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THE FACULTY OF SOCIAL SCIENCES**

**International Economic and Political Studies**

**The privatization process in the Russian Federation  
1992-2001**

**Master's Thesis**

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I declare that this thesis is my own work and has not been submitted in any form for another degree or diploma at any university or other institution of tertiary education. Information derived from the published or unpublished work of others has been given due references.

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## ABSTRACT

The property relations reforms are seen as the main elements of the post-socialist market transformation.

As a result of the economic reforms carried out in the Russian Federation during the last ten – fifteen years, the fundamental changes of the ownership structure have occurred: the enterprises of different ownership forms have appeared, gradually the efficient owner and efficient corporate governance structures are appearing, the state is accumulating experience in carrying out economic policy in capitalist market economy.

The aim of the thesis is to examine the process of privatization in the Russian Federation during the period of 1992-2001. The problems that I treat in the thesis are: the state of the Russian economy at the beginning of 1990s and the heritage of ‘perestroika’; the first steps towards a free market economy; three stages of the privatization in Russia; main economic results of privatization and social aspects of privatization.

The thesis consists of three chapters. The first chapter is devoted to the state of the Russian economics at the beginning of 1990s and to the “perestroika” heritage. It covers first steps towards market economy and analysis of first ‘market’ legal acts that served as a criterion for the completion of the preparatory stage and a foundation for introduction of the officially approved methods of privatization.

The second chapter is devoted to the privatization process in the Russian Federation, and to the theoretical basis of the privatization. In this chapter my analysis of the three stages of privatization and its legal framework is presented. I distinguish the pre-privatization stage of 1989-1991 as the preparatory period for the official conception of the carrying out the privatization in the Russian Federation. It was implemented in two

stages of its realization: voucher and 'monetary' (denezhnaia) privatization. At the same time the government fixed its clear timetable:

- Voucher privatization July 1992 – 1 July 1994;
- 'Denezhnaia' / "Monetary" privatization 1 July 1994 – 1999.

After 1999 we can speak about the privatization that is carried out by the customary designs. An important role played the improvement of legal framework of state property disposal.

The third chapter covers the results of the privatization process in the Russian Federation. To sum up the most important results of the privatization I would say that by 2003 the Russian Federation has already finished the main stage of economic transformation. The country fulfilled the most important tasks of transformation from a soviet type centrally planned economy. It accomplished transformation from an economy, based on state property to an economy based on private property predominance.

## INTRODUCTION

The end of the 20 Century was an unstable and contradictory period for the Russian economy. It was a period of changes of Russian institutional structures, ownership and the executive system of economy. On the one hand these changes of the already for decades existing structures of the soviet type system took place; on the other hand the country was in a search of new ways of its economic and social development.

The end of 1980s – beginning of 1990s was the period when the issues of the necessity to increase efficiency of the functioning of ownership structures arose. According to my point of view the process of transformation of Russian economy hasn't finished yet. The interest in this issue rises due to the important consequences of the first stages of privatization. I want to show how this process contributed to the transition to a market economy, creation of private property, development of the domestic production, attraction of foreign investments and creation of new strata in the Russian society: oligarchs and poor people.

It would not be an exaggeration to say, that the ownership relations play the crucial role in the life of society. It proves to be true not only on the basis of theoretical arguments but also on the basis of the fundamental changes of the ownership relations in my country that were introduced through the privatization process and redistribution of state ownership.

As a result of the economic reforms carried out in the Russian Federation during the last ten – fifteen years, the fundamental changes of the ownership structure have occurred: the enterprises of different ownership forms have appeared, gradually a more efficient owner and efficient corporate governance structures are appearing, the state is accumulating experience in carrying out economic policy in a capitalist market economy.

However, owing to the imperfections of the Russian privatization model that came to the light during its preparation and realization, today it is very important to develop methodological basis for the improvement of the mechanisms of further carrying out of the privatization. Therefore, I think the urgency of the topic of my thesis lies in the fact that the privatization in Russia was poorly understood and through a systematic analysis investigating this topic we can learn from past errors and prevent them to codetermine our future.

The aim of my thesis is to examine the process of privatization in the Russian Federation during the period of 1992-2001.

According to the aim, I cover in my thesis following issues:

- The analysis of state of the Russian economy at the beginning of 1990s and of the heritage of 'perestroika';
- On the basis of analysis of the legal framework to provide an evaluation of the first steps towards free market economy;
- On the basis of analysis of legislative framework and presidential decrees to provide a thorough examination of the three stages of privatization in Russia;
- Description of the main economic results of privatization;
- Analysis of the major social aspects of privatization.

Trying to provide a comprehensive analysis of the way how the topic of the privatization process in Russia was examined, we can say that many of the privatization aspects not only remain controversial but are still investigated inadequately. It is especially due to the fact that the theory and methodology of the privatization in Russian economy have been worked out very weakly. There are still several points of view

concerning the way how to distinguish the stages of privatization process in Russia. The most commonly used approach to the division of the privatization process is to distinguish three main stages: pre-privatization period 1989-1991; voucher privatization 1992-1994; and ‘monetary’ (denezhnaia) privatization 1994-1999. I decided to investigate privatization process more deeply and I have marked out the stage of creation of joint-stock companies before the voucher privatization began. Needless to say that firstly the state enterprises must be “incorporated” i.e. must be reorganized into corporations (joint-stock companies) with well-defined property rights that have rights to issue shares. Then, those shares can be sold for money or exchanged for privatization entitlements. I paid special attention to the third stage and have marked out the scheme ‘loans for shares’, as during this period the assets were passed to the hands of ‘outsiders’ and the new stratum of society – oligarchs were created. Moreover I examined the legal framework of the privatization process and its evolution from 1991 till 2001.

The primary resources I used for writing my thesis were legal documents, legislative enactments, and presidential decrees. General corpus of documents that contains legal framework for carrying out the privatization of the state ownership exceeds 3 thousands statements. The most import of them are tree federal laws: the RSFSR “Law on Privatization of State and Municipal Enterprises in the Russian Federation” of July 3, 1991 №1531-I; Federal “Law on Privatization of State and Municipal Ownership in the Russian Federation” July 21, 1997 №123-Φ3; federal “Law on Privatization of State and Municipal Ownership” 21 December, 2001 №178-Φ3; and also the State Program for Privatization, confirmed by the decree of the President of the Russian Federation 24 December, 1993 №2284. The “Law on Privatization of State and Municipal Enterprises

in the Russian Federation”<sup>1</sup> (‘State Program’) was passed in July 1991, but was extensively amended on June 5, 1992. This law can be seen as the starting point of the privatization process in the Russian Federation.

Data of the Accounts Chamber that was established by the Federal Law were another important source of information “On Accounts Chamber”<sup>2</sup> in 1995. This constitutional authority was given the right to assess legality, efficiency and expediency of actions of the executive power in the sphere of the ownership disposal.

The informational base of the thesis relied on statistical data of the Accounts Chamber, Goskomimushchestvo, the State Committee on Statistics, and on expert judgments of the economic scientists and analysts.

To achieve the aims I set in my thesis I used methods of comparative, statistical and data, systems and structural analyses.

The thesis consists of 3 chapters. The first chapter is devoted to the state of the Russian economics at the beginning of 1990s and to the ‘perestroika’ heritage. The second chapter is devoted to stages of privatization. The process of new economic reforms was launched in January 1992, which was an attempt for Russia to make quick, even momentary passage from soviet type socialist, command-bureaucratic economy to a market one. The third chapter is dedicated to the main economic results of the privatization process.

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<sup>1</sup> The “Law on Privatization of State and Municipal Enterprises in the Russian Federation” was replaced by new “Law on Privatization of State and Municipal ownership in the Russian Federation” that came into force on August 2, 1997. Закон РСФСР от 3 июля 1991 г. № 1531-1 “О приватизации государственных и муниципальных предприятий в Российской Федерации”. М., 1996.

<sup>2</sup> Федеральный закон от 11 января 1995 года №4-ФЗ “О Счетной палате Российской Федерации” - <http://www.ach.gov.ru/zakon/fedzakon/zakon.php>

It wouldn't be an exaggeration to say, that privatization was really the very basis of the systemic institutional transformation in the Russian economy. During the process of privatization in a short space of time a non-governmental economic sector was formed and new market institutions of corporative economic sector were created.

## CHAPTER 1

### State of Russian economics at the beginning of 1990s

#### 1.1 Perestroika and its consequences for Russian economy

“The past fifteen years have been the time of profound changes in Russia’s socio-economic and political structures. The totalitarian regime and the soviet-type socialist command economy in the USSR have collapsed and so did its satellite Eastern and Central European regimes, while newly independent states, borders and establishments have arisen throughout the former socialist zone.”<sup>3</sup>

Suffice it to say, the 1989 USSR, the 1992 Russia and even more so the 2007 Russia have very little in common. Their economies, public and social institutions, property structures are organized differently. The collapse of the socialist regime has given way to market economy, creation of private property and free market. The soviet-type socialist concept had defined the main principles and forms of economic system that had existed during the XX century not only in the USSR, but also in other countries in the world. I would like to stress that the classic soviet-type socialist economy developed in explicit form during the period from 1930s till 1980s in the USSR. In the late 1980s the administrative-command system came to an end. Change of government in the middle of 1980s has cleared the way to fundamental changes. So to say, with Gorbachev in office the country met era of reforms. But new leaders unfortunately didn’t have any particular program of economic reforms. On the plenary session of the Central Committee of the CPSU in April 1985 Gorbachev launched a number of reforms that were a starting point for reconstruction or the so-called perestroika period. The day-to-day economic operation control of enterprises was appreciably weakened and they were granted rights to set

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<sup>3</sup> Yegor Gaidar. A long time. Russia and the World. Essay on economic History. Долгое Время. Россия в Мире. Очерки Экономической Истории. М., 2005, с.649.

volume of output, range of goods and prices. Moreover the “Law on national enterprises”<sup>4</sup>, 1987 allowed enterprises that have executed a government orders to enter the foreign market independently and develop joint ventures and business organizations. Thereby one of the main dogmas of the soviet economic ideology – state monopoly in foreign trade was destroyed.

May 1988 <sup>5</sup> laws opened up possibilities for private ownership in production of more than 30 types of goods and services. For the first time since 1920s citizens were at liberty to deal with business activity legally and individually; these laws have allowed the creation of private entrepreneurs and cooperatives.

However, these and many other economic reforms didn't make national economy functioning better, futile attempt to introduce new methods of management into practice and combine incompatible - administrative-command economy with market mechanisms on the contrary destabilized it. Cumulative contradictions in economic system, the beginning of the common market zone collapse and mistakes during carrying out reforms adversely affected soviet economy. Needless to say that the complication for soviet economic and political system of the country was union republics' striving for independence, and the collapse of the USSR. One of the main reasons that forced union republics to come apart was introduction of policy of “self-financing” (the so-called *khozraschot*). Before 1987 all companies were financed by government, but since 1987 all enterprises turned to self-sufficiency and began to take into account profitability and began to walk away from unprofitable business. The same system was functioning concerning union republics: for instance, some republics were specialized on mining operations, others for its processing, some of them were centers of heavy engineering

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<sup>4</sup> Виноградов В.В. Экономика России. М., 2002, с.45.

<sup>5</sup> Ibidem, с.47.

industries, and others specialized in light industries. This system of cooperation had stopped functioning, because 'the centre' stopped revenue sharing and redistribution of physical resources.

As soon as in 1987 deviations from centralized plan, cessation of directive planning of wages began. Wages started to increase and caused monetary emission and budget deficit. "During those years annual monetary emission was 2-3 billions rubbles, but in 1988 its growth was 8 billions, in 1989 – 18 billions and in 1990 ran up to 24 billions rubbles"<sup>6</sup>. Under centralized stable retail prices it caused increasing shortages of goods.

The consequence was an explosion of the black market not only of foodstuffs, but also of manufactured goods. To solve the problem new methods of rationing and foodstuff distribution were introduced into practice (coupon system). But all these didn't solve problems and in spite of high prices people were obliged to use the informal market. The informal market was used for money-laundering and legalization of 'shadow economy', too.

In attempt to rectify the situation the government resorted to buy consumer goods abroad, for this purpose the government borrowed money and used the gold and exchange currency reserves of the country. In the begging of perestroika foreign debt was approximately 28.5 billions dollars, then in the end of that period (1 of January, 1992) it increased to 103 billions dollars<sup>7</sup>.

**Table 1. Volume of foreign debt of the USSR in 1985 – 1991\*<sup>8</sup>**

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<sup>6</sup> Аганбегян А.Г. Социально-экономическое Развитие России – М.,2004, с. 16.

<sup>7</sup> Ibidem. С. 16.

<sup>8</sup> Гайдар Е. Т. Долгое Время. Россия в Мире. Очерки Экономической Истории. М., 2005, с.345.

Year	1985	1986	1987	1988	1989	1990	1991
Volume of foreign debt (billions dollars)	28.5	31.4	39.2	43	54	61.1	84

- Without taking into consideration debt to the Central and Eastern Europe Countries

An inefficient policy of the USSR was turning the country into a crisis: in spite of the fact that oil prices were extremely high borrowing in abroad was progressing and at the same time soviet government subsidized vassal regimes by providing them credits that would have never be paid back.

Financial crisis with money devaluation, balance of payment crisis, foreign commerce crisis (table 2), and crisis of state trade had run into and it wouldn't be an exaggeration to say that since 1990 the country was involved in socio-economic crisis with decline in volume of output and living standards.

**Table 2. Balance of foreign commerce of agricultural products of the USSR<sup>9</sup>**

Year	1970	1975	1980	1985
Deficit of foreign commerce balance of agricultural products, billions dollars	-1,0	-7,2	-16,3	-17,5

From my point of view, new leaders of the country not instantly became aware of financial crisis' scale they had faced. Unfortunately, the basis for this crisis was formed

<sup>9</sup> Гайдар Е. Т. Долгое Время. Россия в Мире. Очерки Экономической Истории. М., 2005, с. 340.  
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long time ago: by chronic problems of low efficiency of agriculture and necessity to import agricultural products, incompetitiveness of the soviet manufacturing industry products in the world market, low volume of soviet metal products exports and increasing dependence on exports of fuel –energy resources.

**Table 3. Share of export of cars, equipment, means of transport in volume of export from the USSR to advanced capitalist countries<sup>10</sup>**

Year	1970	1975	1980	1985
Part of export, %	3.4	5.8	3.7	3.5

**Table 4. Oil and gas export from the USSR in numerical calculations<sup>11</sup>**

Year	1970	1975	1980	1985
Oil export, millions of tones, including:	66.8	93.1	119.1	129.5
to socialist countries	40.5	69.1	84.8	85.3
to developed countries	24.2	21.8	30.7	37.6
to developing countries	2.1	2.2	3.6	6.6
Gas export , billions of m3 Including:	3.3	19.3	54.2	79.2
to socialist countries	2.3	11.3	30.4	41.3
to developed countries	1.0	8.0	23.8	37.9

Doctor of Economic Science, deputy of the State Duma of the Russian Federation, eminent political figure in transition time, Yegor Gaidar emphasizes in his research the oil crises and its scale to the soviet economy. He says that, “as it were with other oil-exporting countries, in the end of 1970-s – begging of 1980s the soviet leaders believed

<sup>10</sup> Гайдар Е. Т. Долгое Время. Россия в Мире. Очерки Экономической Истории. М., 2005, с.340.

<sup>11</sup> Ibidem, с. 341.

that favorable situation of high oil prices is a long-term phenomenon”<sup>12</sup>. Hence, according to this notion the strategy of foreign borrowings that would permit to finance both military competition with the USA and wage wars (Afghanistan) was created.

But in the time when Gorbachev came in office oil market opportunities had changed. (Table 5) Such situation led to aggravation of problems with foreign trade balance maintenance, especially concerning relations with advanced capitalist countries, whose production can be sold and bought for convertible money.

**Table 5. Oil world real price dynamics from 1971-1992, dollars\* for 1 barrel**

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Year	Average weighted price on crude oil	Price on oil, UK Brent trademark
1971	7.6	7.7
1972	8.1	8.2
1973	10.3	9.0
1974	33.1	31.6
1975	30.1	27.5
1976	28.7	28.9
1977	29.3	29.4
1978	27.9	28.2
1979	60.2	60.2
1980	66.1	66.3
1981	57.6	58.0
1982	50.3	50.6
1983	45.2	43.7
1984	42.2	40.7
1985	39.3	38.0
1986	19.9	18.3
1987	24.9	23.2
1988	19.5	17.7
1989	22.8	20.1
1990	28.2	25.4
1991	22.9	19.7
1992	22.0	19.8

<sup>12</sup> Гайдар Е. Т. Долгое Время. Россия в Мире. Очерки Экономической Истории. М., 2005, с.339.

<sup>13</sup> Ibidem, с. 342.

- In constant prices on 2000.

According to expert judgments the heaviest stage of the economic crisis fell on the end of 1991. We can list the main characteristic features of that period:

- drastic setback in productions in all branches of industry
- intensification of the inflationary process<sup>14</sup>

Particularly complete breakdown of the financial system that became apparent in the way that most part of expenses of the union's budget were covered with emission of money, resulted in naturalization of economic ties and growth of union's republics and regions economic isolation. It can be illustrated on the ruble rate changes, thus in the beginning of 1991 exchange rate was 35-40 rubles for 1 dollar, but by the later 1991, rate fell 3-5 times and reached 110-120 rubles for 1 dollar<sup>15</sup>.

Among the main reasons that predetermined economic crisis of that period the Accounts Chamber of the Russian Federation emphasized the following:

- Deep financial crisis of the country that was characterized by the temporary degradation of government's ability to realize a consistent financial, monetary and credit policy, it resulted in growth of budget deficit and public debt and high inflation rate;
- Destruction of the COMECON (common market zone), break of the economic and technological ties between industries, factories and regions, economic isolation of the union's republics and collapse of the USSR (December 1991);

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<sup>14</sup> Счетная Палата Российской Федерации. Итоги приватизации. М., 2005 с.69

<sup>15</sup> Ibidem, с.69.

- Drop in production in extractive industry and farm production that didn't make up for using raw materials and fuel;
- Reduction of investment activity in all spheres of economy under investors financial degradation;
- Uncontrolled price growth<sup>16</sup>.

I would like to pay attention to changes in the GDP volume: in 1991 in relation to 1990 real volume of GDP came down by 5%, in 1992 by 19-20% and in 1993 by another 12%<sup>17</sup>. Thus during this period severe reduction of rates and part of GDP's capital in comparison with expenses on consumption occurred. In the production pattern of GDP a tendency to services prevalence as against decrease in goods production manifested itself.

