Privatization in the Soviet Union

The Beginnings of a Transition

Sergei Shatalov

Economic initiative has passed from the center to the republics, some of which have already moved from legislation to implementation of their own republic divestiture policies. In an optimistic scenario, this trend will continue. But even under the most pessimistic scenario, it is unlikely that privatization processes identified in this study will be stopped.
This paper — a product of the Socialist Economies Reform Unit, Country Economics Department — is part of a larger effort in the Bank to study, in a comparative mode, the reform process under way in socialist and formerly socialist countries. Copies are available free from the World Bank, 1818 H Street NW, Washington DC 20433. Please contact CECSE, room N6-037, extension 37188 (28 pages). November 1991.

Shatalov, a senior fellow at the USSR Academy of Sciences, completed this paper before the events of August 1991. But his analysis of recent modes of privatization in the Soviet Union is still important for understanding the evolving situation.

The "present" All-Union regime, Shatalov explains, was the first regime to implement wide-scale privatization. The process may take different courses, being initiated from "above" (for example, by ministries) and from "below," by enterprises. Recent measures of the All-Union authorities, he contends, had the effect of restricting any real role in privatization to the social and economic elite because, in early 1991, monetary and price reform wiped out a significant part of household savings.

Leading international corporations are still interested in getting a stake in such top Soviet performers as KAMAZ; in those few cases it will be possible to negotiate terms more advantageous than those dictated by the dwindling value of the ruble. The All-Union government has been anxious to prevent "wild" foreign participation at any cost. That cost may prove excessive, however, as confidence in the ruble and in the Soviet economy weakens.

In the meantime, the economic initiative has passed from the center to the republics. Some republics have already moved from legislation to implementation of their own divestiture policies. This trend appears likely to continue. But one cannot exclude other scenarios, for example, a collapse that provides an opportunity for some political force to try to reverse course and restore authoritarian rule under the slogan of "law and order." Even in such a case, however, it is unlikely that the processes of privatization identified in the study will be stopped.
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Sergei Shatalov  
Senior Fellow  
USSR Academy of Sciences
PRIVATIZATION IN THE SOVIET UNION:  
THE BEGINNINGS OF A TRANSITION

Sergei Shatalov

Massive divestiture of state-owned enterprises is widely seen in the Soviet Union as the centerpiece of economic restructuring. Many influential politicians and economists regard quick privatization as the single most important condition for the success of reform. Yet the road to privatization is difficult, and the size of the task is unprecedented. The Soviet Union is gearing up for major privatization later than other Eastern European nations. Similarities are already emerging: distortions of "spontaneous" privatization, concerns about social equality, difficulties in valuation of enterprises, legal hurdles, and the like. The time is appropriate to study the process that will largely shape the country's economy.

OVERVIEW

No other Eastern European country has as centralized an ownership structure as the USSR. According to an early 1991 estimate, 92 percent of all productive capacity is in the hands of the state—7,000 industrial enterprises and more than 800,000 entities in trade and services. The nation's total capital assets are estimated at 3 trillion rubles, of which 2 trillion rubles are in the productive sectors. Of these productive assets, 45 percent are in industry, another 20 percent in agriculture, 18 percent in transport, and 5 percent in construction.

When one considers the amount of investible savings, privatization of assets priced even at depreciated book value looks largely out of reach. Potential total investor demand is estimated at 150 billion rubles. With 2 trillion rubles in productive assets, divestiture may take decades. Recent moves by the central government, wiping out a significant part of household savings, have strengthened this possibility.

Goals

First and foremost, privatization is viewed as an instrument to improve economic performance. New private owners will strive to cut costs, increase profits, and target their production strategies on consumer needs. The quality and choice of goods will be upgraded. The state will gain both from

1. This paper was completed prior to the events of August 1991. Some of the areas discussed in the paper, notably in the area of legislation, are therefore rapidly being outdated. However, analyses of recent modes of privatization in the Soviet Union are still considered to be important in increasing understanding of the evolving situation.

2. The author wishes to acknowledge CECSE (World Bank) support for this study. The author had benefitted from the incisive discussion during special seminar at the World Bank in April 1991 where this paper was first presented and from Alan Gelb's helpful comments on the earlier drafts. The completion of the study was assisted by a grant from the University of Iowa, where the author was a Visiting Scholar in Spring 1991.

3. Depreciation is estimated at 45 percent in industry and 33 percent in the economy as a whole.

4. Here only key "consensus points" are outlined. Perceptions of different political groups vary greatly, up to the mutually exclusive. For analysis see the section on political context.
part of its gains can be used for monetary stabilization. Enterprises, unable to rely further on subsidies, will face mounting competition and will have to improve performance.

This picture is, of course, idealistic. Not all these goals will be achieved quickly—and they may contradict each other. Overall macroeconomic improvement will be attained only in the long term and is dependent on other aspects of policy. In the deteriorating macroeconomic environment even efficient enterprises may fail. Political tensions may prevent the state from using its sale proceeds to cut its deficit. The extreme monopolization in the country means that competition and improvement in the quality of goods and services will be slow to materialize.

Scenarios

Hardly a year has passed since public debate dropped the term "destatization," which fit the socialistic instincts of some key political figures, and began to use the notion of "privatization." Definitions vary but are gradually becoming clearer. Judging from recent discussions, privatization is often perceived as a very broad process that should lead from tightly centralized structures of ownership and economic decisionmaking to more diversified and decentralized ones. Gennadiy Melikvan indicated that the package of All-Union laws, passed in June 1991, embraces three consecutive processes: elimination of direct administrative control over enterprises; transformation of state-owned enterprises into entities based on other forms of asset ownership; and passing of ownership rights to private individuals, collectives, and nonofficial legal entities. Only the two last processes represent privatization proper.

Even before the adoption of relevant legislation by the All-Union and republican parliaments, "spontaneous" privatization became widespread—that is, privatization not conducted in accordance with any general policy. Authors sympathetic to the process usually call it privatization and use no adjectives. Some critics prefer to use the term "ministerial" privatization. This term seems too narrow and overstates the influence of sectoral ministries.

The transformation really includes scenarios that differ in their driving forces. Some are directed "from above" by ministries ("ministerial" privatization) and/or central government agencies ("showcase" privatization). Others are implemented "from below" by the enterprises themselves. (Only this form can be really characterized as "spontaneous.") Distinction must also be made between big enterprises, which usually reorganize as open joint-stock companies, and smaller ones, which undertake buyouts to become collectively owned entities. Moreover, to denote a special mode of privatization in trade, services, and small industry, there is the term "small-scale privatization."

Basic Available Options—Their Advantages and Drawbacks

In any scenario, regardless of its driving force, three basic options exist. Their relative advantages and drawbacks cause much public debate, summarized in the next section. Here we attempt to assess options in the context of the current inflation-ridden situation.

The first one is the *transfer of ownership into the hands of employees*. This can be achieved either by selling the state property (with discount or not) or, less likely, by giving it away. This model has similarities to employee stock ownership plans (ESOPs) in the West. In the standard ESOP-type arrangement, bank credit is used by employees to finance a buyout of the enterprise. Workers receive participation shares, usually proportional to their length of employment.

In this option, privatization can be achieved quickly, especially when property is sold at a discount. Ownership by those employed in the enterprise creates strong motivation for improvements. Buyouts promise some budgetary gains and may help limit inflation. However, such operations are socially unequal. The capital/workforce ratio in Soviet industry varies from 200 rubles to half a million rubles per employee. Many social groups will be bypassed—retired persons, children, students, those employed in entities of strategic importance (thus not slated for privatization), most workers in social services, and so on. The potential of such buyouts to improve efficiency and contract discipline is doubtful. The probability is high that workers will put job security first, thus compromising further restructuring and modernization. And normally, workers get significant wage increases, which fuels inflation.

Across-the-board division of state property (*the voucher scheme*) is a second option. Free distribution of shares in divested companies can be politically appealing—but only before technical issues are reviewed. Several alternatives are suggested (equal allotments, in proportion to career duration or qualification, average household income). Of all options, this one involves the strongest possibility of spurring inflation. It will not contribute to easing the budget deficit problem. And a more elaborate voucher scheme brings few additional advantages.

Judged by the yardstick of increased efficiency, this model applied on a wide scale is undesirable. Widely dispersed ownership creates few incentives to better performance. A host of small shareowners know nothing about business strategy and cannot influence enterprise decisions. Vouchers provide no guarantees against the purchase of controlling interest in attractive privatized companies by the wealthy few using "smokescreen figures." Most small shareholders will quickly sell their stock to supplement dwindling real incomes. The procedure will not ease social tensions and may create extensive opportunities for corrupt officials to exploit.

