privatization list and prepare an annual report for the City Council</td>
</tr>
<tr>
<td>Before auction</td>
<td>Analyze City GKI documentation, including Certificates of Ownership, privatization list, privatization passports, and other documents prepared by the district privatization commissions</td>
</tr>
<tr>
<td>After auction</td>
<td>Transfer the privatized enterprise to the buyer, and sign the Act of Transfer and Acceptance on the basis of the Contract of Purchase and Sale (see Stage Five, “Auction Procedure”)</td>
</tr>
<tr>
<td>After auction</td>
<td>Issue the appropriate Certificate of Ownership</td>
</tr>
<tr>
<td>After auction</td>
<td>Register the final payments for the privatized enterprise and reimburse the ten-percent preregistration deposits for the losers of auction</td>
</tr>
</tbody>
</table>

2. Information Department

The main functions of this department are as follows:

<table>
<thead>
<tr>
<th>TIMING</th>
<th>ACTIVITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before auction</td>
<td>Prepare and publish the press release containing information on the enterprises to be privatized</td>
</tr>
<tr>
<td>Before auction</td>
<td>Conduct public-relations campaign in media, including newspaper, radio, and television</td>
</tr>
<tr>
<td>Before auction</td>
<td>Analyze the market situation</td>
</tr>
<tr>
<td>Before auction</td>
<td>Organize visits of potential buyers to the enterprises to be privatized</td>
</tr>
<tr>
<td>After auction</td>
<td>Publish the results of the auction.</td>
</tr>
</tbody>
</table>
3. Legal Department

The Legal Department's main duties are as follows:

<table>
<thead>
<tr>
<th>TIMING</th>
<th>ACTIVITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before auction</td>
<td>Prepare legal documents and materials</td>
</tr>
<tr>
<td>General</td>
<td>Supervise legal procedures</td>
</tr>
<tr>
<td>General</td>
<td>Provide general information on legal issues concerning privatization.</td>
</tr>
</tbody>
</table>

4. Accounting Department

The Accounting Department is responsible for all financial affairs, including the collection and distribution of auction proceeds.

5. Auction Department

After the press release has been published, this department organizes and conducts the auction or conditional auction. (See Stage Five below.)

6. Shareholding and Securities Department

This department, being focused solely on large-scale privatization, has no role as yet in the Nizhny Novgorod privatization program.

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**The Standing Commission on Privatization**

One arena in which City GKI and City Fund officials work together is the city's Standing Commission on Privatization. In accordance with the City Regulations of March 6, 1992, the commission is charged with compiling and approving a list of retail shops, catering facilities, and consumer services to be sold. The commission comprises ten members representing both City Administration and Council:

- Three from the City GKI
- Two from the City Fund
- The chairman of the economic reforms commission
- One representative from the city financial department
> One representative from the tax authorities

> The chairman of the City Council trade commission.

A trade union representative also sits on the commission.

The commission works very closely with the chairmen of the City GKI, City Fund, and City Council, as well as with the mayor. The final list of enterprises for sale prepared by the Standing Commission on Privatization must be approved by both the mayor and the chairman of the City Council.

### Conclusion

The privatization process involves both the City Council and the City Administration at different levels and at different times. Lines of supervision may cross: the district privatization commissions, for example, must report to both the City GKI and the district administration. Though differing in duties and lines of authority, GKI and Fund officials must make every effort to work together in order to facilitate this major economic and social transition.
Data Collection

Before any of the retail and service shops and restaurants scheduled for privatization in 1992 can be considered for auction, the city must obtain accurate, reliable information about them to satisfy the public notice requirements (see Stage One above). Unfortunately, in the early stages of implementing small-scale privatization, Nizhny Novgorod officials found that their main difficulty consisted in doing exactly this. In theory, the district privatization commissions and the City GKI obtain preliminary data on enterprises to be privatized from the municipal enterprises themselves, as well as from district finance and inventory departments. In practice, however, little information is readily available.

To address this problem, the City GKI established an information-gathering system in which the district privatization commissions play a critical role. In general, it is important that these bodies be established as soon as possible. The sooner data can be collected, the sooner municipal enterprises can be listed for auction.

The quality and quantity of information depends on close cooperation between city and district administrations as much as it does on accurate sources of basic data.

It also depends on money, at least in the first stages of privatization. The director of the city Finance Department should be instructed by mayoral resolution to allocate enough funds to support the initial work of the district privatization commissions, appraisal commissions, and auditors. It should be emphasized that this is a one-time payment; after the first auctions, the privatization process will not only be able to finance itself but will contribute revenues to the city budget. (See Section 2 (2), "Financial Management," below.)