Suffice it to say, setback in production in 1990s was widespread. All branches of economy were involved in crises, even including branches of production that were working for consumer market. Industrial production index decreased by 8%, index of production of agricultural products by 4, 5%, investments in fixed capital by 15% and inflation increased by 2, 6%<sup>18</sup>.

Thus, investments volume drop was due to volume axe of centralized capital investments, financing at the expense of budget and also there was evident lack of own financial resources of enterprises as a consequence of reduction of produced goods profitability and devaluation of fixed capital.

In 1992 there was sizeable increase in retail prices in comparison with people's income, decline of living standards, development of exchange and payment in kind.

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<sup>16</sup> Счетная Палата Российской Федерации. Итоги приватизации. М., 2005 с.69-70.

<sup>17</sup> Ibidem, с. 70.

<sup>18</sup> Ibidem, с.71.

General setback in production in all branches of economy was a touchy subject for Russian foreign trade. Since 1991 exports and imports were going down, it had grave consequences for the economy. The mechanism of currency earnings centralization that allowed carrying out foreign debt commitments and in that way to keep in touch with the main trade partners was destroyed.

The foreign commerce recession in 1992 turned out to be more profound than total volume industrial recession. For example, in comparison with 1991 foreign trade turnover declined by 23%, export on 25% and import by 21%<sup>19</sup>.

Number of negative factors was the cause of crisis tendencies in the sphere of foreign trade relations. So, it's important too emphasize the export capacity reduction as the result of the aggravation of the setback in industrial production, including branches of the fuel and energy complex that determined volume of export of fuel-energy resources as the main export and income item. The second in importance was the monetary and credit crisis, increase of inflation that reduced the ruble exchange and import rise in prices. Consequently, decrease of the efficiency of the foreign trade; necessity to pay off the ex-soviet foreign debt under the replenishment of the country's exchange reserve took place.

During 1992-1996 the balance of the foreign trade was positive and amounted to 82,8 billions dollars. The foreign trade turnover of Russia was 618,0 billions dollars, including export – 350,0 billions dollars, import – 267,6 billions dollars<sup>20</sup>.

To sum up, during the period of 1989-1998 the Russian Federation experienced a transformational crisis. The transformational crisis “is a deep crisis of a transitional economy that is due to the fact that the former planned organization mechanisms of the functioning of the economic activity were already destroyed and new, market

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<sup>19</sup> Счетная Палата Российской Федерации. Итоги приватизации. М., 2005, с.71

<sup>20</sup> Ibidem, с.73.

mechanisms still were weak or are absent at all”<sup>21</sup>. The decrease of the government financing of some industries and slow adaptation of the Russian enterprises to the market were the features of the transformational crisis. In Russia this crisis was remarkable for its depth and structural non-homogeneity.

**Table 6. Industrial structure of the industrial production (at prices of 1990) <sup>22</sup>**

Branch of industry	1990	1998
The Fuel and Energy complex's branches, <i>sum total</i>	17,3	32,5
ferrous metallurgy	4,6	7,7
non-ferrous metallurgy	4,6	7,6
chemical industry	7,1	7,3
mechanical engineering	27,5	18,0
building materials industry	5,1	3,9
light industry	4,3	1,6
food industry	11,8	13,7
other industries	18,2	15,0

So to speak, in the structure of the industrial production the branch quota of the fuel and energy complex and the metallurgy increased, but on the other hand reduction of the manufacturing industry quota and increase of the extractive industries led to “weighting” of the economic structure, in such way. Even today Russia is a raw material exporting country and its economic structure is biased towards extractive industries rather than processing ones.

This structural reconstruction of the Russian industry resulted from 2 main factors:

- Growth of the Russian participation in the international division of labour;

<sup>21</sup> Виноградов В.В. Экономика России. М., 2002, с.53.

<sup>22</sup> Ibidem, с.57.

- Drastic restriction of the effective demand in Russia in consequence of the mistaken and unsystematic fiscal policy.<sup>23</sup>

The other distinctive feature of that period was the cutting down of the R&D policy, because of its non-competitiveness.

As analysts consider, the decision to start the process of privatization was an answer to economic crisis and the keystone of the economic reforms that had to change property relations and solve a problem of transformation of the economic basis of Russian society.

## **1.2 First steps towards a free market economy**

Since 1992 Russia goes through fundamental changes. Other countries, such as countries of Central and Eastern Europe have entered a new phase a bit earlier. It is not difficult to ascertain the beginning of transformation period in all post-communist countries. “Usually the transformation period is related to communist party power loss, cessation of functioning of former legislative and executive bodies and coming to power of noncommunist governments”<sup>24</sup>. Changing of the power can proceed in different ways, for example, in 1989 in Hungary non communist authorities came to power by peaceful parliamentary elections, but on the other hand, in Romania struggle for new regime took the form of armed revolt. In Russia changing of power resulted from the dramatic event – repression of the August putsch, the collapse of the USSR, the dissolution of the Supreme Soviet and forced president’s resignation.

On the whole, we can mark out 3 stages of the post socialist transformation:

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<sup>23</sup> Виноградов В.В. Экономика России. М., 2002, с. 57.

<sup>24</sup> Экономика. Под ред. Архипова А.И., Большакова А.К.. М.,2006., с.523.

1. The macroeconomic stabilization and economic liberalization; the substance of this period was inflation reduction and elimination of disequilibria in the monetary and credit sphere and ruble stabilization. At the same time the removing of the state restrictions on price, production activity and commerce happened. It was also a time when privatization and forming of new economic institutions had begun;

The first period of the transformation began with the price liberalization in 1992 and ended in 1996-1997 with the inflation overcoming, creation of the main legal and market economy institutions and completion of the first stage of the privatization (voucher stage).

2. The 1998 crisis. Russia's economy collapsed in August 1998, as the rouble was devalued - losing 75% of its value almost instantly - and the country defaulted on its debt.

It wouldn't be an exaggeration to say, that default influenced positively the Russian's economy. The crises had made the domestic manufactured goods to come in great demand that in such a way gave an incentive to its development, development of industry and rural economy. Domestic goods became competitive on the Russian market.

3. The year 1999 has begun the transition to the economic growth. The Russian economy has begun to develop rapidly. It is already the market economy, although the market is still incomplete and quite inefficient.

From my point of view, on this stage it is necessary to continue the reformation process aiming at creation of good conditions for further strong economic growth and increase of the common wealth.

Needless to say, that each country is unique and peculiar. Nevertheless, in theory and practice there are two opposite ways how a country can reach the market economy. One of them is called 'gradualism' and the second one is 'shock therapy'.

"The 'gradualism' conception means to carry out reforms slowly and in series. A source of economic changes is government; according to this conception, a very government, following the long-term reforms program should gradually replace the administrative-command system elements by market relations"<sup>25</sup>. One more distinguishing feature of the gradualism model is striving for softening the economic and social consequences of the reforms and avoiding decline in living standards.

The classical example of the gradualism model is Hungary, the transformation period had started at the end of sixties and during the next twenty years the Hungarian government was extending field for free price formation and private enterprise. And after the change of the regime at the end of 1980s and beginning of 1990s, the new leaders accelerated the transformation process by privatization and creation of a strong banking sector.

The opposite way is the 'shock therapy'; this conception is based on the ideas of the monetarism and the school of rational expectations, the contemporary type of the

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<sup>25</sup> Экономика. Под ред. Архипова А.И., Большакова А.К.. М.,2006., с.528.  
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liberal market theory. For the first time the 'shock therapy' doctrine was worked out for practical application by the American Professor J. Sachs.

It was also some kind of solution to overcome the economic crises in Poland, Bulgaria and Russia.

'Shock therapy' refers to:

- The one-stage liquidation of the directive planning; centralized resources allocation and price and tariffs liberalization of a basic mass of goods and services;
- More or less fast privatization of the main part of the state ownership;
- Rapid liberalization of the foreign-economic activity.<sup>26</sup>

The radical model is flinging the mechanisms of the market self-regulation, lighten a new private sector formation as the main economic driving force. At the same time, this model relates to the drop in GDP, inflation, social costs due to absence of appropriate social policy, namely sudden social exfoliation.

I would like to mention that 'shock therapy' and estimation of its results have become a sticking point in economists' viewpoints. Among those who supported the necessity of the 'shock therapy' in transitional economy, I can mark out the professor of the Columbia University Jeffrey Sachs, who proposed 'shock therapy' as a solution to the economic crises of Bolivia, Poland, and Russia. He acted also as adviser to the

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<sup>26</sup> Экономика. Под ред. Булатова А.С.. М., 2006, с. 586.  
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Russian Government and to the Polish Government; as the argument he used “instability of political regims and need of fast reformation”<sup>27</sup>.

It wouldn't be an exaggeration to say, that the ‘shock therapy’ was realized in the most consistent form in Poland in 1990-1991 by the first noncommunist government under the direction of the Prime Minister Leszek Balcerovicz. The main goals of that economical policy were price and exchange liberalization, blockage of wages, bank interest rise, state downsizing on industry and social sphere financing, liberalization of the foreign-economic activity. The Balcerovicz's government succeeded in the inflation suppression; moreover due to strengthening of the standard development of the private sector and international capital flows, in 3-4 years after starting the shock therapy Poland has entered the economic growth stage.

In Russia the deep economic reforms and the forming of a cabinet were going hand in hand. After the election 1991, 12 June, Boris Yeltsin was elected the president of the Russian Soviet Federated Socialist Republic and in the same year in November the state government was formed and was headed by Boris Yeltsin and Vice-prime Minister Yegor Gaidar. “Even in the autumn of 1990 economic situation was on the grip of destabilization and group of economists, headed by Shatalin and Javlinskij, worked out an economic program “500 days”. They suggested carrying out fundamental economic changes during 500 days, including state sector privatization, orientated on the transition to free market prices, but the government rejected this program.”<sup>28</sup> In such a way, in the atmosphere of the collapse of regime, imminent hyperinflation and the quite justifiable

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<sup>27</sup> Сакс Д.Д. Макроэкономика. Глобальный подход. М., 1999, с.456.

<sup>28</sup> Красникова Е.В. Экономика Переходного Периода. М., 2006, с. 100.

threat of economic paralysis the choice was made in favour of radical reforms. In Russia the 'shock therapy' was applied in 1992-1993 and was conducted in a relatively soft way, because the government was not containing wage-push, was accomplishing active emission of money and crediting unprofitable businesses. As the result, the financial stabilization was stretched out by four years (1992-1996).

During the market transformation cyclical development became apparent not only in Russia, but also in other countries with transformation economy. The active reforms period of 1992-1993 changed into deceleration of advancement to the market and evolutionary development of market institutions in 1994-1996, under the influence of the socio-economic tensions (especially, I want to emphasize the event of October, 3-4 1993<sup>29</sup>). Some stabilization achieved in Russian economy and social sphere in 1997-1998 created conditions for new reform cycle in social sphere, housing, military complex and many other spheres of social life. However, the bursting out crisis in spring 1998 that culminated after the 17 of August, 1998, had canceled all reforms. The necessary prerequisites for the next reforms were created as a result of the political stabilization of 2000.

No doubt, problems that faced the former Soviet Union republics, Russia and other countries of the communist bloc with transitional economy were terrible: it were essential to transfer from one set of prices, that was centrally determined during communism to market price system; to create markets and institutional infrastructure, to put into practice privatization of state property.

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<sup>29</sup> Here I imply so-called 2 weeks civil war or to put it another way, confrontation between Boris Yeltsin and the Congress of People's Deputies that was lasted from the putsch of 1991 and that was developed into military confrontation, seizure of the White House and opening fire, while the hole country was keeping watch on Russian feature in front of their tv screens.

Irrespective of the fact how to evaluate each of the transformation ways, all countries faced the dilemma. If the problems that caused transformation were huge, then what were the choices?

### **1.3. Liberalization of markets**

The principal reform under the transformation to the market was market liberalization. “Liberalization means liquidation of the system of central planning and resources distribution, removal or considerable limitation of state control in all spheres of economic activity.”<sup>30</sup>

At the beginning of 1992, Russian government whose head was the president Yeltsin undertook real steps towards market economy:

- Liquidation of the centrally planned management of the economy;
- Cancellation of the mandatory government contractual work;
- Price and services liberalization (with the exception of energy carrier prices and some foodstuffs).

Needless to say, the main reform that opened way to the market economy was price liberalization that started in January 1992. Specific program of the ‘shock therapy’ was conducted in Russia and in fact and nowhere else it relied on higher number of short-term measures by economic stabilization achievement and the free market creation:

- Price liberalization for establishment of efficient way of balancing demand and supply and contributing to resources redistribution in most effective industries;

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<sup>30</sup> Виноградов В.В. Экономика России. М., 2002, с.101.  
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- Wage and income growth constraint right up to its blockage ( it was needed for prevention of inflation spiral ‘ wage-prices’ untwisting and reduction of costs of production; axe on budget expenditures, especially, arming purchases and central investments, state subsidies and grants; aggregate demand limitation using rise in taxes.

In order to avoid hyperinflation the government worked out measures by carrying out strict financial and credit and monetary policy, the government cut down the budget deficit due to reduction of its income and fixed 28% VAT<sup>31</sup>.

- It introduced volume of money supply control; created conditions for national economy openness with respect to the world market by means of curtailment of the administrative limitations of the foreign trade and fixation of a floating national currency rate with the purpose of making it convertible and finally stabilize the exchange rate<sup>32</sup>.

The government with all its might contained the dynamics of money supply; credits to enterprises were cut down. As it was expected, at first the prices had grown abruptly, but when they faced money supply constraint its growth appreciably slowed down. Little by little the Russian common market was step by step formed. In March 1992 the shop shelves had begun to fill with expensive consumer goods, but because of the wage growth and income control people could not afford to buy almost anything. (I’m going to view the social consequences of the privatization in more detail in the Chapter 3) Suffice it to say, “during the year consumer prices increased 26 times”<sup>33</sup>. In consequence

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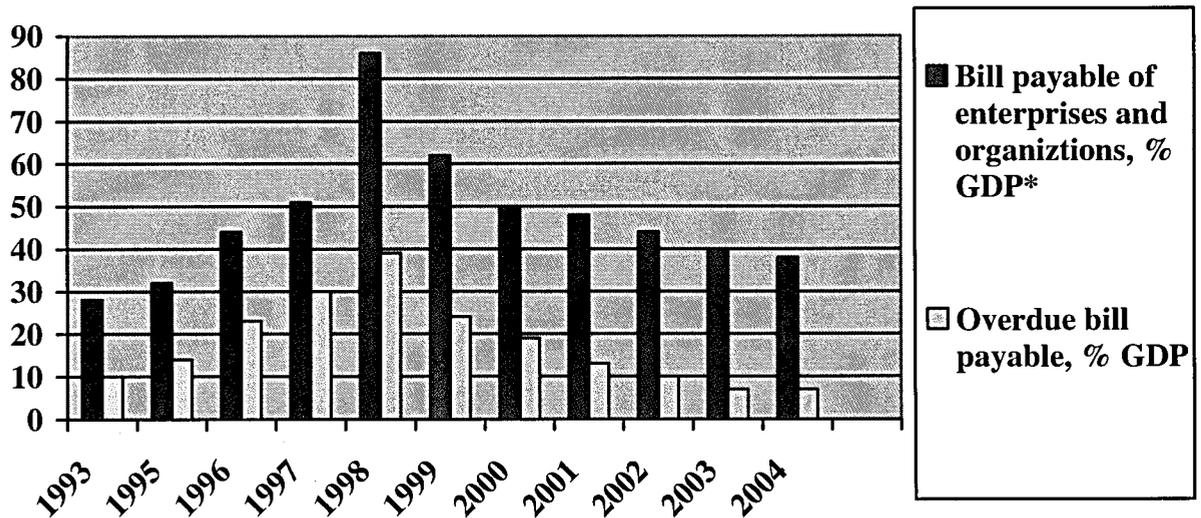
<sup>31</sup> Волкова Г.А., Коваль Л.С., Поляк Г.Б., Черкашина О.А. Под ред. Эриашвили Н.Д. *Налоги и Налогообложение*. М., 2007, с.237.

<sup>32</sup> *Мировая Экономика и Международные Экономические Отношения*. Под ред. Хасбулатова Р.И. Т.1, М., 2006, с. 486.

<sup>33</sup> Аганбегян А.Г. *Социально-экономическое Развитие России*. М.,2004,с.24.

of pressure for money dramatic measures had arisen in the middle of 1992: from one hand it impoverished people denuded of their savings, from another hand – enterprises indebted to government stopped working. This period was marked by the high level of bankruptcies that for its turn radically changed the dynamics of indebtednesses and its share in the country’s GDP (Table 7). At the same time, we can speak about ‘formal success’, as shown by the reduction of the state budget deficit and inflation rates.

**Table 7. Dynamics of indebtednesses and bankruptcies in Russia<sup>34</sup>**



\* According to the GDP data of 2003.

It wouldn't be an exaggeration to say that economic policy was in need of fundamental measures.

<sup>34</sup> Гайдар Е. Т. Долгое Время. Россия в Мире. Очерки Экономической Истории. М., 2005, с.397.  
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Some steps towards stabilization were made: the government and the Central bank conducted reciprocal payments of debts. The Central bank was giving credits for working capital and it made industry work. At one time the government made an attempt to ameliorate social situation, so salaries for state employees as teachers and doctors (even pensions) were increased; it helped to improve Russians life, although living standards were still considerably below average.

But release of blocked cash assets had increased the budget deficit and after several months caused “inflation growth from 8-12 % per month that lasted during May-August to 20-25% in autumn and winter 1992/93”<sup>35</sup>.

The Gaidar’s government was devising measures for prices growth impairment. The government planned to begin stabilization process in 1993, planned to ‘tie’ ruble to dollar and bring inflation to minimum. These plans failed. The State Duma criticized the government and didn’t support its policy, shortly after the State Duma asked the president to change the government. Consequently, in autumn 1992 the Gaidar’s government resigned, the new government was headed by Chernomyrdin.

We would like to sum up the Gaidar’s government work in this first and most essential transformation period. The economic scientists disagree in evaluation of Gaidar’s economic reforms; Russian economist Aganbegian argues that “strategical line on a rapid transition to the market was the only one possible way in that period<sup>36</sup>”. But on the other hand we can mark out some committed errors such as price explosion, as it was aforesaid, the prices increased 26 times. None of the post-socialist countries of the

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<sup>35</sup> Аганбегян А.Г. Социально-экономическое Развитие России. М.,2004,с.26.

