Creating private enterprises and efficient markets

Privatization is the one bright spot on the generally bleak Russian economic landscape

Starting from less than zero in November 1991, a small, determined, and often beleaguered group of Russian reformers—with some important external support—has been able to:

- Devise and implement, in the face of strong resistance, a “corporatization” program that transformed half of Russian state-owned enterprises into joint stock companies.
- Persuade the most important “insider” stakeholders who might have opposed privatization—workers and managers—to take part in the process by offering them shares in the firms in which they work for free or at a low price.
- Conceive and implement a voucher program, giving 144 million participating Russians a chance to become, along with insiders, owners of enterprises.
- Create a national voucher auction system in more than 85 regions, with 750 bid reception centers.
- Facilitate the creation of some 650 private investment funds that compete for vouchers and convert them to diversified shareholdings in newly privatized enterprises.

By the end of June 1994, between 12,000 and 14,000 medium-size and large enterprises had been transferred to private ownership. These firms employed more than 14 million people, or about half of those employed in Russia’s industrial sector. About 40 million Russian citizens had become owners of shares in privatized firms.

These achievements border on the miraculous, having taken place in the absence of consensus on the desirability, scope, and pace of liberalizing reform in general, and privatization in particular, and in the absence of what normally would be considered the requisite administrative and financial resources to implement, monitor, and enforce a privatization program of this magnitude. Yet it was done. The only potentially comparable privatization experiences are those of the former East Germany and the former Czechoslovakia.

Comparisons to Germany and the former Czechoslovakia

In Germany the Treuhandanstalt put more than 10,000 enterprises in private hands between 1991 and 1994—an achievement that cannot and should not be minimized. But German privatization was a case of the integration of a formerly socialist economy into a functioning, indeed flourishing, market economy, an exercise that differs sharply from the total transition that Russia confronted. In Germany an irreplicable combination of West German legal and administrative institutions, West German managers, and West German money eased many of the problems of the integration.

The mass privatization program of the former Czechoslovakia, which transferred 1,491 firms into private ownership in 1992 and 1993, with a “second wave” coming in both successor states that will touch an additional 1,300 firms, is the best and perhaps only comparator to the Russian privatization program. The Czech and Slovak privatization programs are remarkable achievements. Indeed, a few Czechs have suggested that their privatization method is superior to Russia’s since no special inducements have been given to insiders. Outsiders, in the form of external investors and investment funds, have played a major ownership and governance role from the outset, and some Czech practitioners and external observers now criticize Russia for not having followed the same course.

Without disputing the impressive Czechoslovakian achievements, it must be stressed that Russia embarked on privatization in circumstances very different from those of the former Czechoslovakia. First, precommunist Russia in 1917 was markedly different from precommunist Czechoslovakia in 1948. It was less industrialized and less capitalist. Second, the length of the communist period in Russia was almost twice that in Czechoslovakia, meaning that in Russia collectivist approaches and habits had more time to take root and become deeply ingrained. Third, and paradoxically, Czechoslovakia benefited from an absence of reform communism. Unlike Hungary, Poland, and indeed Russia, Czechoslovakia basically maintained the central planning system until the very end. The successor governments thus have not had to debate the scope and pace of liberalizing reform with entrenched, decentralized stakeholders.

All in all, the obstacles to Russian privatization were more numerous and more daunting than those encountered in Germany and Czechoslovakia, or indeed in any other country that has seriously embarked on the process.

**What next?**
The Russian privatization team thus opted for the method that they judged would yield results—and they got them. But as a consequence, the results were tentative and partial. Transfer of ownership to insiders was a striking step, but only a first step. It must now be followed by equally essential second steps opening ownership of privatized firms to external investors and owners. These, in turn, will bring needed capital, market access, managerial know-how, and a bottom-line mentality to privatized companies. External investors will complete the restructuring of firms begun by the transfer of ownership. A significant percentage of restructured firms will become profitable as well as nationally and internationally competitive, and Russia will be well launched on the process of growth and integration into the global economy. Such is the hope.

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**Issues to be resolved**

To put it mildly, much stands in the way of the achievement of this grand aspiration. Ignoring the evident macroeconomic and macro-political deficiencies of present-day Russia, and concentrating solely on the privatization process, one encounters a number of critical issues:

- Insiders fear that the restructuring brought about by external investors will cost them their jobs, thus they do their best to prevent or minimize sales of large blocks of shares to external investors.
- The voucher scheme expired on June 30, 1994. The current political configuration apparently will not tolerate a second voucher issue. But 12,000–14,000 enterprises remain uncorporatized, unprivatized, and lacking the voucher mechanism to spur their divestiture.
- Small-scale privatization in Russia is impressive in absolute terms (with some 85,000 small business units divested), but lags relative to similar programs in the Czech Republic, Estonia, Hungary, and Poland, where a much larger percentage of the entire small-scale base has been divested. Small-scale privatization schools both new owners and consumers in market economics and has proved critical in job creation, essential to the absorption of surplus labor flowing out of the large-enterprise sector.
- Twelve to fourteen thousand medium-size and large firms are now in private hands. But there are few who believe that their future operations will be left entirely to determination by pure market forces, since the current Russian variant of the market deviates so sharply from the textbook model. Privatized firms urgently require technical assistance (to help in the preparation of business plans and in restructuring), credit to finance working capital, trade, and investments, and equity injections to provide both long-term money and active governance.
- Important as privatization is, it is only a part of the transition process, alongside new entrants and greenfield investments.