The third option—*selling productive assets at the market price*—is especially attractive from the official point of view. It will strengthen the budget and provide opportunities to sterilize excess liquidity, if the central government demonstrates restraint. It could strengthen the ruble. The option of selling shares has support among managers of enterprises that have implemented buyouts. Only the sale of shares—not their distribution—creates strong stimuli to overcome indifference and low-quality work.

The sale of state property in auctions is a logical option for small-scale privatization of trade and services. This promises almost immediate improvements on the consumer market. Judging from the country's first trial auctions, the budgetary gain can be substantial, even if beneficial primarily to local authorities. Privatization provides hope for limiting or ending the corruptive atmosphere of centralized distribution.

The drawbacks to selling assets are several. This option works slowly for major industry, thus efficiency gains will come only in the medium term. Social equality is compromised, especially since much of public saving has been wiped out in 1991 by price reform and subsequent rapid inflation.
There also is strong concern that laundered "black economy" money is being used to purchase productive assets.

In reality, a combination of all three options is being implemented in current privatization and is incorporated in the latest legislation. The third option is clearly favored in the All-Union package of laws. In contrast, the voucher scheme figures prominently in the republican legislation. In both sets of legislation, workers' collectives have substantial privileges (the right to apply first, discounts and soft loans for the purchase of shares). Local authorities are given significant powers to conduct small-scale privatization and in certain cases even to influence the restructuring of large industry.

**Major Impediments**

Different forms of privatization encounter varied obstacles, of which four stand out:

- Lack of investible savings in the country and reservations on the part of foreign investors, which grow as political tensions mount.

- Undeveloped valuation procedures, nascent wholesale capital markets and stock exchanges, lack of mechanism to accommodate all parties concerned.

- Negative public attitudes—toward the market and hired labor in general and toward certain groups that might benefit from privatization in particular. Concern that privatization may perpetuate the corruption of public servants is already a major problem.

- The opposition of intermediate layers of government bureaucracy (ministries, state industrial associations, and other bodies that exert direct control over productive entities).

Bureaucratic opposition seems to be the most important; more than 60 percent of enterprises that attempted or completed different "divorce procedures" with their ministries and were surveyed in March 1991 indicated such problems. Lack of own funds and the high price of borrowed funds is also very damaging to privatization moves. (Some "cheaper" intermediate solutions are described in the section on "spontaneous" privatization.) Public rejection of "capitalistic vehicles," however, seems to be a myth perpetuated by the traditional political forces for their own advantage. A survey conducted in February 1991 by the All-Union Center for Public Opinion Surveys of the USSR Academy of Sciences has shown that the majority of those polled had nothing against working for a private employer.

6. Based on the information available on August 1, 1991, the following republics have already passed legislation based on the voucher scheme: Russia, Kazakhstan, Lithuania, Moldavia and Latvia. Ukraine may join them in September.

POLITICAL CONTEXT AND PUBLIC DEBATE

All significant political groups agree that the old, overcentralized economic structure is not viable. Even hardline Communist forces admit that enterprises must have greater autonomy and that "total statization of all spheres of life, including economy" was ruinous. Consensus, however, ends here.

The reformist wing of the CPSU has moved step by step toward the notion of privatization. Its euphemism—"destatization"—was first used in documents of the October 1990 Plenum of the Central Committee. The term privatization proper was first mentioned in the so-called Presidential reform program of October 1990, apparently incorporated from the "500-days" plan. In the Presidential Decrees drafted in March 1991, privatization "without adjectives" was used for the first time. In June 1991 the Permanent Commission of the CPSU Central Committee on Economic and Social problems had developed recommendations on destatization policy that largely continue this reformist trend.\(^9\)

The Communist conservative wing was slow to formulate its own vision of privatization. It clearly rejects denationalization, labeling it a betrayal of the socialist ideal. As one spokesman has said: "Privatization, both as a notion and as a policy, should be eradicated both from the documents and the strategy of the Communist Party and the State. Only partial privatization can be accepted, and only as a tactical slogan, for the sake of economic renewal".\(^10\) The then Russian Communist Party (RCP) leader, Ivan Polozkov, stated "We may not permit the transfer of enterprises into private ownership... under a privatization slogan."\(^11\)

The same position is echoed by some less influential conservative political forces, among them the United Workers' Front (UWF) and the official trade unions. The latter are currently formulating their own program of "shielding the toilers from unbridled capitalism." The vocal if politically insignificant UWF calls for creation of "committees for defense against privatization" in all enterprises.\(^12\)

Total rejection of privatization being impossible, conservative forces have identified workers' collective ownership as the least evil. They play an elaborate game of words, proclaiming that only this form of property offers a socialist course. They view the priority of socialized property (proclaimed in the 1977 USSR Constitution) as essential. The USSR Law on Property, adopted in 1990, and consecutive constitutional amendments that have accepted the priority of individual property over socialized property are condemned as deviations from socialist principles.

\(^8\) Ekonomika i Zhizn', No. 10, 1991, p. 11.


\(^10\) Professor V. Cherkovets, Moscow State University, in Ekonomika i Zhizn', No. 10, 1991, p. 11.


\(^12\) Delovoi mir, No. 8, 1991, p. 1.
Privatization in the Soviet Union

It is difficult to assess the relative influence of the two contesting wings in the Communist Party. The hard-line wing and its allies are increasingly vocal but still unwilling to challenge traditional party discipline and break with the top leadership; more probably, they will continue to maneuver to try to gain leverage. These conservatives have failed to block radical, market-oriented legislation in the Russian Parliament. The new USSR Cabinet headed by Prime Minister Valentin Pavlov and strongly backed by the President seems ready to shift from the "benevolent negligence" of former Prime Minister Nikolai Ryzhkov to a stance of actively fostering private enterprise. In doing this, the Cabinet will probably continue to employ a subtle, "soft" vocabulary about economic change, to pacify the hard-liners.

The most influential non-Communist force in the Russian Republic, the Democratic Russia movement, displays a wide spectrum of opinions, with some groups favoring worker buyouts, some the voucher scheme, and some a full reversal to private property. With the support of the reformist CPSU wing, it had enough influence in Parliament to push the program through. The implementation of this program will bring the real test, but Democratic Russia seems to be romanticizing privatization. While it is correct to view privatization as the centerpiece of all reform, the possibility that it will bring swift improvement in the nation’s economic fortunes is less certain.

Thus, over the past year or so, the political environment has changed significantly—from inattention through heated debate to widespread acceptance of privatization as an important component in economic restructuring. During most of the Ryzhkov period the issue was effectively circumvented. Since public reaction was not clear at the start, the first trial moves had to be carefully phrased. (In the case of the BUTEK experiment, which involved the formation of a consortium of many firms, the move was not called privatization but the creation of a "people's concern." )

Gradually, first steps were taken toward developing key pieces of legislation. During Autumn 1990, the "500-Days" program and the Presidential program both stressed the urgent need to divest state property and the technical difficulties that would be involved. The difference between the two programs was in details: the Presidential program was very short on specifics. As 1990 drew to a close, the composition of the political landscape changed. Some republican authorities moved faster than the All-Union ones to establish legal norms for small-scale privatization and the privatization of land and real estate. This was especially clear in the Russian Republic and the Baltics. The central government readily yielded the initiative.

The center’s reaction was probably an attempt to shift blame for the negative social aspects of massive divestiture onto the new political groups that came to dominate rebellious republic governments. The center’s move was also a reasonable step from the bureaucratic point of view, since privatization procedures are very time-consuming. The same line was obvious in All-Union government attitudes toward local initiatives such as the program of real estate privatization developed by the Moscow and Leningrad City Councils.

Under the Russian Republican economic program of spring 1991, privatization is expected to proceed at full speed. The April 1991 All-Union anticrisis program, largely developed under the direct control of Prime Minister Pavlov, seems keen on rapid privatization, along with creation of a more attractive environment for foreign investors, liberalization of trade, and stabilization of the ruble. There are justifiable doubts, however, about the ability of either level of government to implement its proclaimed goals.
Real debate over privatization developed only in 1990. The public did not become engaged until some key institutions—such as the USSR State Property Fund—were outlined (see the section on institution-building below). Much debate even now appears isolated from economic reality, with experts disregarding real processes of ownership and industrial organization restructuring and speaking in general terms. The broader public is not much interested in "theoretical" issues like gains in efficiency derived from privatization, but it quickly responds to discussion of the "threat groups" that are believed to benefit. Both ends of the political spectrum fan public emotions.

Hard-line conservatives in the Communist apparatus, their press, and the official trade unions are intimidating the public with talk of massive layoffs and other vices of unbridled capitalism. To quote Ivan Polozkov again, "We should not accept unemployment. . . . The party committees should create social security funds and implement social development programs" to provide job security.¹³ The emerging political forces, known under the loose term "democrats," enthusiastically portray their adversaries as "neo-capitalists laundering the party money" and plotting with local organized-crime groups to retain control over the Soviet economy.