<sup>36</sup> Ibidem, с.26.

Central and the Eastern Europe had such an increase in prices. Naturally, the question rises why the prices increased so many times?

Aganbegian sees causes in “absence of preliminary privatization of state shops”<sup>37</sup>, because price liberalization was carried out on the basis of state shops. Obviously, the government didn’t have enough time to conduct privatization, but it could start ‘small’ privatization in the sphere of retail trade and human services. In privatized shops the increase in prices would have been less on account of the owner of a shop, because he holds an interest in deriving benefits from quick selling of commodities, increase in turnover and consequently would not according to him in contrast to directors of a state shops push up prices.

The second reason why it happened was monopolization of many industries inherited by Russia from the soviet-type centrally planned economy that influenced rise in prices. Industries-monopolists raised its prices without any state control and in that way whipped up price increase. I would like to draw attention to the fact, that in spite of the liberalization of most prices, prices on some commodities such as natural resources were maintained on very low level. So, it meant if you could buy, for instance, oil, then you could resell it and would raise money. Thus, we can speak about gradual not momentary liberalization that also affected the economic situation.

Liberalization and stabilization were the two main pillars of strategy of radical reforms. The third pillar was rapid privatization. Stiglitz argues that the first two pillars became obstacles on the path to privatization. ” The high inflation obliterated savings of majority of Russians and the country lacked people who could afford to buy privatized

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<sup>37</sup> Аганбегян А.Г. Социально-экономическое Развитие России. М.,2004, с.28.  
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enterprises”<sup>38</sup>. What is more the government refused to index population savings. It led to undermining government’s authority thus people have begun to salt money away, apprehending the government would betray their trust again. Not to mention the decline of living standards and consequent driving of majority of Russians to depression.

Stiglitz argues that “the strategy of radical reforms in Russia was inefficient: since 1989 the Russian GDP had fallen every year”<sup>39</sup>. That was viewed as a short-term transformation recession which turned into long-drawn economic recession.

To conclude, first stages of economic transformation of earlier 1990s have determined the future development of the country, not only its internal policy, but also its position on the international scene. As the government refused to index holdings and people’s savings, the economic reforms that were started in Russia took another way. The Russian population was short of money thus population capital couldn’t participate in privatization. Due to it the government had to begin nonmarket or in other words semi-free privatization. All mistakes that were made during those years have an effect on further economic development. We can speak about investment repulsion in connection with risk to conduct any affairs or even to be out of pockets. What is more deplorable, economic transition as it was has provided basis for 1998 crisis. Off course, the program of liberalization and stabilization was not a program for achieving economic growth but this program was able to create the necessary prerequisites for future growth.

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<sup>38</sup> Стиглиц Дж. Кто потерял Россию? - <http://rusref.nm.ru/StiglitzLost.htm>

<sup>39</sup> Ibidem.

## CHAPTER 2

### The privatization in Russia

#### 2.1. Privatization as the basis of transition to the market economy

The property relations reforms are seen as the main elements of the post-socialist market transformation. However, the methods of implementation of these reforms, scale, and alternatives of the reorganization forms of the state sector of the economy might be different. One of the postulates of the neo-liberal model of the economic market transformation, which was followed by majority of pos-socialist countries consisted in rapid deregulation of the economy (the fundamental principals of the transformation strategy was based on the Washington Consensus<sup>40</sup> measures that included deregulation, price liberalization, foreign trade liberalization, privatization and support for private-sector development, restrictive macroeconomic stabilization policy based on monetarist theory and reform of the legislative system). In this connection a problem of rapid removal of the state control and privatization of enterprises was posed. It wouldn't be an exaggeration to say that first steps of the economic transformation towards market made to rethink not only the government role in the economy but also the place of the state sector in the transitional economy.

Speaking about privatization I would like to describe its theoretical basis.

First of all, I would like to give definition to the term 'privatization' – "sale or gratuitous assignment of the state assets (ownership) to citizens, labour collectives or

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<sup>40</sup> Williamson J. Did the Washington Consensus Fail? -  
<http://www.iie.com/publications/papers/paper.cfm?researchid=488>  
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private legal persons”<sup>41</sup>. As a result of the privatization of national enterprises private and mixed enterprises in different economic-organizing forms (from individual enterprises to all types of corporations) can evolve.

Evolution of relations that are based on the capital fundamentally changes the whole system of interests in the context of an enterprise and calls for new mechanism of its co-ordination. During the process of privatization and mass transactions (transfer of property rights) new social categories such as owners (shareholders), managers, and wage earners appear. Hence, we can claim, that the privatization creates the necessary prerequisites for fundamental changes in the structure of social groups and social relations.

Success and rates of transformation depend on both logicity and consistency of carrying out economic policy, principles and methods of property-relation reforms, and also depend on conversion of the economy. At the same time, capital market is considered to be the main subject of creation of the efficient market mechanisms complex in the transition economy.

When the post-socialist countries began its transition to the free market economy there were disagreements on the best way to carry out ownership reforms. János Kornai in his book “The Road to a Free Economy” and in his numerous articles that are dedicated to the transition economy distinguishes two opposite strategies: “the strategy of

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<sup>41</sup> Экономика. Под ред. Архипова А.И., Большакова А.К.. М.,2006, с. 584.  
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organic development (strategy A) and the strategy of accelerated privatization (strategy B)”<sup>42</sup>

The main task of the strategy A the creation of favorable conditions for bottom-up development of the private sector: encouraging the launch of new firms by eliminating barriers to entry, guaranteeing the security of private ownership, enforcing private contracts, and applying affirmative action—cautiously—for example, through tax and credit policies.

Strategy A called for the privatization of state-owned companies through the sale (at fair prices) of state assets, preferably to outsiders able to invest in the companies. State property would not be given away—insiders would also have to pay a fair price. After sale, ownership would be concentrated in the hands of a dominant owner.

Strategy A also stressed the importance of hard budget constraints <sup>43</sup> and consistent enforcement of bankruptcy and accounting laws. Hard budget constraints

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<sup>42</sup> Kornai J. Making the Transition to Private Ownership - <http://www.imf.org/external/pubs/ft/fandd/2000/09/kornai.htm>

<sup>43</sup> The budget constraints can be soft or hard. "Soft budget constraints" - a term coined by Janos Kornai, and was one of the most important incentive problems of socialist economies.

"The softening of the budget constraint occurs when the strict relationship between expenditure and earnings has been relaxed because excess of expenditure over earnings will be paid by some other institution, typically by the State. A further condition of softening is that the decision maker expects such external financial assistance with high probability, and this probability is built firmly into his behavior. There are different ways and means to soften the budget constraint of the firm: soft subsidies, soft taxation, soft credit, and soft administrative prices."

Kornai J. The Soft Budget Constraint - <http://faculty.vassar.edu/kennett/Kornai.htm>

"If firms face hard budget constraints, this means that they must cover their costs of production using revenues generated either from the sales of their product or from other financial sources. In the short term, firms facing hard budget constraints may borrow to cover their operating costs. In the long term, however, if firms cannot cover their costs from their revenues, they fail. Hard budget constraints coincide with a situation where government authorities do not bail out or subsidize poorly performing or loss-making firms."

Hard Budget Constraints - <http://www.answers.com/topic/hard-budget-constraints>

introduce a process of natural selection: profitable companies are bought by investors while chronic loss makers are forced into bankruptcy and liquidation.

In contrast, strategy B's emphasis was on the rapid elimination of state ownership. It called for privatization primarily through some form of give away—for example voucher schemes. The goals were dispersed ownership—the equal distribution to all citizens of state assets—and the development of "people's capitalism."<sup>44</sup>

From my point of view, the essential distinction between these two strategies consists not in the set of characteristic features but which description the government emphasizes. Hence, strategy A puts in the forefront the importance of the 'strong' growth of new private sector, while strategy B gives preferences to a rapid elimination of the state ownership.

At the very beginning of the transformation process, "in the early 1990s, only small minority of Western academic economists supported strategy A; the vast majority favored the rapid elimination of the state sector"<sup>45</sup>. But now, when we can see the results of both A and B strategies, experience says louder than any theories, strategy A was better than B.

Obviously, Hungary has followed the strategy A, but on no account we could not idealize this example, because there were some mistakes and failures. On the other hand, achievements in economic sphere were good enough: a lot of new small and medium-sized enterprises have come into being, the role of private contracts increased, and the

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<sup>44</sup> Kornai J. Making the Transition to Private Ownership - <http://www.imf.org/external/pubs/ft/fandd/2000/09/kornai.htm>

<sup>45</sup> Ibidem.

bank sector consolidation began - all that attracted inflows of foreign capital, which created conditions for increase of labor efficiency and exports.

Poland can be seen as a country that applied some methods of the strategy A and some of the strategy B. "Its economic successes have been due not only to its successful macro stabilization but also to the numerous new businesses that have sprung up, the vigorous growth of the private sector, and sizable capital inflows.

The Czech Republic was the first country to pursue strategy B and the prime minister Václav Klaus was 'fighting' for the voucher schemes. János Kornai criticized the implementation of the strategy B.

According to János Kornai, the worst example of the failure of strategy B is Russia. This country "pursued an extreme form of the strategy: a voucher scheme coupled with mass, manipulated transfers of property to managers and privileged bureaucrats"<sup>46</sup>.

From my point of view, both strategies were deprived of concrete results after its implementation, it seems, like the results were more or less based on intuition rather than on some facts. The speed of economic reform matters less than its consecution.

Concrete methods of realization of an ownership reform depend on the principles according to which the state ownership passes to a new owner. Mainly, it is choice between chargeable or free forms of privatization. Before the privatization was implemented the question who could claim property of the privatized national enterprises was put – all citizens, only members of labor collectives, or else holders of a sufficient

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<sup>46</sup> Kornai J. Making the Transition to Private Ownership - <http://www.imf.org/external/pubs/ft/fandd/2000/09/kornai.htm>

capital for a purchase. The urgent question was about the scale of foreign capital access to privatization. All that questions were subject of debates in every post-social country. It wouldn't be an exaggeration to say, the privatization is one of the most politicized elements of the transformation. Indeed, M. Boycko, A. Shleifer; R. Vishny; S. Fischer; J. Sachs “ argue that the key prerequisite for restructuring is depolarization of firms, meaning a change in their conduct from meeting the wishes of politicians of maximizing profits”<sup>47</sup>.

Another characteristic feature is that in many countries with transition economy privatization was carried out simultaneously with liberalization of the enterprises and enactment of business legislation. Transition from one economic system to another primarily presumes transformation in prevailing forms of ownership. Transformation of ownership forms is realized for creation of a more effective market system. The ownership transformation includes both transitions from one form of ownership to another, and redistribution of rights within one form of ownership (for instance, within the limits of the state ownership – transfer of economic decision-making right from headquarters to the level of enterprises).

The purposes of the privatization<sup>48</sup>:

- Forming the wide strata of private owners;
- To increase the efficiency of economic activity of enterprises;
- Creation of competitive sphere and economic demonopolization;

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<sup>47</sup> Boycko M.; Shleifer A.; Vishny R. W.; Fischer S.; Sachs J. D. “*Privatizing Russia*” Brookings Papers on Economic Activity, Vol. 1993, No. 2. (1993), p. 140.

<sup>48</sup> Виногоградов В.В. Экономика России. М., 2002, с.124.

- Attraction of investments, including foreign investments to the real sector of economy;
- Decrease of state budget deficit owing to income increase and state expenses decrease.

The very short step of the privatization is to bring out enterprises from the state economic authority control. According to the neo-liberal theory the main disadvantage of the state ownership is the lack of an efficient owner, who holds an interest in rational use and increase of the value of property.

All models of the privatization can be clustered into “4 main models”<sup>49</sup>:

- Denationalization;
- Selling;
- Free distribution;
- National holding companies creation.

It is possible to give more detailed classification of the privatization forms. Thus, the World Bank marks out such methods of privatization in the post-socialist countries:

- Direct sale of assets; it should contribute to rapid progression of financial market and what is more important it should create favorable conditions for growth of newly founded national, foreign or mixed capital privately owned enterprises. This method was peculiar to Hungary, Croatia, Estonia, and Poland.

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<sup>49</sup> Виноградов В.В. Экономика России. М., 2002, с.125.  
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- Mass voucher privatization; allows relatively fast distribution of state assets among a large number of citizens. Regardless of the fact that vouchers are distributed for free or for some amount of money, voucher privatization can be considered as the socially least conflicting form of privatization. This method was predominant in the Czech Republic, Slovakia, Russia, Mongolia, Kazakhstan and Albania.
- Redemption of control of the stock by manager or / and by workers; in a high extent this method was used in Poland, Slovenia, Latvia, Lithuania and Russia.
- Public proposal;
- Gratuitous assignment to municipal authority;
- Creation of stock companies;
- State stock company with foreign sharing;
- Liquidation.

**Table 1. Methods of privatization of small and large-scale enterprises** <sup>50</sup>

Country	Direct sales	Vouchers	Transfer of shares to an ownership of managers and workers of an enterprise
Bulgaria	main	secondary	don't use
Hungary	main	don't use	secondary
Poland	main	main	secondary
Romania	secondary	don't use	main
The Republic of Slovakia	main	secondary	don't use
The Czech Republic	secondary	main	don't use

<sup>50</sup> Переходный период: анализ и уроки первого десятилетия для стран Восточной Европы и бывшего Советского Союза. Исследования Всемирного Банка - [http://lnweb18.worldbank.org/ECA/eca.nsf/Attachments/Transition%20-%20The%20First%20Ten%20Years/\\$File/Transition.pdf](http://lnweb18.worldbank.org/ECA/eca.nsf/Attachments/Transition%20-%20The%20First%20Ten%20Years/$File/Transition.pdf)

<b>The Russia Federation</b>	secondary	main	main
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In spite of the privatization methods, “any privatization program should be set out to achieve a range of objectives. First and foremost, privatization should be viewed as an instrument for promoting efficiency by creating an incentive-based economy. Second, privatization should lead to a distribution of ownership that is accepted as fair. Third, privatization process should serve the creation of a market structure compatible with the expectations of a decentralized and ultimately democratic society<sup>51</sup>”. It wouldn’t be an exaggeration to say, that private ownership is needed to achieve separation of economic and political decisions.

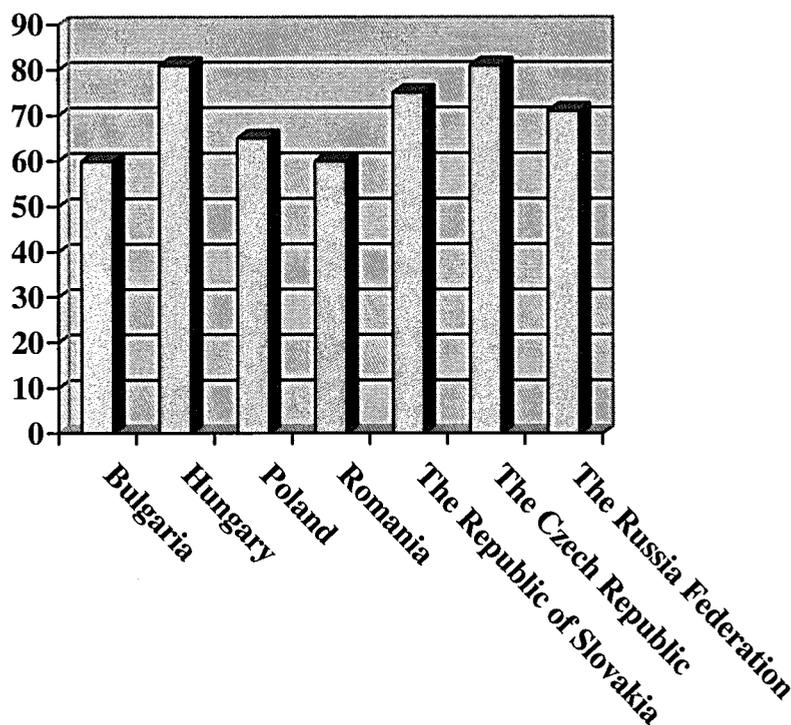
In the post-socialist countries privatization was not uniform, progressive process of the replacement of the status of ownership of an enterprise from state into private or mixed. Formation of the economic structure on bases of ownership marketable criteria was carried out by stages. Enactment of the privatization bills, and of government programs contributed to centralization and regulation of privatization processes. In majority of countries under consideration the laws on separate privatization of small and large-scale enterprises (including public property) were passed. To put it in another way the matter concerns the large and small privatization. On the hole, privatization led to transformation of legislation, for instance passing of civil and commercial code, not to mention important changes in the tax code.

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<sup>51</sup> Gross D., Steinherr A. Economic Transition in Central and Eastern Europe. Planting the Seeds. Cambridge. 2001. p.76.  
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In majority of post –socialist countries the small privatization succeeded and by the middle of 1990s we can speak about its completion. On the other hand, the large privatization was quite complicated task. On this stage governments of all post-socialist countries faced some difficulties: population and investment structures’ means were not high enough for investments in large-scale enterprises.

**Table 2. Share of private sector in the GDP (%) (2002)<sup>52</sup>**



For these countries 15 (approximately) years “were enough to upgrade the economic software, even if the hardware is still to be treated from a different era. The

<sup>52</sup> Страны с переходной экономикой. Содействие Всемирного банка: оценка ДООД / Элис К. Галенсон. Международный банк реконструкции и развития / Всемирный банк. 2004, с.32.

countries of the CIS are clearly in different category”<sup>53</sup>. Since 2004 some of post-socialist countries are members of the EU, so “history has shown that a market economy based on private property performs much better than socialism”<sup>54</sup>.

In every country privatization had special features that were laid within the historical heritage of its economic development long before the transition period had begun. Hence, we can speak about the results and the success of the privatization starting by investigating pre – transitional socio-economic and political situation, the way, how first steps towards liberalization were made and by what means transition to the market economy was implemented, what was the role of the government and how was the legislation prepared for the transition. Resting upon the aforesaid reservations we can picture the most impartial situation in a country and even can make some future predictions.

## **2.2 Pre- privatization period 1989-1991**

The principle features of the Russian privatization are connected with specific character of the Russian economy in its pre-reform period and with its main lines of transformation and development during the 1990s of the XX Century. The ownership transformation serves not only as the pivot of the economic reforms, but also as a key link of the qualitative shifts in society that predetermine the future trends of the Russia’s socio-economic development in the XXI Century.