This section first describes the information that must be gathered before auctions can begin, then describes both the data-collection procedure and the problems officials may encounter while fulfilling their duties.

The Privatization Passport

Summarizing the information necessary for privatization to proceed is the privatization passport of the enterprise scheduled to be sold at auction.

Completing the passport requires four categories of information:

1. General data, including name, location, type of business, bank account data, and ownership status

2. Assets, including (a) the residual book value of the building (if stand-alone) and any equipment on the premises and (b) the book value of the inventory
3. Number of employees

4. Area of the business space.

The technical description of the enterprise, prepared by the district Department of Inventory, is helpful in the preparation of the passport by the district privatization commission. This technical description includes:

- An assessment of the building or space
- A valuation of machinery, equipment, and other fixed assets
- A valuation of inventory, expenses, cash and other financial assets
- A summary valuation of property provided for both the district finance department and the enterprises slated for privatization.

Completing the Privatization Passport

The following organizations and personnel are involved in generating and processing the data necessary to complete privatization passports:

- Members of district privatization commissions.
- Enterprise managers and employees. This allows city officials to merely check and analyze collected information. Although in practice such participation is often difficult to elicit, compliance at this level is very important.
- Outside experts. For example, accountants with experience in dealing with the old wholesale networks should be consulted.

Tasks and Responsibilities

In accordance with this data collection system, the following distribution of responsibilities should be established (see Figure 2-1, “Collection and Preparation of Enterprise Data”):

- Every district privatization commission appoints a person responsible for completing the passport. In practice this work is often performed by the deputy chairman of the commission.
The chairman of the district privatization commission ensures cooperation between district and city administrations.

Other members of the district privatization commission participate based on their technical training and aptitude. For instance, the district Department of Inventory prepares a technical description of the enterprise, and the district Finance Department provides financial information that can only be obtained at the district level.

The person responsible for the collection of information in the district privatization commission passes this data on to the secretary of the City GKI, who must verify its accuracy and completeness and submit it to the City GKI for consideration.

The City GKI reviews the information and submits a final list of enterprises to be sold at auction to the Standing Commission on Privatization at the city level. Upon approval, both the chairman of the City Council and mayor must approve the list, whereupon it is sent to the City Fund for publication. Summary data on the enterprise is supplied in a press release published in the local press, which represents the official decision to privatize the municipal enterprises on the list.

Potential Difficulties

City officials collecting enterprise data should anticipate certain obstacles, foremost among which is the failure to establish clear lines of both ownership and authority.

Establishment of Clear Property Rights

Particular attention must be paid to possible conflicting property rights over what is supposed to be municipal property, such as the existence of lease contracts involving the relevant enterprise.

Many municipal businesses scheduled to be privatized previously belonged to now-liquidated wholesale networks, and acquired the status of separate legal entities only recently. For this reason it is sometimes difficult or impossible to obtain information, including separate balance sheets. Because of the liquidation process many networks did not undertake inventories on shops in 1991, so data from 1990 often has to be used.

Nonetheless, the ownership status of enterprises (for both commercial property and leaseholds thereof) can usually be determined from balance-sheet data obtained from the wholesale networks, or from the city finance department. The latter in most cases holds title to commercial property.
Figure 2-1: Collection and Preparation of Enterprises Data

- **Enterprises and Labor Collectives**
- **District Administration**
- **District Department of Inventory**

Approval by District Council

**District Privatization Commission**

Preparation of Privatization passports and District Privatization List

**City GKI**

Review of Privatization passports
Preparation of City Privatization List

Signature by:
- Mayor
- City Council Chairman

**Standing Commission on Privatization**

Review and Approval of Privatization List

**Fund**

Publication of Enterprise Data in Press Release

**Auction**
Other Problems

Other problems officials may face in trying to obtain reliable data:

- Ideally the privatization passport is submitted to the City GKI together with the necessary exhibits. In fact, delivery of these ancillary documents is often delayed.

- Privatization passports and other financial documents are often incorrect, complicating the process. Careful documentary review is crucial.

- Members of district privatization commissions sometimes report to their district administrations as well as to the City GKI. Such a situation sometimes leads to conflicts, particularly since opposition to small-scale privatization often arises at the district level. In general, it is advisable that the information-gathering structure be fully independent of the district administrations.
Enterprise Liquidation

After the privatization passport has been completed and the municipal enterprise has been cleared for auction, a final stage remains before the bidding can begin: liquidation.