Both of these contending perspectives reflect some reality. The capitalization of large sections of the traditional political and economic elite is obvious and closely resembles the course observed in China in earlier years (see the section below on indigenous capitalist class). During the cooperative boom (1987-88), many cooperatives were created by managers of big industrial enterprises to conceal profits through inventive transfer pricing. Not even a special government regulation adopted in December 1990 restrained this process. As to changes about economic manipulation by "black economy" dealers, mafiosi, and racketeers, here too there is truth. The authorities have been unable to cope with mounting crime; there are widespread charges of corruption and links between the elites and criminal elements. Recent presidential decrees try to address these issues. But with investible money in the hands of criminal elements, such decrees may only hamper what is clearly an important source of financing for privatization.

The specter of foreign investors "buying up Russia" is a popular propaganda theme among Communist hard-liners and among the weak but vocal Russian nationalists. Negative attitudes toward foreigners do exist among the public. However, the situation varies from region to region; those most in contact with foreign investors display more receptiveness toward them. In Leningrad's suburb Vyborg and in the Far Eastern city of Nakhodka, free enterprise zones are ready to be launched with broad public support. By contrast, the citizens of Novgorod, the historical center of the Russian heartland, have tried to block a similar project on grounds that it would open the area to the "corrupting influence of foreigners." This theme will be used further in political battles and will lead to sharp differences in the privatization speeds of various regions.

Employee buyouts have received less attention in debate than they deserve. In several cases, the general public has expressed resentment about such buyouts, presuming that they give the employees of privatized enterprises unfair preference. Sharp criticisms were also reported when the huge KAMAZ truck factory was restructured as a joint-stock company. For the time being, negative public attitudes have limited influence on the decisionmakers, but as privatization gains speed and causes massive layoffs, this may change.

Workers' attitudes toward buyouts from within have evolved over time. At first, the safety of state-controlled enterprises looked not so bad compared with the risks of independent business. The reaction of many workers toward collective ownership was lukewarm, especially if shares were to be purchased, and not gotten for free. With the decline of living standards and the accumulation of positive experience in early buyouts, however, more employees now focus their hopes on private enterprise.

To judge from events elsewhere in Eastern Europe, some political groups in the USSR may be willing to provoke a strongly negative political reaction to privatization. This could conceivably derail the reform.

**COMMERCIALIZATION OF THE STATE SECTOR**

Under the 1987-89 policy of decentralization, the central authorities granted enterprises varying degrees of autonomy. This proved to be an important preparatory stage for privatization proper; without such preparation obstacles would likely be much bigger. But decentralization hardly was viewed in this way when it was launched; a traditional "socialist campaign" mentality prevailed. Forms of partial independence in decisionmaking failed to improve performance and added to the frustration of enterprise managers, however. Thus there was a buildup of commitment to more radical moves.

Decentralization will continue in the future. Even with massive privatization, the state will retain control over 20-30 percent of all productive assets. These will include entities of All-Union relevance — harbors, transrepublican highways, major power generation facilities, significant parts of the armaments industry, and key establishments in the nonproductive sectors such as hospitals, universities, and the like.

These state controlled enterprises will clearly fall into two groups. The first will be entities providing social services, utilities, and infrastructure. In their cases, decentralization will proceed. The second group will be huge industrial concerns whose restructuring may take years or even decades to prepare; to enable their efficient operation in the market environment, these concerns will be "commercialized"—reformed toward the procedures and structure or a commercial entity.

Republican authorities, including those with strong market leanings, have few differences with the All-Union government over the issue of retaining some state control. In December 1990 the Estonian government identified 11 big industrial entities that it plans to retain under direct control; some, such as the Estonian section of the Baltic railway network, have already been transferred to republican jurisdiction by All-Union authorities. In Armenia, 16 huge enterprises, all of them monopolists in the republican market, will remain under the state.14

For enterprises in which the state does not retain control, commercialization will be the first step to the market environment. This preparatory stage may include a number of needed improvements. Financial soundness of the enterprise will be assessed and accounting radically upgraded. Proper

accounting procedures are rare even among the biggest enterprises. This makes it impossible to carry out an independent and objective analysis of a given company's credit standing. Company profitability and competitiveness cannot be deduced from available figures; potentially this can cause a wave of financial crimes and bankruptcies.

Speedy conversion to Western balance sheet and valuation procedures is imperative so that companies can assess their own cost and revenue positions. This will also give commercial banks a reliable foundation for independent loan decisions. In addition, supply and marketing will have to be reorganized. In the supply system, direct contracts should replace the collapsing system of state orders. Enterprise management should be retrained to operate in a competitive environment.

PRIVATIZATION IN THE ABSENCE OF OVERALL STRATEGY — "SPONTANEOUS" PRIVATIZATION

In mid-1990, cases of privatization began to multiply in the USSR. The preceding four years had offered enterprises an opportunity to influence their own production targets, wage levels, and other elements of business strategy. Yet the controlling ministries retained the right of direct administrative control; indeed, administrative reform in 1989-90 even strengthened their hold. The drop in the number of All-Union ministries led to a concentration of decisionmaking authority and weakened the leverage of even large enterprises in the administrative machine. Frustration over hesitant decentralization and perceptions of existing business opportunities pushed enterprises toward cutting the strings of administrative control. And the ministerial bureaucracy, aware of this and unwilling to yield, itself began to "mimic" privatization.

"Spontaneous" privatization—that taking place in the absence of an overall strategy—is now occurring all over the country, including in regions where old political and economic structures are still in control (Siberia, the Central Asian republics). The sectoral composition of privatized entities is also disparate, with large industry clearly leading the way. All the forms of this privatization have certain similarities as to enterprises affected. They are mostly big (employees number more than 1,000) and profitable. Some two-thirds of all cases surveyed by the author involve enterprises with five years of stable profits. A record of profit is definite in "showcase" and "ministerial" privatization. Often an enterprise is first leased out for a period, during which lessees may accumulate funds for a buyout. Privatization can sometimes take place even in weaker and smaller enterprises, since their controlling ministries may have little interest in retaining them.

It is difficult to estimate the extent of all this "spontaneous" privatization. Dozens of cases are reported each month. Most probably these are just a fraction of the total, since the media has lost its initial interest. No central government body has yet begun to compile systematic data on the process.

Privatization from Above

"Showcase" and "ministerial" privatization are the methods of privatization from above. They are similar in mode of ownership transformation. Normally, an enterprise is restructured as a joint-stock company and the ministry retains the controlling share in its stock. Legally, both types of

15. In the KAMAZ truck factory, such difficulties have substantially slowed down its shares subscription by foreign investors.
privatization from above are made possible by the USSR Law on Private Enterprise, which introduced the notion of enterprise owner and formulated important legal guarantees of the latter's rights. The ministries, renaming themselves consortiums or concerns, de facto claim full ownership rights on the enterprises they control.

"Showcase" privatization. The KAMAZ truck factory was the first and the most widely publicized case of showcase privatization.\(^\text{16}\) The plant employs about 140,000 people, and the book value of its assets is estimated at 4.5 billion rubles. Physical amortization is high, probably 40 percent, but this was not taken into account in its valuation. Its capital is split into shares of 100-ruble denomination with 25 percent of them offered to employees. The Ministry of Automotive Industry retains 26 percent of authorized capital. The rest is to be sold to the public and foreign investors.

"Ministerial" privatization. A typical example of ministerial privatization is the Agrokhim concern, recently formed on the basis of one of the elements in the huge and inefficient Agroprom, the State Committee for Agriculture. Prior to the creation of Agroprom, several dozen enterprises producing fertilizers and pesticides were under the control of the USSR Ministry for Fertilizer Industry (MFI). During the brief experiment with Agroprom as a superstructure, MFI remained as one of its subunits, still administering its enterprises. In 1990, it became clear that the top political leaders intended to dissolve Agroprom, and the ex-ministerial apparatus quickly "innovated." It adopted the only available survival strategy—"mimicked" privatization—and formed Agrokhim. The concern's central directorate has the same ministerial staff and exerts the same degree of control over enterprises as previously.

Privatization from Below

Buyouts. As an option, employee buyouts clearly conflict with "ministerial" privatization. In January 1991 a Coordination Committee of Collectively Owned Enterprises was formed by a group of such entities to spread the experience and teach the tactics of "negotiating out" of ministerial control.

In most cases of buyouts, management is a driving force; employees are attracted by promises of guaranteed jobs and pay rises. The enterprise is transformed into a closed joint-stock company with participation shares distributed among employees according to the duration of their career -- and with management holding the controlling stake.