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<sup>53</sup> Gross D., Steinherr A. Economic Transition in Central and Eastern Europe. Planting the Seeds. Cambridge. 2001. p.127.

<sup>54</sup> Ibidem, p.76.

For a more detailed and comprehensive revelation of the main points and features of the privatizing process in Russia, first of all I would like to distinguish privatization stages in Russia.

The official conception of the carrying out the privatization in the Russian Federation provided two stages of its realization: voucher and ‘monetary’ (denezhnaia) privatization. At the same time the government fixed its clear timetable:

- Voucher privatization July 1992 – 1 July 1994;
- ‘Monetary’ (denezhnaia) privatization 1 July 1994 – 1999.

After 1997 we can speak about the privatization that is carried out not by the mass standard schemes, but by the customary designs, where the emphasis is made on the transfer to a private property not of the whole enterprises, but the state’s property share of these enterprises. Also, of no small importance is improvement of legal provisions of state property disposal.

Fast and large-scale privatization that started in the beginning of nineties is still a touchy subject. The specialists’ weight argument is that “privatization was conducted too fast and without preliminary created institutional and legal bases”<sup>55</sup>. As a result such events as concentration of economic authority that has become an obstacle to further reform, tax and budget losses, income differentiation have occurred.

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<sup>55</sup> Переходный период: анализ и уроки первого десятилетия для стран Восточной Европы и бывшего Советского Союза. Исследования Всемирного Банка - [http://lnweb18.worldbank.org/ECA/eca.nsf/Attachments/Transition%20-%20The%20First%20Ten%20Years/\\$File/Transition.pdf](http://lnweb18.worldbank.org/ECA/eca.nsf/Attachments/Transition%20-%20The%20First%20Ten%20Years/$File/Transition.pdf)  
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From my point of view it is more advisable to mark out stages of privatization process in the view of specific applied mechanisms of the ownership redistribution. Hence, we can distinguish pre-voucher stage of privatization, the so-called 'spontaneous' privatization. This stage of privatization was carried out in forms of redemption of leaseholds, creation of the national corporations and spontaneous privatization.

This pre-voucher stage started with the "Law on Individual Labor Activity"<sup>56</sup>, 1986. This law became the first statutory act of the initial stage of the transformation. This law legalized such forms of economic activities as: small private practice, rent on the base of family contract and etc. So, "in 1989 672 thousands of subjects of individual business were registered in the Soviet Union. Important part of them was registered in Russia"<sup>57</sup>.

At the same time some shifts in the division of powers on the enterprises had begun. Before the 1987 all the enterprises were considered as subjects of the management where the state was the owner. After the "Law on State Enterprise (union)"<sup>58</sup>, 1987 was enacted. This law fundamentally changed the status and capabilities of the management. The 1987 "Law on State Enterprises" and the 1990 Soviet "Enterprise Law" " specified a rather elaborate three-tier governance structure, giving considerable powers to the general meeting of the labor collective and a partly elected Enterprise Council"<sup>59</sup>. At one point, we can speak about shifting powers toward workers, however managerial interests remained predominant, so in fact, we can see political conflict "between the so-called

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<sup>56</sup> Закон СССР от 19.11.1986 "Об индивидуальной трудовой деятельности" - <http://pravo.levonevsky.org/baza/soviet/sssr2184.htm>

<sup>57</sup> Виноградов В.В. Экономика России. М., 2002, с.126.

<sup>58</sup> Закон СССР от 30.06.1987 "О государственном предприятии (объединении)" - <http://pravo.levonevsky.org/baza/soviet/sssr1996.htm>

<sup>59</sup> Frydman R., Rapaczynski A., Earle J.S. The Privatization Process in Russia, Ukraine and the Baltic States. Central European University Press. 1993, p. 19.

'industrial lobby', composed of enterprise insiders and the old economic bureaucracy"<sup>60</sup>. Actually, it meant victory of the manager's elite over the party nomenclature. The role of the enterprises managers began to increase. It was a starting point for begging of the ownership rights transformation from the party and the branch ministries to the enterprises managers.

As it was aforesaid the laws of the Soviet Union established a special entity, the so-called 'lease enterprises'. "The official purpose of introducing the lease enterprises was to readjust the incentives of the people in charge of the state enterprises and to improve the performance of the state sector"<sup>61</sup>. The government wanted to assist the breakup of large economic units in both retail and wholesale trade, and what is more important to increase the efficiency of the distribution of goods and services to the soviet people.

Generally speaking, the lease of the state enterprises gave an opportunity to its workers to privatize these enterprises by means of low prices redemption. To sum up, insiders were given control over substantial portion of smaller state enterprises. So, the foundation for insider ownership was laid.

"By the beginning of 1991 over 2.400 enterprises, employing 1.5 million people, had been leased, and accounted for 5.2 per cent of industrial output. In the service sector, approximately 2.000 retail organizations and trusts, 33.000 shops, as well as large numbers of services outlets were under lease."<sup>62</sup> In the end of the winter 1992, the

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<sup>60</sup> Frydman R., Rapaczynski A., Earle J.S. The Privatization Process in Russia, Ukraine and the Baltic States. Central European University Press. 1993, p. 19.

<sup>61</sup> Ibidem, p. 20.

<sup>62</sup> Ibidem, p.22.

number of leased enterprises grew to 9.500 and its staff size reached 8 per cent <sup>63</sup> of total employment.

Now I turn to other grouping of state enterprises, known as ‘corporations’, ‘concerns’, ‘associations’, they have also impacted on the Russian economy. The industrial associations were of interest of industrial lobby in Russia. For the most part the industrial associations were formed by the enterprises themselves, acting under the 1989 amendments to the Soviet “Law on State Enterprises” and the Russian “Enterprise Law”<sup>64</sup>; and many of them were formed according to the decisions of local government bodies. The decision to create the associations was to make them more independent from the state, and then enable the elite to privatize or commercialize them. The entrance to the associations was voluntary and could be called a paying proposition, “since the associations offered benefits of essentially monopolistic cartels, representing and protecting the interests of their members *vis a vis* the governmental authorities”<sup>65</sup>. And what is more, enterprises that didn’t join the associations risked losing state subsidies. Some of the enterprises that entered the associations retained status of the state enterprises and some took on new legal forms. Consequently it resulted in conversion into join-stock companies.

To sum up, “creation of associations as a shield from political changes of the moment has turned out to be quite successful: they have survived the demise of the Soviet Union and still comprise the umbrella organizations of a very substantial part of the Russian industry. According to the reports of the State Committee on Statistics, there

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<sup>63</sup> Виноградов В.В. Экономика России. М., 2002, с.126

<sup>64</sup> Закон РСФСР от 25 декабря 1990 “О предприятиях и предпринимательской деятельности” - <http://www.infogrant.ru/fulldoc.dws?dui=6057>

<sup>65</sup> Frydman R., Rapaczynski A., Earle J.S. The Privatization Process in Russia, Ukraine and the Baltic States. Central European University Press. 1993, p. 23.

existed in Russia, at the end of 1991, 227 concerns, sixteen inter-industry State groupings, 3.076 associations, and 123 consortia organized on the basis of various legal acts allowing such amalgamations.”<sup>66</sup>. These cartels are considered very powerful, for instance the concern Gazprom, “its share in the global and Russian gas production is nearly 20 and 90 per cent, respectively”<sup>67</sup>; Norilsk Nickel controls 96 per cent of nickel, 55 per cent of copper and 95 per cent of cobalt production<sup>68</sup>.

The cooperatives was another form of business association, their existence was ratified by the “Law on Cooperatives”<sup>69</sup>, 1988. The Soviet cooperatives were mainly created in the sphere of agriculture and services rather than in the sphere of production.

The “Law on Privatization of State-Owned and Municipal Enterprises”<sup>70</sup> served as a criterion for the completion of the preparatory stage and transfer to adaptation of the officially approved methods of privatization.

Generally speaking, preparation of the ‘real privatization’ in Russia passed through 3 stages. The term ‘privatization’ was born in depths of the Yavlinskiy’s team while they were preparing documents for the ‘500 days Program’. For the first time in the USSR and Russian history G. Yavlinskiy and his colleagues consistently set aims of the privatization, its plan and the main terms of its realization. They considered carrying out privatization according to the common All-Union (All-Russian) plan of selling of the state ownership to the soviet citizens and foreigners. “Important feature of this method

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<sup>66</sup> Frydman R., Rapaczynski A., Earle J.S. The Privatization Process in Russia, Ukraine and the Baltic States. Central European University Press. 1993, p.25.

<sup>67</sup> Gazprom today - <http://www.gazprom.com/eng/articles/article8511.shtml>

<sup>68</sup> Fact Sheet - <http://www.nornik.ru/en/investor/fact/>

<sup>69</sup> Закон СССР от 26.05.1988 N8998-XI (ред. От 07.03.1991. с изм. от 15.04.1998) “О кооперации в СССР” - <http://www.lawbase.ru/content/view/7921/39/>

<sup>70</sup> Закон РФ от 03.07.1991, N 1531 – I “О приватизации государственных и муниципальных предприятий в Российской Федерации ” - <http://www.arendator.narod.ru/fed11.htm>

was obligatory market evaluation of costs of enterprises that were incorporated with the help of Western leading auditors' companies and banks. Yavlinskiy 's team elaborated full set of documents and regulations that were necessary for privatization and creation of market structures - exchanges, auctions, funds etc.”<sup>71</sup> But the government rejected this program; the reason of rejection was in its plan. It was 'sale privatization', but in that period of time it was impossible to carry out such privatization because of the people's insolvency.

So, the Chairman of the State Committee of the RSFSR of Management of State Property, M. Maley suggested 'national privatization'. He considered that privatization would cover 70 per cent of the main industrial and agricultural assets. According to his plan all population had to receive state ownership valued at 2200 billions of rubles free of charge. The main idea of this privatization mechanism was endowed Russians with special vouchers, whose purchasing power had to rise as the market-value of the privatized ownership would have to be defined. So, the 'Maley's privatization plan'<sup>72</sup> can be described in that way:

- Free distribution of the 70 per cent of the state ownership among 150 millions of Russians;
- Issue of vouchers for each Russian, in the value of 14.000 standard units;
- Carrying out incorporation of the privatized enterprises and sale of shares for vouchers to population;

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<sup>71</sup> Мунтян М.А., Подберезкин А.И Приватизация и Приватизаторы (теория и практика Российской приватизации). М., 2004.,с.25.

<sup>72</sup> Ibidem, с.27.

- Organization of market of shares and their selling for money on stock exchanges after the market evaluation of the privatized enterprises will be made.

Some opponents to the 'Maley's privatization plan' from the Supreme Soviet of the RSFSR (Filippov P.; Shumejko V. etc) at first, pressed for passing a law, that greatly diminished share of each Russian citizen, than backed measures for realizing combined privatization (selling of some part of state ownership by auction with paying for shares by ruble vouchers).

Then the third pre-privatization period came. It was connected with the name of Anatoliy Chubais, the period of preparation for privatization and period of the voucher privatization.

### **2.3 Mass creation of joint-stock companies via voucher privatization**

The mass privatization represents the method of transfer of state assets to population by means of allocation of shares of state enterprises. Usually, population receives shares free-of charge or for minimal payment; it is carried out by means of vouchers, coupons or privatization checks distribution. The mass privatization has the form of the 'joint-stock privatization'. Under the joint-stock privatization shares of a corporation are distributed and sold. Therefore, firstly the state enterprises must be incorporated i.e. must be reorganized into corporations that have rights to issue shares with well-defined property rights. Then, those shares can be changed for money or for privatization entitlements.

The mass privatization represents one of the methods of 'distribution of shares to the population'; shares of the privatized enterprises are distributed among numerous investors. Thus, enterprises have become public corporations, registered on the stock exchange and having supposedly easily liquid exchangeable securities.

One or another variety of the mass privatization programs were implemented in the eighteen country-members of the former COMECON: Albania, Armenia, Belarus, Bulgaria, Croatia, the Czech Republic, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Lithuania, Latvia, Moldavia, Poland, Russia, Slovakia, Slovenia and Ukraine.

The mass privatization program in all countries varies in its scale and extent of controllability. Thus in Russia privatization seemed to be a far-reaching program, it covered one third of the main state assets; it covered 80 per cent of Russian enterprises and all Russian citizens. In contrast to Russian model, Polish privatization model was scanty and covered only 11 per cent of the main state assets and 69 per cent of Polish population took part in its realization. The Czech model can be placed between these two models: it covered 25 per cent of state assets and 56 per cent of population participated in it.<sup>73</sup>

Turning back to the programs of the mass privatization, the type of property that is determined for sale or distribution can be different. In that case we can distinguish three types of property:

- Limited to house and grounds and farms;
- Limited to some enterprises group;

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<sup>73</sup> Ермакович В. Модели Массовой Приватизации - [www.case.com.pl/upload/publikacja\\_plik/9042334\\_104r.pdf](http://www.case.com.pl/upload/publikacja_plik/9042334_104r.pdf)  
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- Limited to some part of shares practically of all enterprises.<sup>74</sup>

According to the third variant all or practically all small and large state enterprises were included into mass privatization program. Only certain part of shares of those enterprises was to be exchanged for privatization entitlements (vouchers, coupons). The best example of realization of the third variant is the Russian Federation. “The Russian privatization program covered 13 thousands enterprises or from 70 to 80 per cent of the total number of the Russian enterprises. The main assets value was unknown inasmuch as the government didn’t do any evaluation of assets.”<sup>75</sup>

It is one of the supposed advantages of voucher privatization as the market evaluation of state-owned enterprises is very different or almost impossible to estimate.

“The formal privatization process began in 1992 and was supposed to be a ‘big bang’ via the voucher approach.”<sup>76</sup> The mass creation of joint-stock companies and voucher privatization was put into practice from 1992 till June 30 1994. The goal was transformation of the state-owned enterprises into joint-stock companies and initial allocation of shares between labor collective and the state. Simultaneously small-sized enterprises were being sold.

In short terms legislation for privatization was created. Laws on forms of privatization, its methods, and variants of benefits for all categories of shareholders, collective or individual owners were created.

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<sup>74</sup> Ермакович В. Модели Массовой Приватизации - [www.case.com.pl/upload/publikacja\\_plik/9042334\\_104r.pdf](http://www.case.com.pl/upload/publikacja_plik/9042334_104r.pdf)

<sup>75</sup> Красникова Е.В. Экономика переходного периода. М., 2006, с. 173.

<sup>76</sup> Gross D., Steinherr A. Economic Transition in Central and Eastern Europe. Planting the Seeds. Cambridge. 2001. p.237.

The analysis of the legal framework, according to which the privatization of 1991-2001 was carried out, is very important for the following evaluation of the privatization results.

General corpus of documents that contains legal framework for carrying out the privatization of the state ownership exceeds 3 thousands statements. The most import of them are tree federal laws: the RSFSR “Law on Privatization of State and Municipal Enterprises in the Russian Federation” of July 3, 1991 №1531-I; Federal “Law on Privatization of State and Municipal Ownership in the Russian Federation” July 21, 1997 №123-ФЗ; federal “Law on Privatization of State and Municipal Ownership” 21 December, 2001 №178-ФЗ; and also the State Program for Privatization, confirmed by the decree of the President of the Russian Federation 24 December, 1993 №2284.

The “Law on Privatization of State and Municipal Enterprises in the Russian Federation”<sup>77</sup> (‘State Program’) was passed in July 1991, but was extensively amended on June 5, 1992. This law can be seen as the starting point of the privatization process in the Russian Federation. This law defined competence of state agencies that were in charge of carrying out privatization of state and municipal enterprises, defined benefits for workers. The law provided 5 methods of state ownership privatization:

1. sale of enterprises according contests;
2. auction sale;
3. sale of shares;
4. redemption of leased ownership;

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<sup>77</sup> The “Law on Privatization of State and Municipal Enterprises in the Russian Federation” was replaced by new “Law on Privatization of State and Municipal ownership in the Russian Federation” that came into force on August 2, 1997. Закон РСФСР от 3 июля 1991 г. № 1531-I “О приватизации государственных и муниципальных предприятий в Российской Федерации”. М., 1996.

5. reorganization of enterprises into join-stock companies.<sup>78</sup>

The analysts from the Accounts Chamber are of the opinion that in practice privatization in Russia started with the coming into force of the Decree of the President of the RF (29 December, 1991, № 341) on acceleration of the privatization of the State and Municipal Enterprises that approved the Guidelines of the State Program of Privatization for 1992.

The 1991 'Privatization Law' set up special agencies that were in charge of carrying out privatization in Russia. So, the State Committee for the Management of State Property, or 'Goskomimushchestvo RF' (GKI) and the Russian Federal Property Fund were created. For privatization of each enterprise special commissions whose membership was formed by the funds representatives on local and regional levels were created; such commissions acted as sellers of the state ownership.

State Program of Privatization of 1992 considered to be a fundamental document for the following mass privatization of 1992-1994, and simultaneously it was a compromise from one hand between paid (for active part of population) and free-of charge (vouchers for all population and benefits for labour collectives) privatization, and from another hand between the model of privatization for all and distribution of shares among workers. But, from my point of view such a compromise involved some evident weak points of the induced model:

- Neglect of restructuring (attraction of investments);

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<sup>78</sup> Закон РСФСР от 3 июля 1991 г. № 1531-1 "О приватизации государственных и муниципальных предприятий в Российской Федерации". М., 1996

- Problems of social infrastructure of enterprises;
- Neglect of demonopolization together with the problem of preservation of technological chains;
- Absence of investments.

Thus, the state government applied following privatization methods:

- Selling of shares of joint-stock companies created during the privatization;
- Selling of non joint-stock enterprises by auction;
- Selling of non joint-stock enterprises by commercial tenders;
- Selling of joint-stocks' shareholdings by investment tenders;
- Selling of property of acting enterprises, companies to be dissolved and liquidated enterprises as well as selling of 'under construction' firms by auctions and competitive tenders ;
- Redemption of leased ownership; selling of enterprises to associations, established in accordance with additional benefits;
- Selling of shares (share fraction) owned by state and municipality by auction, commercial contest including the limited participation.

Consequently, the State Program of Privatization (1992) contained concrete mechanism of privatization of state and municipal enterprises and granted benefits to work collectives during the process of privatization.

The State Program divides all enterprises, according to their eligibility for privatization, into the following categories:

- Facilities and enterprises which are prohibited from being privatized in 1992. (The Pension Fund of the Russian Federation, radio and television

centers, and enterprises involved in monitoring and protecting the environment, pipelines, ports, gold and diamond reserves, most of the nuclear industry, special hospitals and sanatoria, objects of historical and cultural heritage etc).