As mentioned above, small-scale privatization in Nizhny Novgorod does not involve selling city-owned enterprises as ongoing concerns. Rather, it entails the sale of property (or leaseholds) and assets owned by those enterprises. The liabilities are not transferred; the buyer assumes neither debt nor obligations to existing employees. Creditors, who by law are given two months to submit their claims, may still do so but must now apply to one of the city's district privatization commissions. This allows the city to sell its property immediately, without waiting the normal two months for creditors to make their claims.

This approach increases the flexibility of new owners to operate the privatized enterprise in more productive, efficient, and innovative ways. It also eliminates the need for exhaustive review of liabilities before sale at auction. As noted above in Stage Three, this is especially important because of the difficulty of obtaining separate, reliable balance-sheet data on municipal enterprises.

As a matter of principle, the City GKI should seek to require municipal enterprises to settle as many of their liabilities as possible before the privatization process begins. The City GKI should also monitor the financial affairs of each enterprise in the period of time immediately preceding privatization to assure that enterprises do not unjustifiably increase their liabilities during this period.

Legislation Governing Liquidation

Enterprise liquidation is governed by both the federal Labor Code of 1971 (as amended) and the federal Law on Enterprises and Entrepreneurial Activity of December 25, 1990. A presidential decree of April 6, 1992 authorizes district privatization commissions to act as the liquidation committees otherwise mandated in the latter law.

The Labor Code provides that labor contracts may be dissolved in the case of liquidation. Nizhny Novgorod officials provided, in accordance with law, certain "measures of social security," including severance pay. (See Section 2 (1) below.)
Liquidation Procedure

Liquidation procedure can be summarized in five steps.

**Step One: Publishing The Press Release**

As discussed in Stage One, three weeks before each auction, the City Fund issues a press release containing a list of enterprises selected for privatization. This constitutes public notice that those enterprises have been placed in liquidation. It also constitutes official notice to creditors that, after the property is sold at auction, they have two months to submit their claims against the enterprise to the district privatization commission, acting as a liquidation commission.

**Step Two: Notifying Employees**

Nizhny Novgorod requires that certain measures be taken to protect workers affected by privatization. These measures include (a) the right to immediate notice of liquidation and (b) the employee’s right not to be dismissed until after the enterprise is sold. (See Section Two below.)

**Step Three: Preparing The Balance Sheet**

The district privatization commission, acting as a liquidation commission, prepares the liquidation balance sheet for the liquidated enterprise and submits it for confirmation to the City GKI. The commission also conducts a tax review to determine if the enterprise has any debts to the budget authorities to be settled.

**Step Four: Stock-taking and Sealing**

The day before the auction, the district privatization commission seals the enterprise in the presence of a representative of the district administration and the accountant of the enterprise. Before the enterprise is sealed, stock-taking of equipment and inventory is undertaken. This information, which updates data from the passport, is compiled on the basis of inventory/product flow records and balance sheets. Data thus obtained is included in the information provided at the beginning of the auction.

**Step Five: Issuing Notice of Liquidation**

After the enterprise has been privatized at the auction, the district privatization commission issues its notification that the enterprise has been liquidated. This statement announces that financial operations of the enterprise are concluded, its bank accounts
are blocked, and its seal is no longer valid. The commission also publishes in the press a notice that the seal of the liquidated enterprise is no longer valid.

An enterprise is considered formally liquidated when it is removed from the state register by the appropriate authorities. The commission assumes all claims associated with the former enterprise.
Auction Procedure

After the legislative and administrative frameworks are in place, and after the enterprises to be sold have been liquidated, the auctions may begin. At this stage the words *property*, *lot*, and *object* are often used to describe what is actually at auction.

*Auctions* are a transparent way to implement small-scale privatization while assuring that a municipality obtains a market-based price for the enterprises it wishes to privatize. The element of public scrutiny helps ensure that the auctions proceed in a fair manner.

In *conditional auctions* (also called *tenders*), bidders agree to meet preliminary conditions set forth as part of the offer of sale. These conditions might include maintenance of milk production, for example, or of the building itself. Buyers in conditional auctions present written commitments to observe conditions set forward by the seller when registering for an auction. This written obligation is made at the time of registration, after which the enterprise is sold by auction in the normal manner. In general, it is preferable to limit conditions in order to reduce the scope for discretion in the privatization process.