More than 200 buyout cases are known. Almost all the entities are in industry and construction and are small or medium-sized. An example is the Moscow Ventilator Plant, which studied the ESOP model and applied it in September 1990. The plant's combined assets were valued at 6.5 million rubles; 32,500 participation shares of nominal value of 200 rubles each were issued and sold to employees, who had to put in only a 25 percent cash downpayment. The plant had enough of its own funds to extend no-interest loans to employees to finance the rest. This debt will be redeemed from future profits. Some 300 of 500 employees chose to become shareowners, paying 3,000 rubles per person out of their own pockets.

16. KAMAZ was first called an example-setting precedent in July 1990, a month after the new law on joint-stock companies. *Financial Times*, July 30, p. 17.
The collective as an ownership form is unlikely to dominate the economy. The management of most of the 23 enterprises surveyed by the author expressed interest in opening subscription to their capital to the wider public when that becomes technically feasible. The stock market is still embryonic, however, and specialized institutions like investment funds are almost nonexistent. Some enterprises may try to sell shares directly to the public.

It is interesting to note that job security considerations are not always paramount for employees. In privatization, enterprise middle-level administration can be sacrificed (cuts on the order of two-thirds are often reported), and workers welcome the process. There are even possibilities for shedding some on-floor jobs.

Newly independent entities seem to fare better than expected on the score of efficiency and inputs utilization. A recent survey of 30 buyouts showed that immediately after the buyout, production shot up by 15 to 30 percent without retooling—simply through a strengthening of discipline and more efficient use of resources. Salary increased on the average by 160 percent during the first six months after the buyout.

Some enterprises consider it too burdensome to buy out all fixed assets (even at depreciated book value) in a short period. For their part, controlling ministries are unwilling simply to transfer ownership to collectives for free. A compromise path has been advocated by V. Tarasov, head of the private consulting firm "ORGANIZER" (Tallinn). His model envisages a stage-by-stage operation, with only supplies and materials bought in the first year, and fixed assets remaining state property. The loan needed in such a case is thus smaller and its repayment more manageable.

The central authorities welcome most buyouts. Taking note of American practice, both the All-Union and republican sets of legislation envisage tax breaks and interest rate subsidization as well as other forms of support. There are already sample cases. The enterprises of the BUTEK consortium, begun on the initiative of the All-Union government as the "model" for privatizing industries, pay taxes of half or less of the industry average. KAMAZ obtained a special tax rate of 36 percent before the tax reform of November 1990; most enterprises in its range had to remit more than 80 percent of their profits in the centralized ministerial fund.

Ministries often use their ability to distribute inputs to slow buyouts, although cases of cancellation of such initiatives are very few. Some ministries appear less obstinate than others. Flexible attitudes are reportedly dominant in the USSR Ministries for Shipbuilding, Civil Aviation, and Fishing. Some ministries, more powerful and confident in their influence, are inclined to shape privatization to their own advantage: these include the Ministries of Electrical Engineering Equipment, Machine Building and Heavy Industry.

17. Twenty-three industrial entities; Russian Republic; survey conducted in January-March 1991 with the help of private business school SAULEST.


19. Ekonomika i Zhizn', No. 3, p. 6, No. 9, p. 5.
The Future of Larger Entities

As experience with bigger joint-stock companies accumulates and specialized institutions emerge to advise enterprises on restructuring, the attractiveness of buyouts fades. For larger enterprises the solution lies either in direct transformation into a joint-stock company or in the joining of industrial association.

An interesting case is the privatization of the VAZ car factory, with the employment of over 100,000. It is unclear what mode of privatization will prevail. All interested sides—the Ministry for Automotive Industry, employees, management, and the USSR government—look at it as an important precedent.

In February 1991 a special conference of management and employees approved the decision to transform VAZ into an open joint-stock company, very much like KAMAZ. Employees demanded the controlling stake for themselves; this demand was branded "egoistic," and a more guarded decision was taken. Regular shares will be distributed among all employees for free, and each year on the VAZ payroll will give an employee the right to get one 200-ruble share. As a result, the employees' combined share in total capital stock (book value, 11 billion rubles) will be less than 10 percent. The restructuring envisages share subscriptions among the general public and foreign partners, who might get up to 49 percent of the capital stock. The position of the controlling ministry is unclear, however. The VAZ initiative may degenerate into just another case of "ministerial" privatization.

The overcentralization of the Soviet industrial structure opens opportunities for the biggest enterprises to tear away from ministerial control. For them, the legal aspects of ownership can best be solved by appealing to the upper echelon of economic power—by securing the support of a key figure in the top leadership. Both the BUTEK and KAMAZ schemes were developed in 1989-90 at the direct request of the then Prime Minister Ryzhkov.

Because of the difficulty of gaining a "divorce" from a ministry, some big enterprises create industrial associations as a first step toward their privatization. Such structures should not be confused with those of the same name that existed within the old bureaucratic system to simplify centralized control. The new, independent associations unite big enterprises previously controlled by one ministry and with a similar production mix. Some call themselves concerns. Examples of such structures are Technokhim (fertilizers and plastics) and Energomash (power generation equipment).

Industrial associations can have enough leverage and funds of their own to dictate the terms of "delinking" from a ministry. Their policies are similar to the BUTEK consortium, which, being an institution directly sponsored by the All-Union government, was able to request valuation of assets at the depreciated book value. Big industrial associations are able to minimize buyout sums and to finance buyouts easier through their own funds and cheap credit from the state-run banks. On several occasions, associations have exerted leverage at a high level of central government, circumventing "their" ministry altogether.

Perceptions of Privatization

Perceptions of "spontaneous" privatization vary greatly. Reformist experts as well as the liberal press demonstrate skepticism both toward buyouts (alleging an uneven record in improving efficiency)
and toward "ministerial" privatization. "Showcase" privatization, especially the creation of BUTEK, was initially hailed as the herald of transition but came to be questioned as yet another attempt to maintain elite control.

The general public has reacted negatively to certain widely publicized privatization cases, and local authorities have quickly exploited these sentiments. An example was provided by KAMAZ, a firm so large that it literally created the city of Naberezhnye Chelny. Even many local citizens not directly employed by KAMAZ depend on it one way or another for their work. The denial of KAMAZ shareownership to workers not directly employed by the factory yet serving its varied needs was thus perceived as grossly unjust.

Public criticism has had an impact on the development of official privatization programs at all levels. Thus, both the 500-days program and the Spring 1991 Russian Republican program coincide in their guarded attitudes toward buyouts. Employee priority in deciding the course of ownership transformation is required to be limited—in time and by type of shares. In part, this stems from fears that employees will get an amount of privileged shares for free or at a discount. Such fears have grown in view of several scandals involving managers who used a "people's ownership" slogan to grab enterprise control for themselves.

Assessing Prevailing Privatization

It is difficult to assess the effectiveness of "spontaneous" privatization in general and of its different forms in particular. The country's critical economic condition prevents evaluation of real efficiency gains. Managers of large enterprises normally claim that independence has boosted profits and enabled long-delayed retooling. It remains to be seen whether higher profits are not purely inflationary in nature.

One must realistically judge the alternatives, however. In the present political turmoil, there is little chance that a clear, concise, and nationwide privatization program can be developed, much less implemented. There is therefore some ground to believe that even cases of "mimicked" or "ministerial" privatization may not be a complete waste. From the political perspective, even "ministerial" privatization creates significant guarantees against rolling back to a command economy. The emerging class of quasi-capitalists has real interest in keeping control and increasing it. For the first time in their lives, ministerial-bureaucrats turned managers are drawn into a real competitive world. Competition may be weak at the start, but it will intensify with the right incentives from the state. Even now, motivation to work better is stronger under privatization than in the state sector.

The example of truly independent concerns is already present, to study and adapt. The tactic of playing the All-Union and republican governments and sectoral ministries against each other may work for many still-dependent enterprises; thus, direct administrative control can be overcome. One unknown is whether the majority of enterprises will dare to risk losing their ministerial safety net by venturing out on their own. In recent months many enterprises have indeed been ready to do just that.
REGULATIVE AND LEGAL FRAMEWORK

Delineation of Authority

Blurred ownership constitutes the most complicated legal hurdle in the Soviet economy. The problem is inherited from the centrally planned system, where all productive and most other capital assets were the "property of the state." Everybody's property is, of course, nobody's property.

In practice, there have been several levels of state ownership, closely reflecting the pyramid of executive power. The ultimate authority long rested with the top layer, yet the lower layers were not completely devoid of authority. The Moscow region gives a typical picture of ownership structure (percentages are given on the basis of annual turnover and include industry, agriculture, trade and services, transport, and construction). About 70 percent of all productive capacity (mostly huge enterprises) was under direct central control and managed by All-Union ministries. Another 25 percent was managed by Russian Republic government bodies. The rest was so-called "local" industry, trade, and services—many small entities controlled directly by the city and regional councils.