- Facilities and enterprises which can be privatized only by decision of the Russian government ( armament industry, part of the atomic industry, the energy sector, enterprises processing metals, commercial banks, etc).
- Facilities and enterprises which can be privatized only by the decision of the State Property Committee, taking into consideration the consultation with the branch ministers. These include enterprises with more than 10.000 employees, or fixed assets with a book value (as of January 1992) of more than Rb 150 mln, surplus military property, rail, air, and the sea transport enterprises, large construction enterprises, animal breeding farms, educational and research institutions, liquor and tobacco production, petroleum products, medical and pharmacy industry, etc.
- Facilities and enterprises which may be privatized only in keeping with local privatization programs. These include municipal and public enterprises. Decisions concerning these enterprises are to be made by local state property committees. Local governmental bodies cannot introduce additional restrictions.
- Facilities and enterprises to mandatory privatization. These include wholesale and retail trade establishment, restaurants, construction, agricultural enterprises other than state farms, the food production, and processing industry, light industry, all enterprises operating at a loss,

uncompleted facilities, motor transport enterprises, and the property of liquidated enterprises.<sup>79</sup>

The size of enterprise determined the choice of the method of privatization. According to this characteristic, all enterprises were divided into three categories, and each of the categories had its own privatization conditions. Number of workers and the book value of fixed capital served as a criterion for selection of the method of privatization.

*Small enterprises* - with up to 200 employees, and book value of fixed capital of less than 1 million roubles (as of January 1, 1992). "Privatization of small enterprises is to precede without prior corporatization, by means of an auction, tender, privatization placement, or liquidation followed by a sale of assets."<sup>80</sup> These enterprises also could be redeemed by the 'insiders', in other words, by those, who worked in these enterprises. This method also could be used by collectives of enterprises that signed lease contracts with the right of subsequent redemption of enterprise's ownership, with the state.

*Large enterprises* - with more than 1000 employees, or book value of fixed capital over 50 million roubles. Privatization of medium (with more than 200 employees, but less than 1000 employees; book value of fixed capital more than 1 million roubles, but less than 50 million roubles) and large enterprises was carried out into two stages. At first, medium and large enterprises were all to be converted into joint-stock companies. Then, shares had to be issued and sold or distributed among the members of the labor collective, leadership of an enterprise, and outside natural and legal persons, in proportion defined by a collective. Some part of shares could be owned by the state or municipality.

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<sup>79</sup> Frydman R., Rapaczynski A., Earle J.S. The Privatization Process in Russia, Ukraine and the Baltic States. Central European University Press. 1993,p.48.

<sup>80</sup> Ibidem, p.50.

List of industries where the state monopolies had to be created was set by the Presidential Decree “On Measures of Realization Industrial Policy under the Privatization of the State Enterprises”<sup>81</sup>. This decree set that in case of state-owned joint-stock enterprises would be privatized without ‘fastening’ the control packet of shares to the federal ownership, the Russian government and GKI could use the ‘golden share’ for preserving the control over the following enterprises. The ‘golden share’ is a share of the government that gives the veto right during the decision-making process of the stockholder’s meeting.

Article 9 of the Privatization Law prohibits the sale of shares of privatized enterprises to any juridical person of which more than 25 per cent was owned by any state body. The purpose of this provision, in addition to ensuring that privatization is not merely spurious, was to end the practice, common under the laws of the Soviet Union, in which some enterprises or their parts were acquired by other state enterprises. This practice created a network of cross-holding that further obfuscated the ownership and control situation, and gave managerial insiders firmer control over a portion of the state sector<sup>82</sup>.

I would like to dwell on the fact that already in 1992-1993 the shifting from the state as formal owner towards insiders was obvious. Based upon the Privatization Law and its article 5.4 we can speak about three variants of benefits that were granted to enterprise labor collectives benefits (a choice among three variants of preferential terms):

- *Variant I*, allows workers to receive, without payment, 25 per cent of the shares of their enterprises (but with a value of no more than twenty times

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<sup>81</sup> Указ Президента РФ от 16 ноября 1992 г. № 1392 “О мерах по реализации промышленной политики при приватизации государственных предприятий” - <http://www.informika.ru/text/goscom/normdoc/r02/02549.html>

<sup>82</sup> Frydman R., Rapaczynski A., Earle J.S. The Privatization Process in Russia, Ukraine and the Baltic States. Central European University Press. 1993, p. 55-57.

the minimum wage per worker) in the form of preferential, nonvoting stock, and to purchase an additional 10 per cent of the shares (with full voting rights, but with the value amounting to no more than six times the minimum wage per worker) at 30 per cent discount off the nominal price.

In addition to these insider benefits, the high administrative officials of the enterprises (the manager, his deputy, the head engineer, and the head bookkeeper) were also granted an option to purchase a total of up to 5 per cent of the shares at the nominal price (but not more than 2.000 times the minimum wage per person). The procedure for distributing free shares had to be determined by the general meeting of the collective.

- *Variant II* does not grant any discounts, but allows the employees to purchase up to 51 per cent of the shares at the nominal price, with no additional restrictions.
- *Variant III*, available only to enterprises with more than 200 employees and fixed assets between Rb 1 mln and 50 mln, combines discounts to all workers with special privileges for a smaller group of insiders who gain the approval of the whole collective and undertake special responsibilities for the future of the enterprise. The special group enters into an one-year, non-renewable agreement stipulating the commitments and liabilities of its members , with the members obliged to put a collateral equal to no less than 200 times the minimum wage. In exchange, the group immediately receives the voting rights to 20 per cent of the shares from the appropriate property fund. If it adheres to the terms of this agreement, the group can purchase these shares at their nominal price (without any further restrictions) on the expiration of the one-year period. When this variant is

chosen, and all the workers can also purchase up to 20 per cent of the shares at a discount of 30 per cent from the nominal price ( but the purchasing price cannot exceed twenty times the minimum wage per person).<sup>83</sup>

In order to choose Variant II or III, the work collective of the enterprise had to vote for it with at least a two-third majority; in all other cases the Variant I would be chosen.

In addition, the State Program provided that 10 per cent of the proceeds from the sale of shares to outside investors were entered in employees' personal privatization accounts.

According to the privatization Law, assets that were not subject to the corporatization and all assets of liquidated enterprises were to be sold through competitive tenders or auctions. "All auctions and competitive tenders were organized by appropriate (federal or local) property funds, but the initial prices, whether the auction or tender is to be used, are determined on the basis of the enterprises privatization plan approved by the State Property Committee or an appropriate local property committee."

<sup>84</sup> In spite of the fact that the sale price could not fall more than 30 per cent below the initial price determined on the basis of the book value of the enterprise, the sale prices were very low, or even 'symbolic'.

Shares of the state ownership that were sold by auctions could be sold both to natural and legal persons suggested the highest price. And at the same time, 30 per cent of

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<sup>83</sup> Frydman R., Rapaczynski A., Earle J.S. The Privatization Process in Russia, Ukraine and the Baltic States. Central European University Press. 1993,p.57.

<sup>84</sup> Ibidem, p.60.

the sale price was transferred to an account of employees who were fired from the enterprises after the January, 1 1992 and were registered as unemployed.

As the situation with auctions is relatively clear, the situation with competitive tenders may be of further interest. The competitive tenders were put into practice in the way of advertised and closed biddings. These tenders were organized in case where a potential buyer had to comply with certain conditions:

- Preservation of the enterprise profile and destination ( the enterprise had to continue for certain period of time to produce specific goods);
- No staff reduction could be made;
- Necessity to maintain a certain level of investments;
- Financing of social programs.<sup>85</sup>

When the noncommercial tenders (investment auctions) were used the winner of such tenders was a person who submitted the most satisfactory investment program.

In order to increase efficiency of Russian enterprises the government passed the enterprises' management into the hands of insiders, so the large former state-owned companies were accumulated in hands of labor collectives and top managers.

As it was aforesaid, the main pillar of the mass privatization in Russia was voucher approach. However, the voucher mechanism and the nearly free transfer of shares to employees were the most salient aspect of the program, largely because the reformers believed that the use of free mass transfers of property would be more socially acceptable and politically popular than more standard privatization methods that rely upon the sale of property. The Russian reformers emulated the voucher method

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<sup>85</sup> Красникова Е.В. Экономика переходного периода. М., 2006, с. 182.  
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implemented in the Czech Republic, but added extensive worker benefits in order to mobilize as much popular support as possible.<sup>86</sup>

The voucher privatization was carried out in accordance with the Presidential Decree (№ 914) On Introduction of a System of Privatization Vouchers in the Russian Federation (August 14, 1992)<sup>87</sup>

Voucher is the state entitlement of a right of ownership to a share in the free-of-charge distributed state ownership. It was used as means of payment, had end use and had limited period of sale. The period of validity was till June 30, 1994.

The nominal value of the privatization check was set with taking the value of the objects to be privatized in 1993 and population of the Russian Federation into account. The low nominal value of the voucher was due to the fact that property determined to be privatized, was valued on the basis of its book cost as of January 1, 1992, that is without taking revaluation of the property into consideration (the revaluation of the property was carried out as of July, 1 1992<sup>88</sup>) because of rise in prices.

For carrying out the privatization the government issued 148 millions of vouchers<sup>89</sup>. Touching upon the subject, who can participate in the voucher privatization, we can distinguish several groups of participants. Each country chooses which strata of society can participate in the program: all citizens or adults over 18 years old, or some certain social groups as pensioners or those who were employed in the state sector. The participation of only adults was chosen by Poland, the Czech Republic, Slovakia ,

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<sup>86</sup> Appel H. "Voucher Privatisation in Russia: Structural Consequences and Mass Response in the Second Period of Reform" Europe-Asia Studies, Vol. 49, No. 8. (Dec., 1997), p. 1433

<sup>87</sup> Указ Президента РФ от 14 августа 1992 г. N 914 «О введении в действие системы приватизационных чеков в Российской Федерации» - <http://www.informika.ru/text/goscom/normdoc/r02/02507.html>

<sup>88</sup> Красникова Е.В. Экономика переходного периода. М., 2006, с. 181.

<sup>89</sup> Гретченко А. И. Российская приватизация на переломе: нерешенные проблемы транзакционных издержек и управленческих затрат - [www.library.dgtu.donetsk.ua/fem/vip70/70\\_19.pdf](http://www.library.dgtu.donetsk.ua/fem/vip70/70_19.pdf)

Kazakhstan and in many other countries; variant of participation of only certain social groups was chosen by Albania, Croatia and Hungary . The Russian Federation has chosen the variant of involving all Russian citizens. Thus, every citizen received a voucher in the value of 25 roubles. The voucher had the nominal value of 10.000 roubles. Once citizens received their vouchers, they had several ways how to act:

1. To purchase shares of any corporatized state enterprise on the same terms as if the payment were in cash;
2. To purchase state assets at auctions ;
3. To exchange them for shares of special investment funds created in connection with the voucher privatization;
4. To sell them for cash <sup>90</sup>

It would not be an exaggeration to say, that in fact citizens were badly informed about the vouchers and how that mechanism had to function. Speaking about the possibility to sell vouchers for cash, there was not any special market created. It was rather 'black' than official market, where citizens could buy and sell vouchers. As concerns the voucher auctions, it took place on the local level and local authorities were permitted to exclude from the auction's participation undesirable outsiders. That is why, mostly, the Russian citizens preferred to entrust their vouchers to the special private investment funds which had to collect vouchers from the population in exchange for their own shares. The investment funds in their turn had to use these vouchers to purchase shares or assets of privatized enterprises. In theory, investment funds had to fulfill two important functions. "First, the investment funds allow an average investor to diversify

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<sup>90</sup> Приложение к указу Президента РФ от 14 августа 1992 г. N 914 «О введенни в действне системы приватизационных чеков в Российской Федерации» . Приложение о приватизационных чеках - <http://www.informika.ru/text/goscom/normdoc/r02/02507.html>

his modest assets and rely on the expertise of the funds to determine the best method of investment. Second, they can lead to a concentration of holdings which may be used to exert influence on the management of the privatized enterprise.”<sup>91</sup>

The Russian investment funds were private institutions, governed by special set of regulations. In order to avoid financial abuse, investment fund were subjected to a legal limit of no more than 10 per cent in any one firm being privatized. The main conception underlay the creation of such funds was profit earnings. So, a citizen put up vouchers in a fund, the fund took up shares of some enterprises, enterprises had to start working and it was expected that the citizen would get a profit out of activity of enterprises. But very often the Russian citizens were cheated. (Appendix 1)

As these funds were non governmental structures and the state encouraged its creation, a lot of artificial funds were created. As often was the case, the enterprises, whose shares were bought by funds, were declared bankrupt and the property rights devolved to another owner, thus the citizens didn't get any profit.

“The quantitative result of the mass privatization has already become evident by the end of June, 1994: more than 15.000 medium and large enterprises were privatized. By the end of January, 1993, 98 per cent of all vouchers were used. More than 40 millions of Russian became shareholders. Thus, by the end of the voucher stage, 40 per cent of all state-owned enterprises were privatized.”<sup>92</sup>

### **Table 1. Ownership classification of industrial enterprises in 1994:**

#### **Goskomstat data**

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<sup>91</sup> Frydman R., Rapaczynski A., Earle J.S. The Privatization Process in Russia, Ukraine and the Baltic States. Central European University Press. 1993, p.70-71.

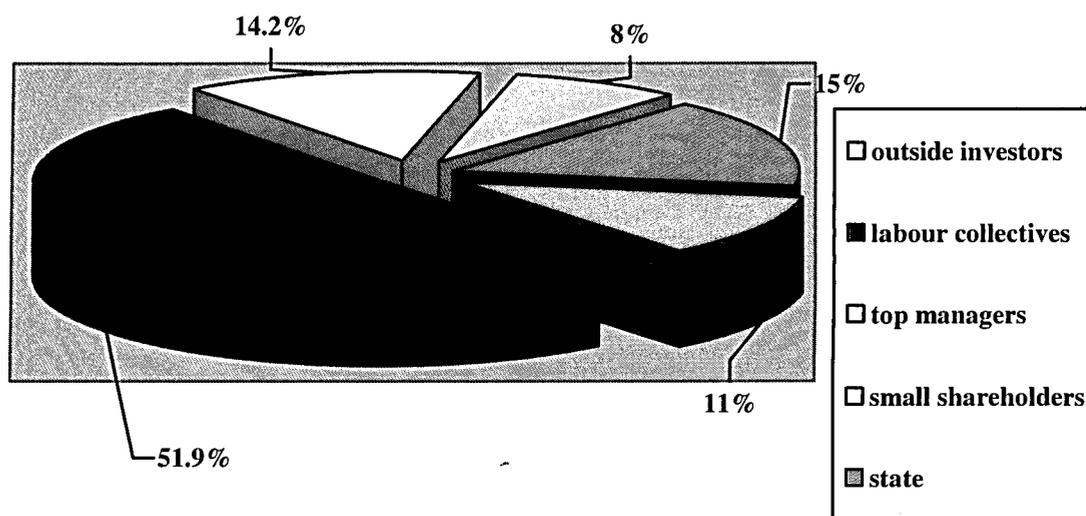
<sup>92</sup> Гретченко А. И. Российская приватизация на переломе: нерешенные проблемы транзакционных издержек и управленческих затрат - [www.library.dgtu.donetsk.ua/fem/vip70/70\\_19.pdf](http://www.library.dgtu.donetsk.ua/fem/vip70/70_19.pdf)

Per cent	Goskomstat classification					
	'State'	'Municipal'	'Public institutions'	'Private'	'Mixed without Foreigners'	'Mixed with Foreigners'
Total number of enterprises	5.3	2.7	0.8	72.6	16.3	2.3
Total number of production workers	16.0	1.4	0.7	25.0	55.3	1.6
Total volume of output	9.4	1.0	0.2	18.8	69.6	3.0

Roughly, one-quarter of old firms remained 100 per cent state-owned in 1994, while about three-quarters have been privatized, at least partially.<sup>93</sup>

As a result of voucher privatization, large state enterprises of Russian economy were collected in the hands of labor collectives and top managers. At the beginning of 1994 the share holdings of the privatized enterprises were distributed in the following way:

<sup>93</sup> John S.E., Estrin S. Russia's Post-Communist Economy. Privatization and the Structure of Enterprise Ownership. Oxford. University Press. 2001, p.180.



- 51.9 % - labour collective;
- 14.2 % - top managers;
- 15 % - state;
- 11 % - outside investors;
- 8 % - small shareholders.<sup>94</sup>

To sum up the results of mass voucher privatization, we can insist that the ‘insider’ model of incorporation prevailed. I would like to emphasize that this model turned out to be inefficient. The preferred insiders’ access to the purchase of shares reduced the outsiders’ investment incentives. Inasmuch as insiders didn’t dispose of its own investment potential; it led to a braking of any structural alterations, that is to say led to block of the industrial restructuring. The situation was aggravated by cutting off the government financing and credits inaccessibility under the hyperinflation.

<sup>94</sup> Красникова Е.В. Экономика переходного периода. М., 2006, с. 182.  
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Neither the government nor the population received any material benefits. The voucher method left out the possibility to collect revenue to the state budget, and didn't provide any particular benefits for the government. "In 1993, the voucher share in payment of the privatized enterprises was 54 per cent, while the real money made up only 46 per cent of the purchase payments. The total gain from the privatization in 1993 was 0.5 per cent from the annual volume of GDP"<sup>95</sup>.

In practice, the mass privatization program presumes non-equivalent distribution of shares among the population. Such situation arose because under the privatization the Russian legislation didn't grant to all levels of the population equal rights and opportunities. The labor collectives of the enterprises were given wide benefits in purchasing shares, at the same time other Russian citizens those, who were not directly related to the production (public service, science, education, social service and public administration etc) were actually excluded from the privatization.

Under these circumstances the following share's repartition in favour of outsiders was inevitable.

#### **2.4 'Monetary' <sup>96</sup> (denezhnaia) privatization**

Since July 1, 1994 we can speak about the new stage of privatization. It was based on the transfer from mainly free- of charge surrender of the state property to its selling according to market prices. The dominant position of this program was orientated on the

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<sup>95</sup> Виноградов В.В. Экономика России. М., 2002, с.128.

<sup>96</sup> The title 'monetary' privatization has sense if you use it in Russian language as 'denezhnaia' privatization. This type of privatization means standard scheme of distribution assets in exchange for money, or in Russian language for 'dengi'.

investment organization of sales and provided investors with an opportunity to buy controlling packet of shares of the privatized enterprises.