As the seller of municipal enterprises, the City Fund is responsible for both auctions and conditional auctions. As discussed in Stages One and Two, its responsibility for each auction begins three weeks beforehand, when it publishes the press release based on information supplied by the City GKI.

This section first describes the general preparation necessary before each auction, then offers a chronological, step-by-step view of the auction process.

### General Preparation

Before each auction the City Fund must prepare generally by advertising, booking pre-registration and auction rooms, and ensuring that trained staff will be on hand whenever required. (Special bank accounts for auction finances, which should be opened before the first auctions, are discussed below in Section 2 (2).)

### Pre-Registration and Auction Rooms

Typically, between two and ten participants will bid for any one property; assuming approximately twenty-five properties per auction, a maximum of 250 seats are needed for potential bidders. However, in Nizhny Novgorod the auctions have been popular with the public, and crowds of a thousand people are not uncommon. City Fund officials in other cities should plan accordingly.
One or two rooms should be booked for pre-registration during the week before the auction. For the auction itself, a room large enough to seat several hundred people (depending on the size of the city) should be secured and equipped with a public address system.

In addition, three separate rooms should also be reserved for final registration and the signing of legal documents on the day of the auction.

Advertisements and Displays

In addition to the press release described above in Stage One, clear, well-distributed advertisements and displays are essential to ensuring that the auction process flows smoothly.

Advertisements, flyers, and posters should specify:

- Date, time, and place of both auction and pre-registration
- Telephone numbers to call for information
- Property to be sold.

Personnel

The City Fund should designate and train personnel appropriate to each stage of the auction process. The City Fund should provide:

- An experienced auctioneer to lead the bidding
- A City Fund official to witness the signing of legal documents following each sale
- Two auctioneer’s assistants
- One or more typists, with typewriters, to provide an official record of the proceedings.

Auction

The City Fund’s auction activities can be divided chronologically into four phases (see Figure 2-2, "Auction Procedures and Documents"):

- Pre-registration
- Registration
Auction

Post-auction.

**Phase One: Pre-registration**

Pre-registration starts one week before the auction date. As specified on the application form (see below), prospective bidders must pre-register for the auction on or before the date on which their application is filed. The City Fund should take care to make very clear where the pre-registration is being held, to the point of making signs to advertise the location and direct the public once inside.

The room in which pre-registration is held should contain such necessary information as lists of enterprises up for auction, starting prices, and auction rules.

In order to pre-register, all prospective participants must deposit in the appropriate City Fund sub-account an amount equal to ten percent of the starting price of the items for which they wish to bid. (See Section 2 (2), "Financial Management," below.) Participants wishing to take part in more than one round of bidding must pay a ten-percent deposit for each bid. In return, participants are issued a bank receipt.

Participants must then submit this bank receipt to the appropriate City Fund official along with an identification card or other means of identification and a completed application form.

Legal persons representing other individuals or legal entities must also submit the following:

- A *power of attorney*. Under the Privatization Law, legal entities must be represented by proxies possessing the "power of attorney" to sign all legal contracts to do with the auction. This power of attorney, granted by the entity to the legal person, must be submitted with the application form. (Individuals may also authorize other individuals to represent them in an auction or conditional auction.) Companies whose state-owned share is greater than 25 percent are ineligible to participate in auctions or conditional auctions.

- A copy of the *found ing documents* of the entity granting power of attorney.

If all is in order, the participant is issued a pre-registration receipt. Pre-registration ends the day before the auction.
Figure 2-2: Auction Procedures and Documents

**PRE-REGISTRATION**
- Application Form
- Power of Attorney
- Deposit Receipt
- Pre-Registration Receipt
- Participant List

**REGISTRATION**
- Participant List
  - (confirmation signatures)
- Participant's Ticket
- Auction Program
- Auction Rules

**AUCTION**
- Number Cards
- Record of Purchase
- Contract of Purchase and Sale

**AFTER AUCTION**
- Inventory List (book value)
- Act of Transfer and Acceptance
- Receipt for Keys
- Contract of Lease
- Certificate of Ownership
  - (Non-Payment Notice)
  - (Notice of Termination)
Application Forms

Application forms are made available to potential bidders at the City Fund's offices. Each form is accompanied by a package containing:

- Samples of the legal documents bidders will be asked to execute during and after the auction
- Instructions for participation in the auctions.

Application forms must be submitted no later than the day before the relevant auction. Each form contains information identifying the bidder and the lot for which he or she is bidding. Different applications exist for:

- Legal persons representing legal entities, such as private companies or labor collectives, participating in open auctions
- Natural persons participating in open auctions
- Legal persons participating in conditional auctions
- Natural persons participating in conditional auctions.