When the pyramid structure began to change in the past two years, multiple conflicts appeared among individual entities. The most widely publicized and politically charged have been conflicts between All-Union and republican levels of government. But even city districts have tried to assert their control. An extreme case was the attempt by authorities of the district in central Leningrad to claim exclusive rights of ownership on the Nevsky Prospect—the city’s main thoroughfare and commercial area. Conflicts between regional and city councils over pieces of previously jointly controlled property have been common.20

Institution Building

The work of two different sets of institutions is important for the success of privatization. The activities of the official ones, created by the authorities of different levels, are analyzed in this section. The other, no less important group include market institutions—investment companies, mutual funds and the like. Privatization strategies elaborated by diverse political forces differ in the comparative role of these two. Divestiture policy of the central authorities relies heavily on the creation of additional layers of government bureaucracy; private-sector schemes pay more attention to the independent institutions. Ideally, the two sets of institutions should complement each other—with central agencies overseeing the process and ensuring an environment conducive to privatization, and private and mixed institutions doing the groundwork.

Three blocks of legislation provide cornerstones for the process of transition to a market economy: laws on entrepreneurship, antimonopoly laws, and privatization laws proper. The reform effort was officially launched with the creation of the USSR State Property Fund (SPF) on August 9, 1990. In June 1991 the basic principles of the privatization program were laid out in the All-Union law on privatization. Most important of these principles are the freedom of choice and the voluntary character of ownership transformation; equality of all forms of ownership, including private; and the open and competitive character of transformation. Employees of an enterprise are given priority in

share subscription, though the amount of priority is constrained by the competitive nature of the process. The possibility of foreign ownership is accepted; it is unclear whether full legal equality will be granted to foreign investors.

The USSR State Property Fund and the Antimonopoly Committee will be authorized to develop technical regulations. A financial mechanism, including the state-controlled lending scheme for privatizing entities, will be developed jointly by the SPF and the USSR Gosbank.

The delineation of SPF and AMC mandates became clear in February-March 1991. The SPF is empowered by the Supreme Soviet to exert ultimate property rights on all enterprises of All-Union importance. The SPF has no direct role in the management of enterprises; its task is to develop and implement nationwide privatization in cooperation with counterpart institutions in the republics. To prevent "mimicked" privatization, the SPF can overrule decisions of the ministries and other lower-level authorities in restructuring ownership rights. The SPF will develop expertise and valuation procedures and issue recommendations on the preferred course of privatization (distribution, lease, or sale of assets). For enterprises of strategic relevance not liable for privatization, the SPF will remain the ultimate owner and prepare their commercialization.

Chairmen of both the SPF and AMC are appointed by the Supreme Soviet. In most republics similar committees for the management of state property and antimonopoly committees were created in late 1990 and early 1991.

At present, differences exist between All-Union and republican legislation, which may perpetuate a "war of laws." These differences reflect the rapid polarization of the political scene. Let us take a closer look to the difference between the Russian Republican and All-Union laws and first list ideological factors.

- Prior to adoption of the Law on Private Enterprise in April 1991, USSR laws evaded the notion of private property, continuing the tradition of the 1977 Constitution (which referred to individual rather than private property). Russian Republican legislation uses the term private property and, no less important, permits private ownership of land.

- All-Union Laws therefore still assume the priority of socialized forms of property ownership, including collective property. In the Russian laws collective property is treated as part of private property and all forms of property ownership are proclaimed equal.

- The substance of privatization, as treated by the Russian Republican legislation, is real transition to the economic model based on private enterprise and the negation of "socialist choice."

The Russian Republican laws seem to be more comprehensive than the All-Union ones, which still try to reconcile two incompatible ideologies. In implementation procedures, differences between All-Union and Russian concepts are no less important:

- Russian Republican laws aim at forcing the process and at embracing as wide an array of entities as possible, including large industry. All-Union laws envisage a slow process of "graduation."
- In agriculture, the Russian Republican laws envisage rapid privatization of big state-owned farms (sovkhoz).

- The Russian laws also provide republican bodies with a much wider array of instruments to speed up privatization.

The All-Union laws reflect stronger positions of hard-line political forces in the All-Union Supreme Soviet than in the Russian parliament. Yet our tentative judgment is that the All-Union laws, although more guarded in styling, will have largely the same consequences as the Republican ones. Indeed, since April 1991 one can see convergence in the two sets of legislation, with the All-Union laws dropping some of the above-mentioned characteristics and moving closer to the model of private ownership and entrepreneurship.

The most contentious issue which has to be addressed in privatization laws is the delineation of ownership rights. Most republics, including Russia, claim that these rights belong to them and that the "delegation" of ownership from the republic to the All-Union bodies is derivative. Events may take various courses, and examples of both confrontation and compromise exist.

In stimulating the restructuring of big industry, republican demonopolization committees will enter into open conflict with sectoral ministries. These ministries have significant leverage in the All-Union government, which rarely takes the side of enterprises openly. Current All-Union government policy can best be described as "benevolent negligence," with most enterprises escaping ministerial control being able to ignore the directives of yesterday's masters. The strengthening of the State Property Fund mandate seems also to favor enterprises against ministries.

Making Models or Making Tissue?

All parties agree that it will take years and perhaps decades to restructure big industry. In the near future the All-Union SPF and its republican counterparts set a more modest aim of training professionals who then will be able to advise enterprises on specific aspects of privatization (financing, industrial organization, auditing, accounting). Two visions of the process exist. Traditional thinking in the central government bureaucracy is to choose one enterprise and make it a "model" so that all others will follow. This is the "socialist emulation" mentality, developed over decades and now deemed appropriate for the transition period. Needless to say, the best performing enterprises would be chosen as models—and their experience would not be generalizable.

A markedly different approach appears in the work of liberal economists such as the 500-days plan and the Russian Republican plan of April 1991. A similar position is taken by the Soviet private sector. Their goal is to create a "market tissue" of specialized entities that will be able to provide financing and consulting services, making privatization self-sustaining. This progression appears to be taking place already, with more and more specialized private agencies created.

Small-Scale Privatization

One of the points of the points of convergence between the All-Union government vision and the liberal vision is the central role of local authorities in small-scale privatization. Hundreds of thousands of tiny entities in trade, services, urban and communal services, food processing, construction, and the like will be auctioned soon. Rapid inclusion of these enterprises in the
emerging market system should create a cushion for the inevitable job losses in big industry and also produce visible improvements in the consumer market, thus lessening political tensions. Apart from these benefits, central authorities expect little gain from small-scale privatization. The largest share of returns from auctions will go to municipal and regional budgets. With proper legislation in place, the job can be done independently by special committees on privatization and demonopolization directed by the city and regional councils. Several dozen such committees are already active.

Republican committees for property management endorse only auction rules. In February 1991 recommendations on privatization for local authorities were adopted by the USSR Council of Ministers. This document is remarkably flexible, stating only broad principles of competitiveness, openness, and equality of all bidders, and otherwise giving city and regional councils powers to tailor their own policies. Thus, in June 1991 the Moscow Council conducted its first auction, selling ten little stores. The Leningrad Council has held several highly successful auctions too, selling more than 100 stores to private owners.

Both Republican and local authorities have much independence in styling their "own" regulative environment for joint-stock companies and small businesses. In 1990 and early 1991 the right to issue licenses for such entities was transferred step by step to the lower levels of government. A small business started by an individual is registered by the district council (the lowest level of authority). Companies with limited liability as well as joint-stock companies with capital under 50,000 rubles are registered by the city and regional councils. Both the latter and the republican governments can alter the tax regime and other aspects of business environment.

For productive enterprises, being shifted from central to republican jurisdiction often brings few advantages. Republican authorities can become allies in the enterprise drive to escape ministerial control—but contrarily, they can try to exert the same direct control with the same stifling consequences. The Russian Republican government seems to have taken the first course with its recent regulations providing incentives, including lowered corporate tax rates and more favorable administrative procedures, for enterprises that quit the All-Union "umbrella" for the republican one. And with amendments to the penal code being within Republican jurisdiction, the Russian Republic has dropped Article 154 (on economic crime) and proclaimed the inviolability of property and ownership rights.

Complexity and Future Needs

The traditional malaises of the Soviet legislation—too generalized laws and weak implementation—have only gotten worse in recent years. Numerous regulations, issued decades ago by central authorities and sectoral ministries, are still in place and contradict new legislation. Certain portions of the penal code, such as those on economic crime, discriminate against entrepreneurship. Key pieces of legislation, like the bankruptcy law, are not ready. The All-Union government is still deterred by the high social costs of bankruptcy proceedings that would thin the ranks of unprofitable enterprises. This is thoroughly understandable, but foot-dragging on reorganization has a negative impact on the economy and helps perpetuate anachronistic features.

Ideally, the legal framework should start with amendments to the constitution or with a new one stipulating equality of all forms of ownership and the inviolability of property rights. (The draft Russian Republican constitution contains exactly this and has caused much fury among hard-liners in the Russian Communist Party.) General guarantees for all investors, including foreign ones, should
be strengthened further. Normative documents should be reviewed to eliminate discordances with newly adopted legislation.