The Presidential Decree “On the Main Regulations of the State Privatization Program of the State and Municipal Enterprises in the Russian Federation after July1, 1994”<sup>97</sup> set a new stage of privatization. This program made provision for sale of remaining assets in the state ownership by auction only for money (not for vouchers as during the previous stage).

The ‘monetary’ privatization started from July, 1 1994; it was aimed at:

- Further privatization of the state ownership;
- Attraction of investors;
- Restructuring the macroeconomic structures;
- Increase of income of the federal budget due to the proceeds from privatization.

Officially, the implementation of the new Privatization Program related to the exigency to solve two main problems: to get additional financial resources to the federal budget and to attract investors for enterprises restructuring. The pillar of investors’ attraction was a kind of attempt at least to compensate losses of the nonstandard methods of privatization.

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<sup>97</sup> Указ Президента Российской Федерации от 22 июля 1994 г. № 1535 “Об основных положениях Государственной программы приватизации государственных и муниципальных предприятий в Российской Федерации после 1 июля 1994 года” - [http://www.frem.ru/user\\_files/6223.doc](http://www.frem.ru/user_files/6223.doc)

In practice, the purpose of increasing income of the federal budget became the main issue of this stage. That led to ambiguous decisions as carrying out the scheme 'loans for shares' and loan auctions in 1995-1996.

The voucher auctions continued till the end of 1994. "By the end of voucher auctions, the everyday volume of auctions on the Russia's commodity exchange in Moscow ran up to 10 million dollars."<sup>98</sup> Thus, the government supposed that it would stimulate the establishment of a group of the 'key shareholders', having at the least blocking share holdings (5 per cent). It was expected from the outsiders, who had blocking share holdings to exercise control, which would restrain the managers' power. Thereby, the authors of the privatization program supposed that the market mechanisms would weaken the insiders' control. They believed that the Coase Theorem <sup>99</sup>would function. But, from my point of view, it was useless to wait for functioning of the nascent stock market with zero transaction costs. It was expected that the accumulated by the private investment funds' shares would lighten the process of the redistribution of the ownership in favour of outsiders.

Actually, the redistribution of the property rights began after July 1994, with the series of secondary transactions with securities, but these transactions were accompanied by discrimination against outsiders (forced to shoulder the increasing transaction costs) from managers. Often, managers threatened with loss of jobs workers who decided to sell

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<sup>98</sup> Гретченко А. И. Российская приватизация на переломе: нерешенные проблемы транзакционных издержек и управленческих затрат - [www.library.dgtu.donetsk.ua/fem/vip70/70\\_19.pdf](http://www.library.dgtu.donetsk.ua/fem/vip70/70_19.pdf)

<sup>99</sup> Coase Theorem: If there are zero transaction costs, the efficient outcome will occur regardless of legal entitlement. The theorem states that when trade in an externality is possible and there are no transaction costs, bargaining will lead to an efficient outcome regardless of the initial allocation of property rights. – Coase R. The problem of Social Cost - <http://www.sfu.ca/~allen/CoaseJLE1960.pdf>

their shares to outsiders. Managers repurchased securities of workers at low prices in exchange for promise that their job will be guaranteed. The ex-directors of the enterprises turned into businessmen, accumulated controlling packets of shares. From 1994-1996, the share of top managers in the common property increased 2 times.

We can come to conclusion that the initial stage of the ‘monetary’ privatization didn’t bring quick and transparent redistribution of property. By means of formal and informal restrictions (including illegal) for workers on sale of shares to outsiders, managers succeeded in keeping control over the privatized enterprises. Only partly we can speak about the success of the ‘monetary’ privatization: from one hand, the assets sale is always more efficient than their free-of charge distribution, but on the other hand, the results of the ‘monetary’ privatization stepped back in comparison with the replaced scheme ‘loans for shares’.

Before I will start describing the scheme loans for shares, I would like to dwell on the data showing how the structure of the ownership changed.

**Table 1. Ownership structure in privatized, all old, and *de novo* firms**<sup>100</sup>

Shareholding	Privatized firms (unweighted)	Privatized firms (weighted)	All old firms (unweighted)	All old firms (weighted)	<i>De novo</i> firms (unweighted)	<i>De novo</i> firms (weighted)
Total state	15.0	25.0	38.0	41.9	1.4	0.5
Total private	85.0	75.0	62.0	58.1	98.6	99.5
All insiders	66.1	54.2	48.2	42.0	71.4	62.4
Workers	46.2	39.9	33.5	30.6	6.5	4.0
Managers	19.6	14.3	14.3	11.0	63.6	57.2
All outsiders	18.9	20.8	13.8	16.1	27.1	37.1
Banks	1.0	0.7	0.7	0.5	0.0	0.0
Investment	4.5	8.6	3.3	6.6	0.0	0.0

<sup>100</sup> Granville B., Oppenheimer P. Russia’s Post-Communist Economy. Privatization and the Structure of Enterprise Ownership by Earle J.S., Estrin S. Oxford. 2001, p. 183.

funds						
Other domestic firms	6.7	4.5	4.8	3.4	7.6	2.0
Foreigners	0.4	0.7	0.3	0.5	0.0	0.0
Individuals	5.9	6.2	4.3	4.8	16.2	30.7
Valid N	235	235	319	319	24	24

Note: the category 'All old firms' includes enterprises that were particularly or fully privatized and enterprises that had not begun privatization and were still held by state. 1994 employment were used to weight firms in the columns labeled 'weighted'.

John S. Earle and Saul Estren analysed figures in this table. In companies which had participated in some form of privatization, we find that, on average, insiders had 66.1 per cent of all shares, distributed between workers (non managerial employees) with 46.2 per cent and managers 19.6. Outsiders held 18.9 per cent and the remaining 15 per cent of shares were still held by the state. The nearly two-third concentration of shares in the hands of insiders provides strong confirmation of the view that employees, especially non-managerial workers, have been the biggest beneficiaries of Russian privatization policies. However, as our survey reveals, outsider's shareholdings are not negligible and they are distributed across companies unevenly enough to give outsiders dominant ownership in a substantial number of companies. The most important outsider owners are investment funds, other domestic firms and individuals. The latter group is quit dispersed, since individuals acquired their stakes mostly by bidding for their vouchers singly in public auctions. The shareholdings of banks and foreigners are tiny.<sup>101</sup>

The increase in outsiders' shareholdings was obvious, as the beginning of 1994 outsider's shareholding was 11 per cent and already in the end of 1994 it was 18.9 per

<sup>101</sup> Granville B., Oppenheimer P. Russia's Post-Communist Economy. Privatization and the Structure of Enterprise Ownership by Earle J.S., Estrin S. Oxford, 2001, p. 182.

cent. Also the fact that top managers began to concentrate in their hands controlling packets of shares proved to be true: in the beginning of 1994 top managers held only 14.2 per cent and in the end of 1994 increased their share up to 19.6 per cent.

Let's turn now to the scheme 'loans for shares'. In August 1995, the head of the 'Oneksimbank', O. Potanin suggested the scheme well known as 'loans for shares'. The Russian government agreed to use share holdings as loans for credits. During 1995-1996, 12 loans auctions, representing combination of investment tender and auction, were carried out. The carrying out of such auctions was forced and was due to difficult financial position of the government, burdened with debts (at that time the debt was more than 70 per cent of the annual GDP). "The fact of the loan auctions was in, that Russian government obtained credits against their share holding for the period of 3 years under the minimum interest rate in 6 per cent per annum."<sup>102</sup> Creditors in their turn assumed obligations to pay off enterprises' debts in the budget and on wages. When the time of loan was up the government had to either repay or display shares for sale. Thus, shares of the 29 enterprises were put up for closed auctions for banks. And at the same time the future repayment was considered as improbable. That would allow banks to become shareholders. If the government hadn't repaid, banks would have a possibility to sell the shares that they had for loans. In fact, none of the credits was repaid. "So, 12 auctions returned to the state budget 5.1 billion roubles, including 1.5 billion roubles of liquidated debts of enterprises to the government. Among the winners the two Russian banks 'Oneksimbank' and the 'Menatep' bank prevailed."<sup>103</sup>

The implementation of this scheme faced some legal problems: the commencement of legal actions and limitation of foreigners' participation. In fact, such

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<sup>102</sup> Красникова Е.В. Экономика переходного периода. М., 2006, с. 183.

<sup>103</sup> Ibidem, с. 183.

auctions represented either 'self-redemption' of enterprise's stocks or noncompetitive sale of shares. At the same time a number of court examinations were carried out but no infringements were found. Thus, we can note that it was due to imperfection of the legislation. It is obvious, that particularly all powerbrokers held an interest in getting the given share holdings under their control. The most generally-used method was quasi-public sale of the pledged share holdings and their purchasing through affiliated persons. Banks which were acting as auctions' organizers confined the circle of participants and created favorable conditions for their applications' victory. "Thus, the Bank 'Imperial' took control over LUKOIL, the 'Onexsimbank' took control over Norilsk Nickel and etc." <sup>104</sup>

Thus, the government didn't repay obtained credits and assets passed into the hands of oligarchs. The intimacy to the Russian authorities was the determining factor of the oligarchs' victory. Two factors had a decisive importance. First of all, the privatized enterprises were large and their purchasing needed vast sums of money; secondly, the government acted as the seller of the state property and those officials who were involved in this process did not fail to take advantage of the opportunity to suit their own ends.

The so-called oligarchs not only pursued the efficient functioning of the acquired enterprises, but also paid off their arrears of wages and tax debts.

Starting from the 1997 we can speak about the improvement of legal provisions of state property disposal. Already starting from the mid 1990-s the question about the enactment of a new privatization law and also the creation of an external control mechanism over the process of privatization was put. The State Duma of the Russian Federation created the Committee of the Privatization Results' Analysis of 1992-1996.

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<sup>104</sup> Гретченко А. И. Российская приватизация на переломе: нерешенные проблемы транзакционных издержек и управленческих затрат - [www.library.dgtu.donetsk.ua/fem/vip70/70\\_19.pdf](http://www.library.dgtu.donetsk.ua/fem/vip70/70_19.pdf)  
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One of the elements of the control system creation was an adaptation of the Federal Law “On Accounts Chamber”<sup>105</sup> in 1995. This constitutional authority was given a right to assess legality, efficiency and expediency of actions of the executive power in the sphere of the ownership disposal.

In 1997 the principals of the privatization were subjected to some corrections. In July 21, 1997 the new “Privatization Law”<sup>106</sup> was enacted. This law that had to solve deficiencies of the privatization legislation came with new methods of privatization of the state and municipal ownership, changed the way of carrying out tenders. The investment tenders were cancelled and transfer of the property rights of sold by the commercial tenders ownership has become possible only after a winner would meet investment and/or social conditions (regarding to an object of privatization).

The new privatization ideas were aimed at:

- Break with the idea of privatization as the method of the increase of the budget income;
- The passage to the model of the ‘case-by-case’ privatization;
- Evolution of the privatization process of real estate, including land occupied by the privatized enterprises. It was very important for investments attraction, industry diversification and increase of efficiency.

Analyzing the Privatization Program of 1997, we can dwell on the main goals of the privatization of that period:

- Attraction of investments;

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<sup>105</sup> Федеральный закон от 11 января 1995 года №4-ФЗ “О Счетной палате Российской Федерации” - <http://www.ach.gov.ru/zakon/fedzakon/zakon.php>

<sup>106</sup> Федеральный закон от 21 июля 1997 года №123-ФЗ “О приватизации государственного имущества и об основах приватизации муниципального имущества в Российской Федерации” - <http://www.akdi.ru/gd/proekt/055222GD.SHTM>

- Downsizing of the budget expenditures;
- Creation of conditions for the development of housing market;
- Protection of owners and shareholders' rights;
- Social support of population.

For realization of the aforesaid, it was intended to go away from the rates and high number of privatized enterprises towards transparency and quality of a small number of open and competitive transactions with property rights.

The Asian crisis of 1997, coinciding with a period of depressed oil prices took priority of the financial crisis of 1998, when national currency lost 75 per cent <sup>107</sup> of its value. Consequently, financial crisis put an end to the stage of the 'monetary' privatization.

During the 'monetary' privatization the results of the first stage of the privatization underwent profound changes. "In this way, the insiders' shareholdings decreased from 66.1 per cent to 20 per cent approximately." <sup>108</sup> The outsiders, who raised their capital during the 1990-s, not only pressed the insiders, but also were the main characteristic feature of the stage of the 'monetary' privatization.

The period from 1999 till 2000 was a period of interval in the process of privatization. In September 1997 the Russian Government passed new program document of the new privatization period "The Conception of Management of State and Municipal Ownership and Privatization in the Russian Federation"<sup>109</sup>. In this Conception it was stated that "in spite of the 58.9 per cent of enterprises being privatized; number of

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<sup>107</sup> Виноградов В.В. Экономика России. М., 2002, с.120.

<sup>108</sup> Красникова Е.В. Экономика переходного периода. М., 2006, с. 184.

<sup>109</sup> Постановление от 9 сентября 1999 г. N 1024 о "Концепции управления государственным имуществом и приватизации в Российской Федерации" - <http://www-old.rosim.ru/base/dir/pp/pp1024.txt>

problems was not solved”<sup>110</sup>. Such as, the wide strata of efficient private owners were not created; investments attracted during the privatization were insufficient for industrial, technological and social development of enterprises, etc. In fact, the governmental Conception of 1999 formulated requirements against the new privatization legislation under which the new Federal Law “On Privatization of the State and Municipal Ownership”<sup>111</sup> was enacted in 2001. Since 2001, the large-scale privatization was recommenced. The new Privatization Law has set the rules of development of the privatization program of the Federal ownership. As a whole, during 2002-2003 the detailed mechanisms and realization procedures of carrying out the privatization were developed. In 2003 for the first time, the Russian government ratified Prediction plan (program) of privatization of federal and municipal ownership for 2004, and the main guidelines of the privatization of the federal ownership till 2006.

Analyzing the results of the Russian privatization, Russian economist A. Gretchenko is of opinion, that “Russia used such methods of privatization that needed specific institutional conditions, that, in fact were absent, and consequently, the transactional costs and inefficiency of the privatized firms were high. The main fault of privatization was that the privatization started well before the basic legislation, necessary for the proper functioning of the market economy, was passed.”<sup>112</sup> Today, the analysts from the Accounts Chamber declared, “that from the formal-legal point of view, by now,

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<sup>110</sup> Постановление от 9 сентября 1999 г. N 1024 о “Концепции управления государственным имуществом и приватизации в Российской Федерации” - <http://www-old.rosim.ru/base/dir/pp/pp1024.txt>

<sup>111</sup> Федеральный Закон от 21 декабря 2001 года № 178-ФЗ “О Приватизации государственного и муниципального имущества”. М., 2005.

<sup>112</sup> Греченко А. И. Российская приватизация на переломе: нерешенные проблемы транзакционных издержек и управленческих затрат - [www.library.dgtu.donetsk.ua/fem/vip70/70\\_19.pdf](http://www.library.dgtu.donetsk.ua/fem/vip70/70_19.pdf)

in the Russian Federation the developed legislation for regulation of the privatization process has been formed”<sup>113</sup>.

Unfortunately, weakness of the institutional base is still constraining the economic growth of the country. Further, I am going to examine the main economic results of the privatization process in the Russian Federation.

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<sup>113</sup> Анализ процессов приватизации государственной собственности в Российской Федерации за период 1993-2003 годы (экспертно-аналитическое мероприятие) / Руководитель рабочей группы – Председатель Счетной палаты Российской Федерации С.В. Степашина. – М., 2004, с. 35.

## APPENDIX 1

One of typical cases follows. This fund had the name 'Rikap-Fund', my parents invested their vouchers into this fund. The fund exchanged vouchers for its shares, where shares had the price of 7 roubles and the nominal value was 1000 roubles. Today this fund is liquidated. My parents, as the other share holders of this fund didn't get any profits.

## *Уважаемый акционер "РИКАП-фонда"!*

Совет директоров в лице Председателя совета Волкова Владимира Анатольевича и Управляющий в лице Генерального директора АО "Финансово-инвестиционная компания "УРАЛ-ТРАСТ" Королева Андрея Николаевича информируют Вас о результатах работы фонда и о подготовке общего собрания акционеров.

Число акционеров "РИКАП-фонда" составляет 122 тысячи человек, величина оплаченного Уставного капитала равняется 2.5 млрд. рублей. По данным Госкомитета по управлению имуществом "РИКАП-фонд" является одним из крупнейших чековых фондов на Урале. Устойчивость деятельности фонда зависит от его размеров. У крупного фонда шире возможности для экономического маневра средствами и получения высокой прибыли.

Финансовые отчеты фонда, с перечнем предприятий, куда вложены чеки ежеквартально публиковались в еженедельнике "Телевидение и радио". Финансовый отчет за 4-й квартал 1993 года будет опубликован в газете "Уральский рабочий" в феврале 1994г.

Основная задача управляющей компании - получение максимальной прибыли фонда. Прибыль формируется в соответствии с действующим законодательством за счет двух источников - дивидендов, полученных от предприятий и доходов от операций с ценными бумагами.

Предприятия будут перечислять фонду дивиденды не ранее 2-го квартала 1994 года после проведения своих годовых собраний. Точная величина дохода по этому источнику на сегодня неизвестна. Несмотря на то, что фонд старался приобретать акции наиболее устойчивых (доходных) предприятий Урала, состояние экономики, продолжающийся общий спад производства заставляет думать, что пока получение высокого дивиденда от предприятий невозможно. В 1993 году от 3-х предприятий в виде промежуточных дивидендов получено 7.2 млн рублей.

Основной источник доходов в 1993 году - операции с ценными бумагами. Прибыль, полученная управляющей компанией для фонда составит не менее 290 млн. рублей.

Порядок расчета дивидендов и сроки их выплаты определит годовое собрание акционеров.

**Инвестиционная политика фонда связана с настоящим и будущим Уральского региона.**

В настоящее время в активах фонда находятся ценные бумаги 72 предприятий, составляющих основу уральской промышленности и Российской экономики. Среди них: Первоуральский новотрубный завод, Синарский трубный завод, Уралхимпласт, "Ювелиры Урала", заводы по обработке цветных металлов и другие. Эти вложения - залог устойчивого и долговременного существования "РИКАП-фонда".

### **Уважаемый акционер!**

Общее годовое собрание состоится в срок с 25 марта по 15 апреля 1994 года.