Applications submitted by legal entities are required to disclose the percentage of share ownership by the state. This allows the organizer of the auction to verify that the applicant is eligible to participate under the Privatization Law and the City Regulations, which state that no entity with more than 25% state ownership is eligible to be a bidder.

Although this information is kept confidential, the auctions themselves are open to both public and media.

Participant list

When pre-registration is finished, the City Fund prepares a numerical list of participants. This is used during the auction to control attendance and ensure that at least two bidders exist for each property to be auctioned.
**Phase Two: Registration**

On the day of auction two or three City Fund officials conduct a final registration. This is held in the same building as the auction, but in a different room. The City Fund should supply:

- Displays for the properties scheduled for auction. These should include a drawing of the building/space, starting price, records of equipment and inventory, and other pertinent information.
- Signs and tables for registration.

**Participant’s Ticket**

Upon presenting the receipt of pre-registration, participants may purchase a ticket permitting them to take part in the auction. The price — in Nizhny Novgorod, 500 rubles — should be marked on the ticket. A City Fund official records on the ticket the participant’s name and the lots for which he or she has registered to bid. The official then assigns the ticket a number (or numbers) according to the order in which applications were received; signs it; and applies the stamp of the City Fund.

The City Fund should prepare different types of tickets for participants and non-bidding members of the public.

**Auction Materials**

Bidders then exchange their tickets for the following:

- **Number cards** large enough to use while bidding. Numbers in Nizhny Novgorod range from 1 to 1000, the first two digits signifying the property for sale and the last two the bidder. (Ticket number 0406, for example, would denote fourth property, sixth bidder.) This number should be the same as the ticket number. A different color should be used to distinguish members of labor collectives, who bid at a discount (see Section Two below).

- **An auction program** describing each property’s name and address, type (leasehold or stand-alone building), starting price, and other information, including the order in which it will be auctioned. The auction program should also contain auction rules describing correct bidding protocol.

When registration is completed the City Fund officials check number of tickets issued against the number of applications to ensure sure that all participants have arrived. They
also make sure that, in accordance with federal law, there are at least two participants for each round of bidding. Exception is made only for labor collectives. (See Section Two below.)

**Phase Three: Auction**

In Nizhny Novgorod auctions typically last three to four hours and are normally held on Saturdays. They are open to the public.

The auctioneer's assistants sit next to the auctioneer, checking that bidder and property numbers are correct for each round of bidding and verifying the price paid for each property.

Before the bidding begins, the auctioneer reviews aloud the rules for bidding listed in the auction program (see above). The auctioneer also should mention the penalties for violating auction rules, including a fine (linked to final bid price) applied to anyone who does not comply with any established procedure, that is, refuses to sign the record of purchase or any other agreement, or to pay for the acquired property.

These penalties should be determined well in advance of the auction, and published in the local press. The auctioneer should also give information on the inventory and fixed assets that must be bought by the winning bidder.

Finally, bidders should be invited to ask questions regarding auction procedure both before the bidding starts and during the intermissions between the sale of individual lots.

**Bidding**

As each round of bidding begins, the auctioneer states first the name and number of the property, then the starting price, and asks for bidders at that price. Participants wishing to bid at that price raise their number cards so that the auctioneer can see them. If a bid is made, the auctioneer recognizes that bid, then asks for one at a stated higher price. Bidding continues in this manner until no one is willing to bid higher. At this point the property is awarded the highest bidder.

The registration procedure attempts to guarantee at least two bidders for each round. However, if for any reason two bidders do not participate in a given round, the round is declared invalid and the property remains unsold. (An exception is made if the sole bidder is representing a labor collective; see Section 2 (1) below.)

Following a round of bidding, losers should return their number cards in exchange for their original tickets. They may reclaim their pre-registration deposits on the next
working business day by presenting their pre-registration receipts. The City Fund should ensure that this happens quickly and efficiently.

City Fund officials should instruct the winner (or buyer) as to where and when he or she should sign the Act of Transfer and Acceptance and Receipt for Keys and purchase inventory and equipment, as buyers are required to do. (See Phase Four).

Record of Purchase

After each sale the City Fund prepares a Record of Purchase summarizing the results of the auction of that object. Numbered in chronological order, each Record of Purchase is signed by the buyer, the City Fund official (acting as seller), and the auctioneer.

If the auction is invalid, either because there was only one bidder or because no participant was willing to purchase at the starting price, a Record of Purchase for an Invalid Auction is similarly executed.