**SOURCES AND MECHANISMS OF FINANCING**

Because of the USSR's continuing political upheaval, massive participation in privatization by foreign investors is unlikely. In examining domestic sources of financing, it is important to distinguish the official and the shadow sectors of the economy. In the official sector, investible resources are scarce. The volume of household savings is too low to finance a massive one-time privatization effort. Regardless of how the value of productive assets is calculated, investible savings are hardly more than one-fifth.

One can only guess the current volume of resources controlled by the "black economy." Some such resources were legalized as early as 1988, through the emerging cooperative sector. Amnesties for "shadow capital" (black market money) is mentioned from time to time in public debates. The position of the All-Union government is typically two-sided. On one side, there are recent decrees on "economic crime;" on the other, certain moves to absorb key segments of the black market into the official economy. In most republics (Russia, the Baltics, Georgia, Armenia), authorities display more readiness to legalize shadow capital. Yet the atmosphere remains tense and most probably most such money will continue to operate underground or flee the country. Capital flight in 1990 is informally estimated by government sources at 3-5 billion rubles; this year it will definitely grow.

*Funds from Within*

The major part of resource flows into restructured entities will thus be provided "from within" the existing system, by funds accumulated by enterprises themselves and, probably in a lesser degree, by the traditional political institutes ("the party money"). Bigger enterprises have the capacity to finance their ownership restructuring. The Soviet monetary system traditionally is characterized by a divorce between two components of the money supply. Cash circulation is regulated more tightly than noncash transactions between various economic entities. In 1987-90 the acceleration of noncash circulation has contributed measurably to inflationary pressures. As these mounted, it has become even more difficult to convert money on current accounts of enterprises into cash. Since 1988 the desire to use enterprise balances was one of the important driving forces in the creation of cooperatives by state-owned enterprises, and the USSR Council of Ministers regulation, passed in December 1990, has had little deterrent effect. The semi-legal exchange rate is 3.5-4 "non-cash rubles" per one real ruble. Most huge enterprises—even if chunks of profits have been appropriated by the central ministries—possess sizable resources in their accounts.

*Loan Sources*

The role of bank lending looms large in the case of smaller enterprises buyouts. A survey of 14 such cases in August-October 199021 shows that on average, two-thirds of transaction volume was financed by borrowing; in only one case was the share of debt under 50 percent. In 1990 the biggest source of lending for buyouts was the Promstroibank (state-controlled Bank for Industrial Construction). In late 1990 major independent commercial banks began to follow. Buyouts of

21. Survey by the author.
enterprises forming the BUTEK were largely financed by its own in-house commercial bank, KREDOBANK.

With the breaking up of specialized state-controlled banks, commercial banks very soon will come to dominate the financing of such buyouts. Commercial credit with maturities over one year is rare and available exclusively to big enterprises. Even these loans are expensive, with interest rates over 20 percent and rising. One cannot estimate the real interest rate in today's rapidly accelerating inflation. Two immediate dangers are obvious. First, in the immediate future buyouts may become largely impossible for scores of smaller, less profitable enterprises unless they join BUTEK-type consortia or succumb to ministerial privatization. Second, and more important, there exists a real possibility that with many restructured enterprises unable to stay afloat in the economic crisis, new commercial banks will be saddled with irrecoverable debts and will themselves go bust.

The major difficulty of mounting a massive banking effort to finance privatization is the legacy of bad loans on the books of bigger state-controlled banks. Mid-1991 estimates made by the Institute for Banking of the USSR Gosbank indicate that the ratio of problem loans to capital for these banks is so overwhelming that their net worth is generally negative. Unless the burden of problem loans is removed, the banks will never be able to let their behavior be guided properly by market principles. The shakiness of their balance sheets means that the capital they put at risk in new transactions is not even their own but has to be charged to government funds.

The legacy of the past must be kept separate from present activities. This is one of the axioms of successful restructuring. There must be a firm division between troubled old loans and new lending. Loans outstanding that are noncollectible from public enterprises should be hived off to a special public fund, and their extent must be made explicit. The government will then have to decide how the burdens of the past are to be shared out. This is a governmental responsibility. It would be an illusion to think that private investors at home or abroad would be willing to take on this debt load.

Apart from the activity of commercial banks, there is a dearth of specialized agencies to promote privatization. Only in February 1991 was the need addressed to create specialized investment funds to enable the launching of joint-stock companies in the market. The first to arrive were consulting agencies, which offer complete services for enterprise restructuring, asset valuation, and buyout or conversion into joint-stock companies. By mid-1991 a dozen such agencies operated in Moscow alone. Almost all of them were started as brokerage houses, dealing for their clients—big industrial enterprises in the numerous recently created exchanges. Offering privatization and restructuring advice was a logical extension of their relations with the clients. A few of the biggest ones, like Brokinvestservice, are getting ready to control the nascent stock exchange. However, none of them can yet offer financing for such operations.


23. The author knows only one case when an agency specialized on privatization consulting was launched in Spring 1991 as a result of successful transformation of GUM department store into a joint-stock trading house.
Some niches are already being filled by foreign institutions. Of all specialized institutions, foreign consulting firms with relevant experience are most urgently needed. In the United States, Ernst & Young and Price Waterhouse are preparing themselves to enter this potentially profitable sector of the Soviet market.

An Interesting Model

In an attempt to overcome this institutional weakness, one of the big commercial banks in the USSR—the MENATEP Financial Group—recently proposed an interesting model of a privatization consortium. It is based upon the creation of a specialized financial institution—a privatization consortium with leading commercial banks and the Russian Republican Ministry of the Economy as founders. To benefit from international experience, the participation of international investors will be sought. The consortium will create a range of specialized investment companies. These subsidiaries will deal directly with privatized companies, buy their stock, and lend for enterprise restructuring and modernization. The investment companies will trade in the privatized enterprise stock on the stock exchange and will search for foreign investors willing to put money into privatized Soviet industry. The Russian Committee for the Management of State Property will accumulate the money paid by new shareowners to investment brokers.

The model opens additional opportunities for commercial banks to engage in the privatization process. Some of them may grasp this opportunity to evolve into specialized investment banks, leaving the sphere of short-term financing. The Russian monetary authorities will be able to control the divestiture process. Valuation in this model is based upon the real market value of the productive assets. The balanced ownership structure of the consortium is an important element to prevent the misallocation of funds and corruption and the excesses of government control over privatization. Monopolization of share ownership in the hands of insiders can be also prevented. However, the model contravenes Russian republican legislation on stock exchanges, which explicitly forbids the banks to operate on stock markets. Chances for the implementation of this plan are unclear.

Another option proposed recently by V. Perlamutrov24 envisages that certain divisions within the USSR State Property Fund would operate semi-independently as investment banks, with resources equal to the combined assets of state enterprises they control. These divisions would issue shares for the amount equal to nominal (depreciated) value. Subscription would then be open for employees and the general public. If the employees chose not to buy these shares, they would pay dividends to the SPF. Shares would be sold at auction, and later through the stock exchange, which would move the price closer to the real market level. The proposal has some similarities with the MENATEP model. It is unclear, though, that the SPF would indeed want to sell shares rather than keep them.

VALUATION OF STATE PROPERTY

Two widely discussed alternatives for valuing state property are (1) valuation on the basis of depreciated book value of productive assets and (2) valuation on the basis of current market value, calculated from the capitalized expected rate of return. A possible middle way is to value the productive assets at the market level with a discount, which may vary for different types of investors.

24. Prof. Perlamutrov is the leading expert in the Central Econometric Institute of the USSR Academy of Sciences.
Enterprise managers clearly prefer the first form of valuation; official institutions press for the second choice. Selling assets at the market price is the choice of most influential reformist experts.

The only official document now available to analyze the All-Union government views on valuation was issued in January 1991. It is called "Provisional norms for the valuation of state enterprises and organizations liable to buyouts and sale" and was developed jointly by the Finance Ministry, Gosbank, Gosplan, and Goskomstat. The document essentially blocks enterprise attempts to value assets at depreciated book value. The valuation method proposed in it ignores relative depreciation altogether and in calculating absolute (physical) depreciation uses traditional methods based on the residual principle, as practiced since the 1930s. All ratios used in the document are adopted from the traditional centralized system. This means that valuation is not related at all to the potential future profitability of privatized assets.

In reality a combination of valuation options is in use today. Small-scale trade and services outlets are sold at the auction price. The big industry assets are normally valued at the discounted market level. This is comparable to some publicized privatization cases in Western Europe, where the discount was usually 10 to 20 percent. If the government hopes to spread ownership widely, the discount should be significant. It seems unlikely, however, that the present All-Union leadership will choose the paths of popular capitalism.