### **Повестка собрания.**

1. О внесении изменений в Устав фонда (по предложению Совета директоров Устав фонда приводится в соответствие с Указом Президента РФ от 24.12.93 г. №2284 "О государственной программе приватизации государственных и муниципальных предприятий в Российской Федерации").
2. Отчет управляющей компании фонда о результатах деятельности "РИКАП-фонда" в 1993 году.
3. О дивиденде.
4. Разное.

Предварительные расчеты финансовых затрат на подготовку и проведение собрания акционеров составляют более 30 миллионов рублей и включают рассылку уведомлений, типографские расходы, регистрационные услуги, аренду зала, подготовку материалов.

Напоминаем Вам, что расходы, связанные с проездом и участием в собрании несет сам акционер. Решение собрания может быть принято большинством голосов лишь при участии в голосовании акционеров или их представителей, имеющих более 50% голосов. Каждая акция дает акционеру один голос.

В собрании акционер участвует лично, а если он не имеет такой возможности, то согласно ст.103 "Положения об акционерных обществах" (Постановление Совета Министров РФ №601 1991г.) обязан предоставить доверенность на голосование Совету директоров или своему представителю.

В этих условиях предлагаем Вам:

1) В случае желая принять личное участие в собрании акционеров выслать в адрес АО "РИКАП-фонд" уведомление, заполненное в произвольной форме с указанием серии и № сертификата, количества акций.

2) В случае невозможности принять личное участие в собрании, оформить доверенность.

Доверенность можно оформить на:

- Совет директоров фонда;

- учредителей фонда: СКБ-банк, Тагилбанк, Уральская горнопромышленная ассоциация, Средуралстрой, компания "РИКАП", компания "УРАЛ-ТРАСТ", фонд "ИНТЕРПРИВАТИЗАЦИЯ".

(Доверенности, высланные в оговоренные ниже сроки будут заверены Регистратором фонда, в соответствии с реестром акционеров.)

- члену Вашего трудового коллектива - акционеру фонда.

(Мы даем возможность ознакомиться с материалами собрания за 10 дней до окончательной даты проведения собрания.)

Для Вашего удобства, а также для проверки данных, внесенных в реестр акционеров, мы прилагаем к данному письму заполненную от Вашего имени доверенность, которой и предлагаем Вам воспользоваться. Если Вы обнаружите неточность или ошибку в приведенных данных, просим Вас сделать четко и ясно необходимые исправления, подписать и выслать доверенность в адрес Фонда.

Если Вы намерены лично участвовать в собрании, все исправления можно сделать на обратной стороне доверенности, либо на уведомлении о личном участии, либо на отдельном листке бумаги, подписать и выслать в адрес Фонда. Все исправления будут внесены в реестр акционеров.

Обратите особое внимание на номер счета в банке и номер отделения банка! От этого зависит скорость и точность поступления дивидендов!

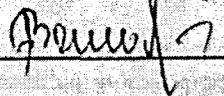
Объявление об окончательной дате проведения собрания будет сделано после предварительной регистрации в газете "Уральский рабочий".

Особо обращаем Ваше внимание на то, что доверенности, материалы по сверке реестра акционеров и другие документы необходимо выслать в фонд не позднее 10 марта 1994 года по адресу:

620151, г.Екатеринбург, пр.Ленина, 34-617  
контактный телефон: (3432) 51-09-11

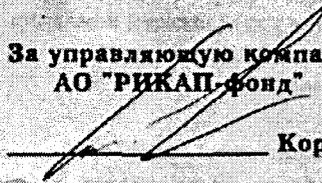
*С уважением к Вам*

Председатель Совета директоров  
АО "РИКАП-фонд"



Волков В.А.

За управляющую компанию  
АО "РИКАП-фонд"



Королев А.Н.

Январь-февраль 1994 года



Серия 1

# РИКАН-ФОНД

056035

Акционерное общество открытого типа  
Уральский чековый инвестиционный фонд

Уставный капитал 1 000 000 000 рублей.  
Количество обыкновенных акций 1 000 000 шт.  
Номинальная стоимость акции 1 000 рублей.

### Сертификат акции

Каврева Ольга Анисовна

является владельцем пятидесяти

за номерами 56035

на общую сумму пятидесяти тысяч рублей

Председатель Совета директоров

Член Совета директоров



И.А. Волков

А.Н. Коротев

Код государственной регистрации: 62-10-002

Дата государственной регистрации: 25.12.92

#### Условия обращения акций

1. Сертификат акции - ценная бумага, которая является свидетельством владения поименованного в нем лица определенным числом акций общества.
2. Перед передачей сертификата одного лица другому, участникам сделки необходимо связаться с инвестиционным фондом и зарегистрировать смену владельца акции.
3. Новому акционеру выписывается новый сертификат.
4. Акционер обязан сообщить об изменении своего местонахождения инвестиционному фонду.

#### Условия и порядок выплаты дивидендов

1. Размер и дата выплаты дивиденда объявляется собранием акционеров по результатам года.
2. На дивиденд имеют право акции, приобретенные не позднее, чем за 30 дней до официально объявленной даты его выплаты.
3. Новый владелец акции обязан сообщить инвестиционному фонду о своих правах на владение ценной бумагой не позднее 30 дней, до официально объявленной даты выплаты дивиденда.
4. Дивиденд выплачивается чеком, платежным поручением, почтовым переводом.
5. Общество объявляет размер дивиденда без учета налогов.

Регистрация права владения акциями произведена по адресам:

1. 620151 г. Екатеринбург, ул. Ленина д. 34 к. 617, телефон 81-09-11

2. \_\_\_\_\_

28 мая 1995 г.

номер договора \_\_\_\_\_

подпись регистратора \_\_\_\_\_

## CHAPTER 3

### **The main economic results of the privatization**

The development of the Russian economy was carried out under conditions of fundamental transformation of the whole system of public, economic and political structures. The economic reform was one of the main aims of the transformation period. Thus, it was a transformation of the soviet-type economy, controlled by the government into a market economy that functioned according to the market laws. This transformation was orientated on the deliberate creation of private sector, by means of privatization of the state ownership and grass-route creation of new private firms, spreading the market discipline on the state-owned enterprises. The privatization of the Russian enterprises has become the key element of the economic reforms carried out by the Russian government. It was necessary to create critical mass of enterprises, orientated on profit; enterprises which were not in need of the government support for their survival; and also create strata of private owners who were eager to invest in their enterprises and in their restructuring.

As appears from the sources of the Accounts Chamber, “during 1992-1996 in Russia such an economic model was created, within its boundaries only the branches of economy have developed which were either able to produce competitive export (gas, oil, oil productions and partly chemical and metallurgy products) or were monopolies (fuel and energy complex, food industry, railway lines and metallurgy) or were orientated on production of the living essentials (food industry, gas, electrical energy).”<sup>114</sup>

As the analysts argue the decision to start privatization in the Russian Federation was one of the forced answers to the economic crisis of the beginning of 1990-s and key

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<sup>114</sup> Счетная палата. Итоги приватизации. М., 2005, с. 76.  
Anastasiya Kavreva

elements of the economic reforms. But, as it was already mentioned, the insufficiency of the development of the privatization legislation framework and transformation of the ownership, on the whole, were obstacles in the way of solving many of the issues stated as aims in that period (creation of an efficient owner, development of private initiative as one of the factors of the overcoming of the economic crisis, enhancement of efficiency of activity of enterprises, etc.)

The experts of the Accounts Chamber draw a conclusion, that the Russian privatization was exceptional not only by its scale, but also by its matter. In contrast to the countries with developed market economy, where the transfer of the state ownership into private hands was understood as a means to solve a problem of the increase of efficiency of the enterprises; in Russia, the privatization should provide radical changes in ownership relations, that is to say, to solve the problem of the economic fundamentals of the Russian society. From the beginning of the privatization in Russia, the mass transfer of the state assets to the private hands occurred and only after that the government has launched the restructuring. Actually, this factor fundamentally slowed down the process of forming efficient owners, corporate governance structures and locked down possibilities to attract investments.

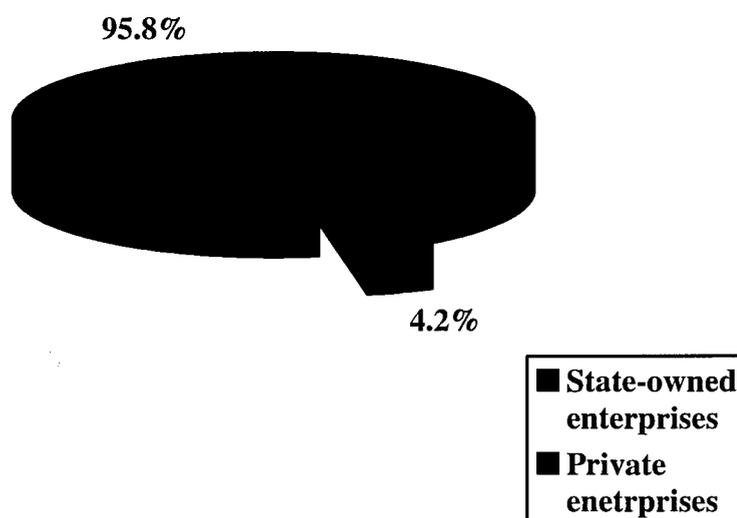
For the most part, Goskomimushchestvo was entrusted with organization and control over the privatization process in all branches of industry. Essentially, branch ministries were removed from the priorities and substance resolution of the privatization processes and had only secondary functions. That is why, frequently the branch peculiarities of an enterprise and importance of the preservation of industrial communications were not taken into account during the privatization process. In the long run it resulted in fatal consequences for the economy as a whole. Among major problems

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we can list: 'inefficient owner', inefficient corporate governance, corruption, lack of investment capital, need of restructuring, etc.

In the beginning of 1992, in spite of the redistribution of the state ownership, during the spontaneous privatization, the state ownership was predominant and enterprises of the state sector of economy provided two thirds of the whole commodity turnover.

**Table 1. The structure of the ownership in the Russian industry 1991** <sup>115</sup>



According to the Accounts Chamber of the Russian Federation over the period of 1993-2003, 96 414 state-owned enterprises were privatized, including 16 701 enterprises of the federal ownership or 17.32 per cent from the total number of the privatized enterprises. At the same time in 1993-1994, 71 829 enterprises were privatized

<sup>115</sup> Счетная палата. Итоги приватизации. М., 2005, с. 79.  
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(accordingly, 49 924 and 21 905), that made up 74.5 per cent from the total number of privatized enterprises during 1993-2003.<sup>116</sup>

Under the report of the State Committee of Statistics of the Russian Federation, in January 1997 the total number of privatized enterprises ran up to 126 793. In 1991 about 150 thousand enterprises were still state-owned; the Russian Federation was shareholder in 3896 associations and companies, in 2500 joint-stock companies which represented basic branches of industry, and the state share was more than 25 per cent of the nominal capital. Moreover, regarding 580 joint-stock companies the Russian government exercised a special right in participation of their management, the right of the 'golden share'.<sup>117</sup>

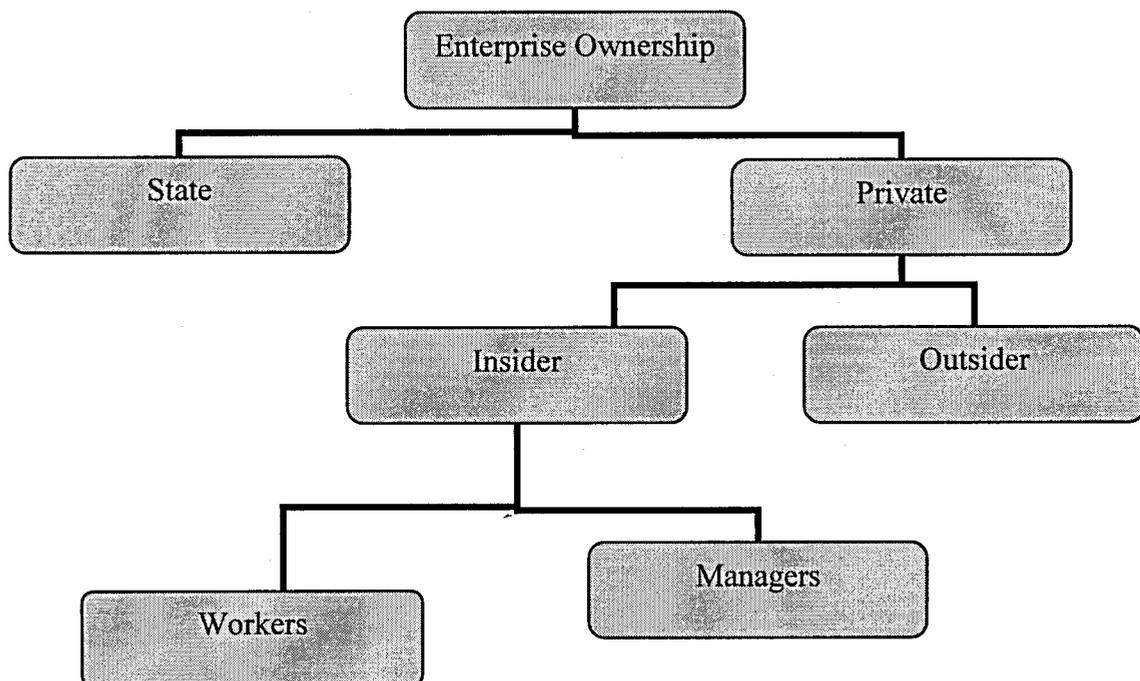
The first stages of the privatization process created the necessary prerequisites for overcoming the crisis in the Russian economy and for further development of the economy.

It is evident, that during 1990-s the transformation to the real variety of the ownership forms was carried out.

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<sup>116</sup> Счетная палата. Итоги приватизации. М., 2005, с. 78.

<sup>117</sup> Ibidem, с. 79.



“The bulk of people who received ownership rights in Russia’s mass privatization were insiders – both workers and managers. The ‘outsider’ category is also heterogeneous, ranking from relatives of workers through company suppliers to investment funds and foreign corporations.”<sup>118</sup>

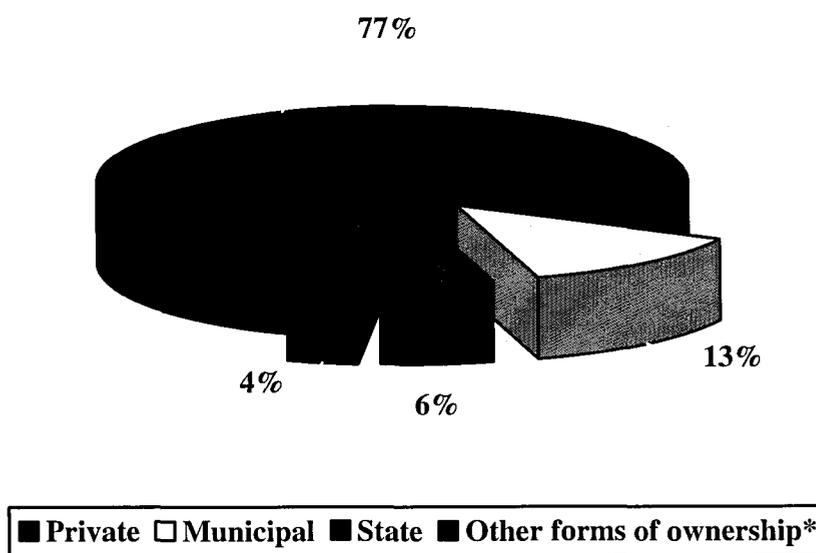
The institute of the private property has had legislation framework and has become one of the instruments of attraction of private initiative of the Russian citizens in solving economic problems. Privatization and processes connected with it resulted in the fundamental changes in all spheres of social life, started formation of the entrepreneurial mentality, development of initiative and self-dependency of commodity producers. As a result of the privatization the large private sector of economy was created that helped to overcome state ownership monopoly, to set up foundation for development of the economic ties and use of the competition mechanisms.

<sup>118</sup> John S.E., Estrin S. Russia’s Post-Communist Economy. Privatization and the Structure of Enterprise Ownership. Oxford. University Press. 2001, p.174.

Privatization contributed to formation and development of number of new economic institutions, contributed to creation of favorable conditions for foreign investment attraction, liquidation of trade and services deficit on home market. It would not be an exaggeration to say, that the crises of 1998 made the domestic products come in great demand and gave an incentive to increase of their production. Investments in the national economy made Russian goods competitive.

The privatization processes lasting more than 10 years led to considerable changes in the ownership structure:

**Table 2. The structure of the ownership in the Russian Federation in 2003** <sup>119</sup>



\* Mixed (state-private) type of ownership, including participation of non-residents

<sup>119</sup> Счетная палата. Итоги приватизации. М., 2005, с. 79.  
Anastasiya Kavreva

In a qualitative sense, the structure of the Russian ownership differs from the ownership structure of developed countries with capitalist market economy. On the basis of the analysis of the Russian privatization, I can distinguish following characteristic features of this process:

- Predominance of the stock ownership, mainly in the form of open joint-stock companies;
- Accumulation of the main part of capital in hands of 'insiders' – managers and workers of privatized enterprises, during the first step of privatization;
- Devaluation of privatized assets, and their sale to oligarchs;
- Preservation of the considerable part of share holdings in the state ownership; as usual, such share holdings are smaller than control stocks and even smaller than blocking stocks.

It was stated in the beginning of the privatization that framed structure of property would have a transitional nature and later on would transform into a more effective structure. Attraction of new outside investors, including foreign investors who could invest their money through exchange and off-exchange stock markets in development of these enterprises in exchange for participation in a share capital, had to be the primary factor of the privatization. However, these expectations had not come true. A lot of enterprises have not been able to attract capital investments in exchange for participation in their share capital.

The analysts from the Accounts Chamber dwell on intensive creation of new private enterprises as one of the positive results of the privatization in Russia. "From the period of 1991 to 2003, total amount of enterprises and organizations have increased from

2250 thousands to 4149,8 thousands, and at the same time the number of state enterprises have decreased from 322 thousands to 157 thousands (in 2002) and made up 3.78 per cent from the total amount of the registered legal persons.”<sup>120</sup>

Mass privatization coincided with deep economic crises that affected not only the state of the Russian enterprises, but also the financial position of Russian citizens, employed in these enterprises. Redistribution of the GDP in favour of non-governmental sector led to reduction of real income of population, especially, of the main mass of budget sphere’s employees: teachers, doctors, scientists and etc.