Contracts of Purchase and Sale

In a separate room the winner and a City Fund official should then sign the appropriate Contract of Purchase and Sale. If the property is a leasehold, they will on the next business day also sign a Contract of Lease. (These contracts are discussed in more detail above in Stage One.)

The winner may then either stay to observe the next round of bidding or leave the building, surrendering his number card before leaving.

Phase Four: After the Auction

Buyers are told before and during the auction that they must purchase not only the property/leasehold for which they bid at auction, but also the equipment and inventory. On the first working day after the auction, the buyer meets with a City Fund official to review and value the equipment (at residual book value) and the inventory (at book value). After the value is confirmed, the two parties then sign the Act of Transfer and Acceptance. This act gives the buyer possession of, and legal responsibility for, the building (or leased space) and all related equipment and inventory. (In practice, the amount of inventory and equipment involved is often negligible.)

At this time the buyer also signs a Receipt for Keys evidencing that he has taken possession of the keys. Alternately, the receipt can be incorporated into the Act of Transfer and Acceptance.
Auction Results

The City Fund must announce the results of the auction not later than 30 days after the auction. The results, published in the local press, should summarize the signings of Records of Purchase, Contracts of Purchase and Sale, and Acts of Transfer and Acceptance. The City Fund may also choose to publish the results in a separate information bulletin.

Payment

Ownership rights for the properties sold during the privatization process can be obtained only after full payment is completed. Normally, buyers must pay within thirty days. However, in accordance with the present legislation, labor collectives buying their enterprises have a right to pay on an installment basis. When this happens, ownership or lease rights is granted after 30 percent of the purchase price is paid. However, this 30-percent payment must occur within the first 30 days.

When the buyer pays for the property, the city issues him or her a Certificate of Ownership. There are two forms of certificates of ownership: one for the right to own property (i.e., a stand-alone building) and one for rights to lease space in a shared building.

Failure to Pay

Should a buyer fail to pay in the required time, the City Fund may serve Notice of Non-Payment on the buyer.

Should payment not be forthcoming following such notice, the City Fund may send the buyer a written Notice of Termination. This nullifies any pending Contract of Purchase and Sale.
SECTION TWO:

RELATED ISSUES
The preceding chronological discussion of the process of small-scale privatization in Nizhny Novgorod leaves room for a thematic review of two important corollary issues: employee participation and financial management.

1. Employee Participation in the Privatization Process

Although employees may initially object to small-scale privatization, city officials should also consider the benefits of involving them in the privatization process. Their ability to collectively act as bidders at auction constitutes a potentially excellent means of transferring ownership to those with a vested interest in making a market-based economy work. Moreover, by discouraging speculation, encouraging employee ownership helps stabilize the privatization program. By granting labor collectives financial inducements to participate in the auctions, Nizhny Novgorod officials acted with a combination of logic, compassion, and political expediency.

This section outlines both these incentives and the social security measures promulgated as part of the Nizhny Novgorod privatization program.

Labor Collectives

Legally, a labor collective is not a labor union per se. Rather, it can be defined as a group of natural persons who are currently employed at enterprise, as well as retirees of an enterprise who, in accordance with labor legislation, have a right to continue their employment at the enterprise.

Eligibility to Participate

To participate in auctions, members of the labor collective should establish a “limited liability company” in accordance with the RSFSR law “On Enterprises and Entrepreneurial Activity.” As long as more than one-third of the employees of the enterprise slated for privatization are members of the company, the company is entitled to all the discounts granted to labor collectives in the small-scale privatization process.

The City Regulations instruct the district authorities and the City GKI to register the newly established limited liability company within three days of receipt of their application.

Participation in the Auction

To qualify as a bidder, the labor collective must choose no more than one legal person to act as its legal representative in accordance with federal legislation. This is a contractual relationship freely negotiated between the collective and the legal person.
When pre-registering for an auction, as with any joint-stock company wishing to bid at auction, the legal person is required to submit an application describing the percentage of shares belonging to the state, local councils, public organizations, associations, charities, and other public institutions. If the ownership share of any of these institutions exceeds twenty-five percent, the federal Privatization Law prohibits the legal person — and thus the company — from participating in the auction.

The legal person should also submit identification, a copy of official identifying documents, and a pre-registration receipt confirming his pre-registration deposit, as well as his passport. (See Stage Five, “Auction Procedure,” above.)

After winning the round of bidding, the representative signs the appropriate purchase/sale and/or lease contract. After paying 30 percent of the purchase price he obtains the ownership certificate.