In cases of "ministerial" privatization, depreciated book value can easily be used because funds are not paid to other parties. The same is true in most cases of "showcase" privatization. BUTEK easily obtained the government's approval of the first option for all enterprises taken under its umbrella. Big enterprises forming concerns and associations can usually influence the valuation process and also purchase assets cheaply.

In the buyouts of smaller companies, surveyed cases reveal complaints about the excessive size of sums requested by the controlling ministry. Even here, the burden is hardly unbearable, since inflation is taken into account only rarely and firms are undervalued. Another related issue is enterprise debt, normally assumed by the privatized entity in full. However, most debts were contracted in years of very low interest rates; in the present inflationary environment the debt load is rarely troublesome for an enterprise.

**DEMONOPOLIZATION**

Overconcentration of industry is inevitable in the centrally planned system. Industrial reforms implemented since the early 1930s have greatly reduced the number of entities and boosted their average size. In 1951 Soviet industrial establishments numbered more than 205,000; in 1990 they stood at 47,000. According to recent Goskomstat figures, in 219 of 644 groups of industrial production classification the share of a leading enterprise was more than 50 percent. One hundred

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25. Total depreciation is calculated as the difference between equipment output minus supplies of new construction. The difference is then spread over the "normative" number of years. This rarely takes into account technical innovations and reflects solely the physical wear. Normative period usually extends far beyond ten years.
and nine giant plants accounted for 90 percent of all industrial output. In all machine-building sectors 80 percent of production is monopolized by three or four enterprises. And as reported by Gossnab, 2,000 industrial products with combined production volume of 11 billion rubles were produced in 1990 in only one enterprise each.

This level of concentration becomes even more spectacular if compared with the record in industrialized Western countries. In the United States, industrial entities with more than 1,000 employed accounted in 1990 for 0.5 percent of the total number of enterprises and 31.6 percent of combined industrial production; for the USSR, respective figures were 17.3 percent and 74.5 percent. In five Western European countries and Japan, such enterprises accounted for 19 percent of all industrial employment, in the United States 25.2 percent, and in the USSR more than 74 percent.

In studying "Soviet" monopolists it is easy to take their formal likeness with Western counterparts for substantive similarities. Under the market system, monopolies emerged in a competitive environment; even when they attempt to eliminate competition, they use market mechanisms and target their strategy on customer demand. In the command economy, huge monopolies emerged as a result of administrative decisions. Their growth depended on the ability to "overfulfill plan targets," regardless of consumer needs.

Demonopolization policy should take this into consideration. In Western antimonopoly practice, when there is political commitment to break up huge concerns, the market usually takes care of the rest. In the current Soviet situation, antimonopoly law can remain just another nice political declaration. Without a grant of full independence to basic producing units, demonopolization will remain the field for ministerial games. All other pieces of legislation (company, bankruptcy, property law, and the like) should be permeated with antimonopolistic considerations. This is still not the case in either All-Union or Republican laws.

It is not only production structures that are monopolized. Even more important for the present state of the economy is the monopolization of distribution channels. All-Union institutions have controlled distribution channels until recently. Gosplan had direct authority over 60 percent of the distribution of all production; sectoral ministries controlled another 30 percent; and Gossnab most of the rest. The system, however, provided no guarantees for the punctuality of supplies, and enterprises have long relied on their own backup network of direct barter arrangements.

Today, ministries manipulate the distribution system to push privatization in the desired direction. In almost all cases of buyouts, managers claim that their former bosses use the supply lever to slow the process and to "punish" independent enterprises. Yet the system is so inefficient now that this leverage is not very strong. And direct links between producers and wholesalers (commodity exchanges and marketing firms) promise to ease the distribution problem.

Not all markets have been stifled by monopolies; some do have competition (the watch industry is an example). To spur competition, it would be logical to open the economy to external


27. Austria, Belgium, France, Sweden, and Italy. All data provided by Goskomstat. Delovoi mir, February 1991, pp. 64-65.
competition. The quality gap between imported and domestic products is significant and consumers prefer the former. But there are some serious obstacles. With the present weakening of the ruble, imported products are out of reach for most consumers. And despite welcome changes in the investment and exchange regime, some recent moves by the All-Union government have scared off foreign investors.

With external competition unlikely, the authorities have begun to think about fostering domestic competition. The Russian Republic was the first to create an Antimonopoly Committee; relevant legislation is expected to take effect in late 1991. The USSR Antimonopoly Committee, outlined in the draft of the President's decree in March 1991, has a similar mandate. It will develop relevant legislation and exercise direct control over implementation. Together with its republican counterparts, the USSR Committee will monitor markets, identify instances of abuse of monopoly power, and impose sanctions and penalties. Its prescriptions will be binding and can be overruled only by judicial bodies or the USSR Arbitration Committee.

Antimonopoly committees aim to create the proper regulative environment for industrial restructuring. Such committees must be alert for abuse of monopoly power by concerns of all types. At the same time, too strict an antimonopoly policy is unjustified given the seriousness of the nation's economic crisis.

In 1991 the Russian Republic Antimonopoly Committee plans to review the policies of all big industrial entities (associations, consortiums, concerns, intersectoral productive amalgamations). Among urgent practical steps contemplated by the Russian Antimonopoly Committee are:

- To develop trade and distribution networks, to foster direct horizontal ties among enterprises, to help create commercial firms in distribution, storage capacity, and the like.

- To monitor the privatization of larger industrial entities (the Committee has the legal power to demand breakup of huge enterprises into smaller ones).

- If restructuring is excessively costly or impossible because of accounting lapses, to create a special regime that might include marketing of the monopolized product via intermediaries, obligatory sale of some of the product on the external market, and introduction of price ceilings.

- To develop a special regime for small-scale enterprises; to stimulate new entries into highly monopolized markets by means of tax breaks, cheap credit, and so on.

Local antimonopoly commissions in cities and regions will serve as outposts of the republican bodies, implementing their policies. The mandate of local bodies already active does not exceed monitoring/data collection and fostering small-scale enterprises.

**SECTOR SPECIFICS**

Of all the details of privatization, sequence seems to cause the least controversy. Only the timing of land reform remains highly debated.

The initial stage of privatization will witness quick auctioning of small and medium-sized entities in *trade and services*. This has already begun through test auctions conducted in several regions.
Pricing reflects market value. In the optimal scenario, it will take two years to complete this privatization stage. It is stimulated by the emergence of thousands of private small-scale enterprises.

Moscow alone has 22,000 minor units in trade and services. Of these only 2,000 are department stores and service centers whose privatization might require an approach similar to that for bigger industrial establishments. Another 2,000 units are service outlets and small shops. These and thousands of microunits (stalls, kiosks) can be sold quickly and profitably.

In preparing for this stage, local authorities will eliminate the "super-structure" that still controls such minor units. A precedent has been set by the Leningrad City Council. In December 1990, it eliminated Lenagroprom—a regional subdivision in the All-Union Agroprom responsible for the production, distribution, and marketing of food in the city and suburban area. This body owned more than 18,000 eateries, food stores, storage facilities, and the like. In early 1991 a much smaller committee on food supply and retail trade was created with no direct administrative power; its functions are simply to monitor quality of products and to help new entities enter business. An independent commercial bank was created (in place of the financial arm of Lenagroprom) to support small-scale enterprise in the city's food supply industry. Simultaneously, the Leningrad City Council auctioned the first 100 food stores.

Similar programs have been implemented by local councils in Perm, Samara, Vologda, Khabarovsk, Saratov, and other regions. But there are also examples of the opposite type. In Nizhny Novgorod and Stavropol, local authorities have banned all forms of small privatization as "state property grabbing by the mafia."

The second stage of privatization is the sale of small-scale industry, with special arrangements for employees. Along with this will come privatization in construction and transport (excluding major All-Union communications facilities, which will remain under state control). Pricing normally will be close to market value (especially in the highly profitable construction industry), with discounts to accommodate special demands of employees.

The privatization of construction is considered to be vital, since it may radically increase efficiency. As of January 1, 1991 unfinished construction equalled 200 billion rubles—10 percent of all productive capital assets. The 500-days plan envisaged privatization of one-third of all construction within 18 months. In fact, sales may be even bigger and faster. Private enterprise is flocking to construction because of great demand and quick returns.

In early 1991 the USSR State Committee on Construction (Gosstroi) and the USSR Ministry of Finance developed norms for auctioning unfinished construction projects. About 10 percent of all such projects were selected for auction; an important goal is to direct the proceeds from auctions into the consumer goods industries. Foreign bidders are welcome.

Privatization takes a peculiar course in the distribution and supply system, which for decades has been one of the key levers of central planning. The USSR State Distribution Committee (Gossnab) has controlled a vast network of specialized and regional distribution companies (glavsnabs). In 1989 these glavsnabs were renamed marketing firms and given more freedom; the expectation was that they would be the foundation of the wholesale market for capital and consumer goods. In reality, the sphere fell victim to "ministerial" privatization in its purest forms.
The Moscow regional distribution company (Mosgorsnab) is a case in point. In 1990 it was reorganized as the independent Moscow Marketing Company (MMC). It retains control over a score of huge specialized firms with combined annual turnover exceeding 6 billion rubles and with customers that are mostly big industrial entities. Without recourse to any legal procedure, the assets of the firms in MMC control were proclaimed the property of this company and the firms themselves were "restructured" as its subsidiaries—they lost even the limited property rights they had obtained in 1989. The Russian Republican Distribution Committee, in its turn, retains full control over MMC. This situation has close parallels in other regional state distribution committees.

Luckily, this is only part of the picture. Apart from 20 big regional firms like MMC, Gosnab controls 142 commercial trading centers and dozens of mixed companies that continue to dominate the distribution system. Many of them are diversifying, and thus competition within the Gosnab system grows. Competition also comes from fully independent bodies. When the Moscow Universal Commodity Exchange was created by Gosnab subsidiaries in early 1991, it had to face the challenge of two strong independent exchanges, namely the Moscow Commodity Exchange and the Russian Commodity Exchange (RTSB). The Gosnab-sponsored exchange is the smallest of three.

Gosnab has also launched specialized exchanges in major cities. For example, the Ryazan exchange specializes in grain, the Tuymen one in oil and gas, the Alma-Ata one in cotton, and so on. There are already over one hundred completely independent exchanges, and about two dozen of them are big enough to compete with Gosnab structures. Most likely, competition in other regions will become as fierce as in Moscow.

Privatization has taken similar course in the financial system. Here we shall look only at banking. Soviet banking was rudimentary before perestroika, due to Marxist credo that services do not create surplus value. There was no autonomous banking or financial sector; the economic functions of money were preempted by the Five-Year Plan. The commercial side of banking was split into two separate types of institutions, for households and for enterprises. In this breakdown, the role of the state-run savings bank (Sberbank) was to take care of household savings. Lending and investment banks were accessible only to the enterprise sector. There were three such banks: Promstroibank, the Bank for Industrial Construction, which financed long-term industrial projects; Agroprombank, which financed agriculture and food processing; and Zhilsotsbank, for housing construction. A foreign trade bank—Vneshekonombank—was also important, with a mandate to manage the country's foreign exchange earnings.

The past three years have witnessed rapid proliferation of independent banks, in three distinct waves. First came cooperative and commercial banks. Some of these emerged as early as 1987, and in 1989-90 hundreds appeared throughout the country. The majority are still small; only a handful have assets in excess of 1 billion rubles.

Somewhat later sectoral ministries decided that they needed their "own" banks to smooth the transition to a decentralized economy. The peak of such creation was in 1989-90. Most of these banks are big, with assets of over 1 billion rubles; they specialize in serving their respective industries. They have little independence in setting their own business strategy, but that may change as they grow in strength.

In 1989 three specialized state-run banks were given much more freedom. This was called "commercialization" and had consequences unexpected by the government. In 1990 all three began to
split up; branches in various regions set themselves up as fully independent commercial banks. They took new names but retained their customers—big enterprises. It may soon be impossible to distinguish them from other commercial banks except for their size (mostly large) and premises (old but better-than-average offices).

A few of the biggest state-controlled and sectoral banks have already announced the intention to spread outside their traditional circle of customers. This signifies the advent of a new period, when competition will tear down artificial barriers between different types of banking institutions. In the optimal circumstances, distinctions between three groups of banks will go, making way for normal specialization in various areas of the market.

As of August 1, 1991, the commercial banks of all three types numbered about 1,735—not many considering the size of the Soviet Union. Prior to the splitting up of the three specialized state-run banks, new commercial financial institutions accounted for slightly more than 5 percent of the consolidated assets of the Soviet financial system; it is now closer to 15 percent.

The final stage of economic reform will see the restructuring of big industry. Enterprises of strategic importance (aerospace and armaments, the All-Union transport system, the ocean fleet, telecommunications, advanced electronics) will remain under direct state control, at least in the foreseeable future. This control may take new forms. The 500-days plan, for example, envisioned transformation of such enterprises into "transrepublican joint-stock companies," with shares distributed to the republican committees for property management. They would thus be collectively owned by all constituent republics.

The future may see many conflicts as sovereignty-seeking republics try to assume full control over installations of All-Union importance. (The Klaipeda harbor in Lithuania is among the most widely publicized cases.) In the past, all industrial and communications projects of any importance were financed largely from the All-Union budget. Given that fact, there seems little hope for easy resolution of conflicts over the strategic entities.

In certain cases, the central authorities have used privatization to counterbalance a republic's drive for independence. In Estonia, the industrial association INTEGRAL was created in 1990, uniting big, centrally controlled entities. As now structured, INTEGRAL plants are joint-stock companies with the controlling 51 percent stake owned by the All-Union ministries. Employee support has been secured by sale to them of 49 percent of shares at a discount. INTEGRAL's leaders (and, seemingly, the majority of employees) are deeply involved in the central authorities' conflict with the Estonian government seeking independence. Estonian authorities label INTEGRAL's actions "the directors' plot."

THE GROWTH OF AN INDIGENOUS CAPITALIST CLASS

With change in the structure of ownership comes the revival of the entrepreneurial class. Modes of economic conduct, priorities, and working styles evolve. This process is taking place both within state-dominated entities and at the grass-roots level: recent legislation opened the way to formation of literally thousands of small businesses. These businesses are different from the much criticized cooperatives; they are real private enterprises and seek no disguises. At the same time, we witness elite transformation into a proto-entrepreneurial class.
The first saplings of a fully independent private sector appeared in spring 1988 and developed in several waves. The first to come (and quickly to degrade into the economic "shadow" zone) were cooperatives. Joint ventures multiplied, despite early skepticism. Since autumn 1989, several legal acts have strengthened guarantees for foreign investors. Fully owned foreign subsidiaries can be created in the USSR; joint ventures receive important benefits such as tax breaks. Since spring 1990 small-scale enterprises have proliferated. And with the adoption of regulations on joint-stock companies in June 1990 has come the fourth wave, definitely the strongest.

Ideally, the alternative sector will create strong demand for jobs (especially in the services) and rehabilitate the consumer market. But this is conditional on efficient antimonopoly policies, which are still under consideration. In most sectors of the economy, private monopolies substitute for public ones.

It is too early to deliver a verdict on the emerging private sector. Its key instruments and segments are still lacking; some early successes may turn into failures from faulty government policies and adverse macroeconomic conditions. The macroeconomic environment is hostile, so the sector is unable fully to demonstrate its strengths. Most private entities are less creditworthy than state-owned ones and have to pay much more for ruble loans, not to mention foreign-exchange financing.

The "capitalization" of important sections of the political and economic elite is another process under way. Competing political forces echo each other in denouncing their opponents for "intertwining with criminals and black-market dealers." Both sides are correct in this verdict. Bureaucrats from the Communist-dominated central apparatus are largely behaving the same as non-Communist political activists recently elected in regional and city councils. But the majority of neocapitalists are from the economic elite—managers of big enterprises and apparatchiks from sectoral ministries.

All these aspects of capitalization are inevitable and should be welcomed. If the present neocapitalists are not the most competitive group of people, the market will eliminate them. Attempts to roll this process back are socially undesirable and economically counterproductive. Most of today's neocapitalists have at least two important qualifications. First, they were the earliest to see the new opportunities and to grasp them. This business instinct is a vital aspect of success. Second, many ministerial bureaucrats, and especially managers of enterprises, know their industries well. Their technical expertise can be helpful in devising new strategies in the market environment.

CONCLUSIONS

The present All-Union government is the first regime to implement wide-scale privatization. Its commitment to the task seems sincere. But the process may take different courses, and different social groups may benefit from it.

Recent measures of the All-Union authorities seem to be aimed at denying a real role in privatization to any social group apart from the economic and political elite. In early 1991 monetary and price reform wiped out a significant part of household savings. It also scared off foreign investors.

Leading international corporations are still interested in getting a stake in such top Soviet performers as KAMAZ; in those few cases it will be possible to negotiate terms more advantageous
than the ones dictated by the dwindling ruble. The All-Union government is anxious at any cost to prevent "wild" foreign participation. That cost may prove excessive as confidence in the ruble and in the Soviet economy weakens.

In the meantime, the economic initiative had passed from the center to the republics. Some of them have already moved from legislation to implementation of their own republican divestiture policies. In an optimistic scenario, this trend will continue.

One cannot, of course, exclude other scenarios. The present regime may collapse, providing an opportunity for some political force to attempt to reverse course and restore authoritarian rule under the slogan of "law and order." Even in such a case, however, it is unlikely that the process of privatization will be stopped.
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