Discounts and Preferences Provided to Labor Collectives

In accordance with the Fundamental Provisions, the labor collective’s limited liability company, having won the auction, is entitled to pay:

- At a thirty-percent discount on the purchase price
- On a one-year installment basis as long as it pays 30 percent of the purchase price within 30 days.

The collective’s final bill is further reduced if it can prove that between 1989 and 1991 it paid for physical improvements to the enterprise out of enterprise profits left at the disposal of the labor collective. In this case, the reduction in price equals the amount spent on improvements.

Social Security Measures

Employees dismissed as a result of privatization receive a percentage of the purchase price. In Nizhny Novgorod, this percentage was initially ten percent. However, the State Program now stipulates thirty percent, as long as this does not exceed twenty monthly minimum wages per employee.

The Nizhny Novgorod measures stem from an April 6, 1992 mayoral decree. Within three days of publication of the list of enterprises to be auctioned, the City GKI (or the relevant district privatization commission) must send notice to the labor collectives of the enterprises involved. Managers are responsible for notifying employees concerning
the liquidation order, obtaining their signatures acknowledging this awareness, and submitting these documents to the City GKI along with data on the number of workers to be dismissed.

If the labor collective does not buy the enterprise, within two days after the auction the manager must notify employees of any planned dismissals. Employees who do not obtain ownership of their former enterprise will be paid thirty percent of the purchase price of the enterprise. The City GKI subsequently transfers these funds to the accounts of district employment agencies.

The district privatization commission informs the employment agencies about the possible unemployment consequences of the privatization transaction, specifying professions, skills and the amount of likely payments. The employment agency offers jobs according to the professional training, skill, and experience of the dismissed worker. If no jobs are available, the agency offers vocational training for work in other sectors.

In accordance with federal law, the Nizhny Novgorod Administration pays from its budget the individual wages of persons unemployed as a result of the liquidation of an enterprise for two months. Employees are also entitled to severance pay and may qualify for unemployment benefits as well.
2. Financial Management

As much as privatization is about property, it is about finance, and no small-scale privatization program can succeed without ensuring its soundness in this regard. Moreover, since Russia's cities have in effect been given massive amounts of state property to sell, efficient management of auction revenue can only serve to enhance what should already be a profit-making venture for city administrations anxious to invest in their future.

Administrative Budget

Only in the privatization program's initial stages will program administration require direct funding from the city budget. Following the first auctions, the central organs of privatization — namely, the City Fund and the City GKI — will be able to divert auction proceeds toward reimbursing the city for its initial outlay.

Collection and Distribution of Auction Proceeds

In accordance with federal legislation, the City GKI and City Fund, in conjunction with the city's Department of Finance, should establish two bank accounts to handle the various financial transactions called for in the privatization program. (See Figure 2-3, "City Fund Auction Accounts.")

1. General Account

First, for the overall financial management associated with implementation of auctions, a general account is established at a local bank. It has three sub-accounts with differing purposes.

The first sub-account holds pre-registration deposits. Auction winners forfeit their deposit as part of their payment; losers are immediately reimbursed.

The City Fund deposits all sale proceeds into a second sub-account. Deductions are made from this sub-account for payments to labor collectives, to the municipal, regional, and federal budgets, and to the accounts of the City GKI and City Fund (see below).

A small percentage of sale proceeds are deposited in a third sub-account for administrative costs that effectively constitutes the budget for the City Fund. Funds from this sub-account go toward preparation and implementation of auctions. This includes advertising, staff and contractor wages, rent (if any) of location and public address system, and preparation of printed materials.
Figure 2-3: City Fund Auction Accounts

**GENERAL ACCOUNT**

- Pre-Registration Deposits
- Sale Proceeds
- City Budget

**Sub-Account: Deposits**
- Reimbursement to Losers

**Sub-Account: Sale Proceeds**
- General Creditors
- General Distribution
- One-Time Proceeds

**Sub-Account: Administration**
- 4.5% of Proceeds
- One-Time Reimbursement
- Auction Expenses

**SPECIAL ACCOUNT**

- Post-Auction Buyer Payments
- Inventory Creditors

*for Inventory*
2. Account for Inventory and Equipment

Proceeds from the sale of inventory and equipment are transferred to a separate bank account for working capital from which creditors' claims are satisfied and with which are defrayed any obligations associated with the enterprise's inventories. (Most of these claims concern inventory debt.) Resources remaining after the repayment of enterprise debts/obligations are transferred to the sub-account for sale proceeds described above. General creditor claims and debts associated with equipment are satisfied with resources from this sub-account.

Distribution of Auction Proceeds

Once budgetary considerations are met, the Provisional Regulations allow municipalities a certain amount of discretion with regard to "special-purpose funds" targeting social welfare, environmental protection, and infrastructure. Now, in accordance with the State Program, the city must pay to dismissed employees 30 percent of the proceeds, an amount not to exceed twenty monthly minimum wages per employee.

The remaining funds are distributed as follows:

- City Budget ......................... 45%
- Regional Budget .................. 25%
- Federal Budget .................... 20%
- City GKI ............................ 4.5%
- City Fund .......................... 4.5%
- Federal GKI ....................... 0.5%
- Federal Fund ..................... 0.5%

Lease payments will be transferred to the city budget.
Conclusion

Privatizing small-scale enterprises in the Russian Federation is only the beginning. The social, political, and economic ramifications of rebuilding Russia’s private sector are immense. Although the necessary legal and administrative framework now exists at the federal level, translating the privatization process to the local level will require considerable effort and commitment.

Moreover, as the process involves a massive relocation of both capital and labor, administrators will often be required to balance short-term needs against long-term goals. By showing how the City Nizhny Novgorod developed its own privatization program, this manual should make this task easier by providing a model that other cities can adapt to suit their particular needs.

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Glossaries

The following glossaries offer brief descriptions of (1) key legislation, (2) key administrative bodies, and (3) key terms to do with small-scale privatization in the Russian Federation in general and Nizhny Novgorod in particular.

1. Key Legislation

Federal

Privatization Law. Establishes the overall legislative framework for privatization in the Russian Republic, including provisions for the creation of the GKI and Fund. See Annex 1.

Fundamental Provisions. Establishes the goals, objectives, procedures, and restrictions of the national privatization program. It was these provisions that guided Nizhny Novgorod officials in their efforts to design a program of their own. See Annex 2 (a).

State Program. Further develops, and supercedes, the Fundamental Provisions. See Annex 2 (b).

Provisional Regulations. Specify operational guidelines for various facets of privatization. See Annex 3.


City

City Regulations, March 6, 1992. The driving force behind the Nizhny Novgorod auction program, these regulations institute the administrative procedures for mass small-scale privatization in the city. See Annex 5.

City Regulations, April 22, 1992. An amendment to the March 6 regulations incorporating the results of pilot auctions and of proposals by the permanent commissions of the City Council. See Annex 6.

City Fund. A resolution establishing and regulating the City Fund. See Annex 7.

City Privatization Program. A resolution defining the city’s privatization program. See Annex 8.

2. Key Administrative Bodies

City GKI. City Goskominuschestvo, or Committee for the Management of State Property. With the district privatization commissions, responsible for (a) gathering data on municipal enterprises to be privatized, (b) developing for the City Fund periodic lists of those businesses, and (c) liquidating them. Branch of Federal GKI.

City Fund. Property fund responsible for administering individual auctions and distributing auction proceeds. Branch of federal Property Fund.

Standing Privatization Commission. Includes members of both City GKI and City Fund. Approves list of enterprises to be privatized.

District Privatization Commissions. Work with the City GKI to gather data and compile lists of enterprises to be privatized.
3. Key Terms

Auction. The public sale of property to the highest bidder. In the Russian Federation, the chief tool of small-scale privatization. Its confidential variant is the conditional auction.

Book Value. The current balance-sheet value.

Conditional Auction. A confidential form of auction in which the buyer agrees to certain conditions of sale, such as continuing to sell bread or milk or to maintain an historical building. Also called a tender.


Inventory. Non-depreciable physical assets of an enterprise.

Liquidation. The fourth stage of the privatization process. To reduce the burden on buyers before an auction, city authorities close an enterprise down, appraise its value, and assume all its debts and obligations.

Oblast. Russian word for province. The city of Nizhny Novgorod is the capital of the eponymous oblast of Nizhny Novgorod, also known in Russian as the Nizhegorodsky Oblast.

Privatization Passport. The information-gathering document city authorities must complete for each liquidated enterprise before it can be auctioned.

Residual Value. The remaining balance-sheet value of a depreciable asset, such as equipment.

Shared Building\Structure. City-owned building housing several enterprises. In this case only the right to lease space is sold at auction. Also called multi-purpose.

Stand-Alone Building\Structure. City-owned building housing only one enterprise. In this case the entire structure is sold at auction. Compare shared building/structure.