It is obvious, that structural changes in industry needed increase in public assistance, not only assistance to unemployed, but also to the vast strata of citizens who received social payments. Before the privatization began all social payments were paid by enterprises, after their privatization the reformation of state institutions or creation of new institutions, dealt with prescription and payment of social benefits were needed.

Privatization caused increase of poverty rates, today approximately 20 per cent<sup>121</sup> of the Russians live below the poverty line. A touchy subject is also polarization of society. “Thus, in the end of 1994, income of 10 per cent of rich people of Moscow exceeded 24 times the income of 10 per cent of the poor men.”<sup>122</sup> Decrease of earned income led to a stratification of society: the Gini coefficient increased from 0.26 per cent in 1987-1990 to 0.47 per cent in 1996-2000<sup>123</sup>. During the privatization the middle class

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<sup>120</sup> Счетная палата. Итоги приватизации. М.,2005, с. 80.

<sup>121</sup> Страны с переходной экономикой. Содействие Всемирного банка: оценка ДООД / Элис К. Галенсон. Международный банк реконструкции и развития / Всемирный банк. 2004, с.52.

<sup>122</sup> Счетная палата. Итоги приватизации. М.,2005, с. 121.

<sup>123</sup> Страны с переходной экономикой. Содействие Всемирного банка: оценка ДООД / Элис К. Галенсон. Международный банк реконструкции и развития / Всемирный банк. 2004, с.72.

has practically disappeared; for the most part, Russian society consists of 1-2 per cent of rich minority and majority that has become poor.

Thus, the social pyramid of the Russian society looks this way:

- 15 per cent of GDP falls on less than 2 per cent of the rich Russians;
- 10 per cent belongs to the middle class that disposes with 25 per cent of the national wealth;
- 8-10 per cent of mass stratum of entrepreneurs that posses 20 per cent of the national wealth;
- The rest 58 per cent of population belongs to the category whose earnings are near or below the cost of living and 40 per cent of GDP falls on this social group.<sup>124</sup>

The basis of market economy should be a wide stratum of middle class that is theoretically, 60-70 per cent of the whole population. “After the numerous researches were done, the analysts have come to conclusion, that only 16-20 per cent of the Russian population can be included in the middle class.”<sup>125</sup> Above it there is a thin stratum of rich people and below it a wide stratum of poor people is situated. So, the Russian government has a lot to do to improve living conditions.

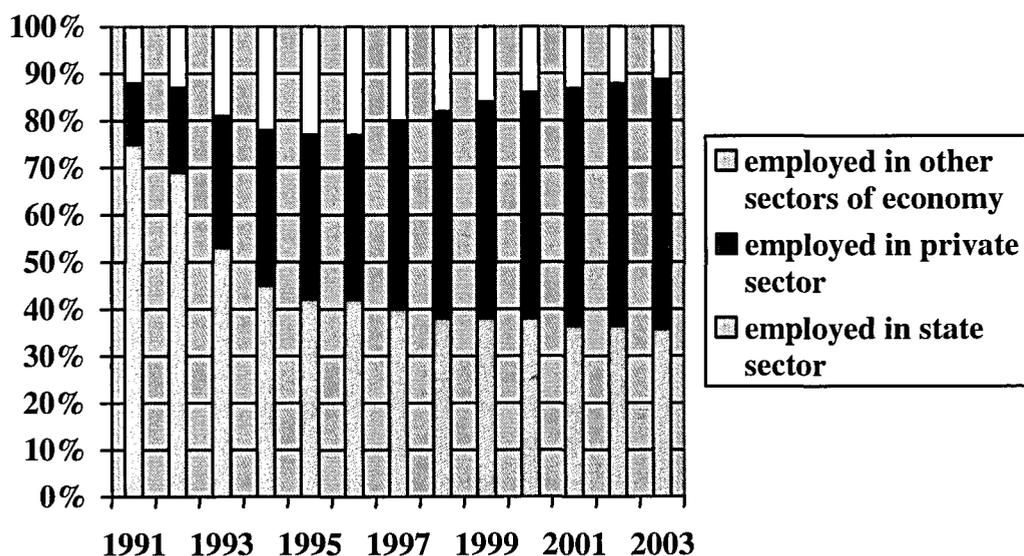
The privatization process of 1991-2001 has been accompanied by changes in the occupation patterns of the Russian population. Table 3 shows increase of share of citizens employed in private sector of economy.

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<sup>124</sup> Счетная палата. Итоги приватизации. М.,2005, с. 123.

<sup>125</sup> Аганбегян А.Г. Социально-экономическое Развитие России. М.,2004,с.80.

**Table 3. Share of employed people in different sectors of economy** <sup>126</sup>



I would like to emphasize, that there is no direct relation between quantitative results of the privatization and qualitative changes in economy. Quite the contrary, mass distribution of the state assets under the conditions of absence of proper legal and institutional conditions, led to the deceleration of the process of the formation of efficient owners, and didn't assist the process of restructuring and modernization of economy.

“According to the World Bank experts’ evaluation, today Russia has the highest level in the world of concentration of the private property”. <sup>127</sup>That is to say, the situation that hampered the process of attainment of the competitiveness of the Russian economy has arisen. In Russia formation of the strata of small and medium owners and entrepreneurs which serve as the driving force for the economic development and support

<sup>126</sup> Счетная палата. Итоги приватизации. М.,2005, с. 80.

<sup>127</sup> Ibidem, с. 81.

for political stability in developed democratic states, was postponed to an uncertain future.

The private property is still unstable and connected with inefficient corporate governance. The controlling packets of shares in the privatized enterprises will pass through many hands for a long time till the optimal ownership structure will be developed.

By 2001 the privatization as the element of economic transformation has become less relevant and gives way to the questions of corporate management, increase of managerial effectiveness of the state ownership and restructuring of the privatized enterprise. An efficiency of the post-privatization supervision over the state ownership, management of share holdings which belong to the state is still an urgent question.

To sum up the majority results of the privatization, I would say that by 2003 the Russian Federation has already finished the main stage of economic transformation, aimed at the country's economic basis fundamental change. The country made transfer from an economy based on state property to the economy based on private property predominance.

Concluding the results of the privatization in the Russian Federation I distinguish several economic tendencies that were shaped under the influence of the privatization:

- Economic growth's dependence on export's of raw materials.
- Creation of competitive industries that can successfully resist import; undisputed leaders are industrial branches producing consumers goods.

“Thus, for example during the last six-five years more than one third of productive capacity of the food industry was renewed.”<sup>128</sup>(by 2003) Moreover, strengthening of rouble stimulated development of assembly industries on the basis of foreign accessories with foreign enterprises’ license use. It would not be an exaggeration to say, that some industries participate in competitive struggle on external and internal markets.

- Worsening of the social conditions in spite of growth in real earnings. Especially, it results in insufficient accessibility of majority of social services and its poor quality.
- Increase of investment activity.

The main determining factors of the increase of investment flows were first of all high world’s prices of energy supplies that provided strengthening of investment activity in the fuel and energy complex; improvement of financial performance of enterprises and brought general economic stability in the country.

- Changes in the GDP structure. During the recent years considerable shifts towards reduction of share of goods and increase of share of services, especially market services, have happened. “Thus, in 1999 about 40.5 per cent of GDP fell on goods, while the services’ share was 49.2 per cent, in 2003 about 35.8 per cent of GDP fell on goods and 52.6 per cent on services”.<sup>129</sup>

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<sup>128</sup> Счетная палата. Итоги приватизации. М.,2005, с. 112.

<sup>129</sup> Ibidem, с. 115.

As the analysts from the Accounts Chamber of the Russian Federation declare “in 2003 the new stage of the Russian privatization has started. This stage concerns operational legal framework development, improvement of procedures of mechanisms of disposal and administration of state ownership.”<sup>130</sup> Finally, the government should change the privatization goals: from the method of getting profits to the budget to the instrument of the modernization of economy.

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<sup>130</sup> Счетная палата. Итоги приватизации. М.,2005, с.115.  
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## CONCLUSION

The last decades have been the time of profound changes in social, economic and political structures of the Russia Federation. Collapse of the communist regime made the country move towards free market economy.

The property relations reforms are seen as the main elements of the post-socialist market transformation. However, the methods of implementation of these reforms, scale, and alternatives of the reorganization of the state sector of economy might be different.

The principle features of the Russian privatization are connected with specific character of the Russian economy in its pre-reform period and with its main lines of transformation and development during 1990s.

So, for more detailed and comprehensive revelation of the main points and features of the privatizing process in Russia and its results, I have analysed the privatization stages, and results of privatization methods applied.

From my point of view it is more advisable to mark out stages of privatization process in the view of specific applied mechanisms of the ownership redistribution. Hence, we can distinguish pre-voucher stage of privatization, the so-called 'spontaneous' privatization. This pre-voucher stage started with the "Law on Individual Labor Activity"<sup>131</sup>, 1986. This law became the first statutory act of the initial stage of the transformation.

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<sup>131</sup> Закон СССР от 19.11.1986 "Об индивидуальной трудовой деятельности" - <http://pravo.levonevsky.org/baza/soviet/sss2184.htm>

The official conception of the carrying out the privatization in the Russian Federation provided two stages of its realization: voucher and 'monetary' privatization. At the same time the government fixed its clear timetable:

- Voucher privatization July 1992 – 1 July 1994;
- 'Monetary' (Denezhnaia) privatization 1 July 1994 – 1999.

To sum up the results of mass voucher privatization, we can say that the 'insider' model of incorporation prevailed. I would like to emphasize that this model turned out to be inefficient. The preferred insiders' access to the purchase of shares reduced the outsiders' investment incentives. Inasmuch as insiders didn't dispose of its own investment potential; it led to a braking of any structural alterations, that is to say it blocked the industrial restructuring. The situation was aggravated by cutting off the government financing and credits inaccessibility under the hyperinflation.

Labor collectives of the enterprises were given wide benefits in purchasing shares, at the same time other Russian citizens those were not directly related to the production (public service, science, education, social service and public administration etc) were actually excluded from the privatization.

Under these circumstances the following share's repartition in favour of outsiders was inevitable.

Since July 1, 1994 we can speak about the new stage of privatization. It was based on the transfer from mainly free- of charge distribution of the state property to their selling at market prices. The dominant position of this program was orientated on the

attraction of investors and provided an investor with opportunity to buy controlling packets of shares of the privatized enterprises.

During the 'monetary' privatization the results of the first stage of the privatization underwent profound changes. "In this way, the insiders' shareholdings decreased from 66.1 per cent to approximately 20 per cent."<sup>132</sup> The outsiders, who raised their capital during the 1990-s, not only pressed on insiders, but also were the main characteristic feature of the stage of the 'monetary' privatization.

After 1999 we can speak about the privatization that was carried out not by the mass standard schemes, but by the custom designs, where the emphasis is made on the transfer to a private property not the whole enterprises, but the state's property share of these enterprises. Also, of great importance is the improvement of legal provisions of state property disposal.

The privatization processes, lasting more than 10 years led to considerable changes not only in the ownership structure but also in the whole system of Russian economy.

The institute of the private property with an appropriate legislation framework has become one of the instruments of attraction of private initiative of the Russian citizens in solving economic problems. Privatization and processes connected with it resulted in the fundamental changes in all spheres of social life, started formation of the entrepreneurial mentality, development of initiative and self-dependency of commodity producers. As a result of the privatization the large private sector of economy was created that helped to

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<sup>132</sup> Красникова Е.В. Экономика переходного периода. М., 2006, с. 184.  
Anastasiya Kavreva

overcome state ownership monopoly, set up foundation for development of the economic ties and use of the competitive market mechanisms.

The analysts from the Accounts Chamber dwell on intensive creation of new private enterprises as one of the positive results of the privatization in Russia. “From the period of 1991 to 2003, total amount of enterprises and organizations have increased from 2250 thousands to 4149,8 thousands, and at the same time the number of state enterprises have decreased from 322 thousands to 157 thousands (in 2002) and made up 3.78 per cent of the total amount of the registered legal persons.”<sup>133</sup>

Mass privatization coincided with deep economic crises that affected not only the state of the Russian enterprises, but also the financial position of Russian citizens, employed in these enterprises. Redistribution of the GDP in favour of non-governmental sector led to reduction of real income of population, especially, of the main mass of budget sphere’s employees: teachers, doctors, scientists and etc. Privatization caused increase of poverty rates, today approximately 20 per cent<sup>134</sup> of the Russians live below the poverty line. A touchy subject is also polarization of society.

By 2001 the privatization as the element of economic transformation has become less relevant and gives way to the questions of corporate management, increase of managerial effectiveness of the state ownership and restructuring of the privatized enterprise.

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<sup>133</sup> Счетная палата. Итоги приватизации. М.,2005, с. 80.

<sup>134</sup> Страны с переходной экономикой. Содействие Всемирного банка: оценка ДООД / Элис К. Галенсон. Международный банк реконструкции и развития / Всемирный банк. 2004, с.52.

To sum up the most important results of the privatization, I would say that by 2003 the Russian Federation has already finished the main stage of economic transformation, aimed at the country's economic basis change. The Russian economy accomplished transformation from a soviet-type economy based on state property to a capitalist market economy based on private property predominance.

Nevertheless there are still several unsolved post-privatization questions:

- Lack or absence of the competition in market;
- Weak structures of the corporate management, managerial opportunism;
- Poor restructuring;
- Oligarchs' rule over the Russian economy;
- Corruption.

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## **PROJECT**

The process of privatization in the Russian Federation (1992-2001)

Introduction

**Chapter 1** - State of Russian economics at the beginning of 1990s.

1.1 Perestroika and its consequences for Russian economy

1.2 First steps towards a free market economy

1.3 Liberalization of markets

**Chapter 2** – Stages of privatization in Russia

2.1 Pavlov's monetary reform

2.2 Gaidar's "shock therapy"

2.3 Joint-stock and voucher privatization

**Chapter 3** - The main economic results of privatization 1993-2006.

3.1 The economic end/aspect of privatization

- Results of privatization in the main sectors of Russian economy

3.2 Social aspect of privatization

3.3 'Advantages' and 'disadvantages' of privatization

3.4 *Future trends of privatization (privatization of real estate of natural persons)*

**Chapter 4** - Results of privatization as the aspect of the foreign investments

4.1 Development of the foreign investments' market and market of capitals

4.2 The main investment directions

4.3 The most "attractive" economic sectors for foreign investments

4.4 Multinational corporations and Russian market

**Conclusion**

The object of my thesis is to examine the process of privatization in Russia during the period of 1992-2006.

According to the object, problems that I cover in my thesis are:

- To analyze state of Russian economy at the beginning of 1990s and heritage of ‘perestroika’;
- To describe stages of privatization in Russia;
- To examine the main economic results of privatization; how the process influenced on the main sectors of Russian economy;
- To look through the social aspects of privatization;
- To look into the results of privatization as the aspect of the foreign investments.

The interest to this issue rises from the consequences of the privatization and how this process contributed to the transition to the market economy, creation of private property, development of the domestic production, attraction of foreign investments and liquidation of consumer goods deficit in Russia.

The thesis consists of the 4 chapters.

The first chapter is devoted to the state of the Russian economics at the beginning of 1990s and to the “perestroika” heritage. By the middle of 80s political regime, that had formed in the USSR and controlled countries of the East Europe and social and economic systems were on the verge of crisis. Negative events in economics reduced to

development of social sphere. Average annual income per capita was approximately 50% from developed countries (Great Britain and France).

With the Gorbachev in office, the RSFSR met era of reforms. So, plenary session of the Central Committee of the CPSU in April 1985 headed for the rapid social and economic development of the country. A number of reforms were launched: (but new generation of soviet leaders didn't have clear program of economic and political reorganization). Gorbachev's economic policy suffered from in consequence and was a semi decision. Lack of clear time table of reform realization was a real weak point of the Gorbachev's policy.

1988 was a turning point for RSFSR:

- it was a time when production was decreased and some industries were cut down (in agriculture and industry)
- all these policy caused dearth, and even in Moscow new methods of rationing and foodstuff distribution were introduced into practice (coupon system)
- inflation growth
- decline of living standards

In autumn 1990 economic situation became strained and reached critical point. Group of economists, headed by Shatalin and Iavlinskij worked out an economic program "500 days"; they suggested to carry out fundamental economic changes, including state sector privatization, orientated on the transition to free market prices, but the government rejected the program.

The second chapter is devoted to stages of privatization. The process of new economic reforms was launched in January 1992, which was an attempt for Russia to make quick, even momentary passage from socialist, command-bureaucratic economics to market.

At the beginning of 1992, Russian government led by president Yeltsin undertook real steps towards market economy. New government led by scholar economist E. Gajdar developed the radical program of economic reforms in the sphere of national economy. The name for this program was “shock therapy”. But the main transfer to market was property privatization. This reform supposed to make private sector the predominant sector of economics. Most of enterprises became private join-stock companies.

In my diploma I want to pay attention to the tree stages of privatization in Russia:

1. The first stage – mass (voucher privatization) privatization (1992-1994). The main purpose was to create a broad circle of owners, mainly small shareholders, by means of surrender of state property;
2. The second stage – monetary privatization (1994-1999). The main purpose was replenishment of profitable part of budget, attraction into Russian economy strategic investors, increase of privatization effectiveness;
3. The third stage – improvement of legal provisions of state property disposal (199-2003).

The third chapter is dedicated to the main economic results of privatization process. It wouldn't be an exaggeration to say, that privatization was really on of the main system-institutional transformations in the Russian economy. During the process of

privatization in a short space of time was formed non-governmental economic sector and new market institutions of corporative economic sector.

The fourth chapter is dedicated to the results of the privatization from the point of foreign investments. The process of mass privatization in Russian in 1992-1994, rush development of Russian equity market and creation of its legal framework, were some kind of impulse to create a base for development of foreign investments in Russia.

Today Russia keeps its positions and remains one of the largest recipient of foreign investments in CIS. In absolute amount total cost of M&A bargains approximately corresponds to the level of Bulgaria and Hungary.

To conclude, Russian privatization was unexampled, not only because of its scale, but also because of its matter. In contrast to countries with developed market economy, where assignation of the government property into the private hands was just the way to solve the problem of increase of effectiveness of a number of enterprises, in Russia privatization was called to provide radical changes in property relations, that is to say, to solve a problem of modification economical basis of the Russian society.

In spite of the fact that during privatization was solved the problem of modification of the forms of property (more than 58.9% of enterprises became private), new market institutions were formed (join-stock companies, equity market, system of institutional investors, banks, insurance companies); most of privatization measures were accompanied by moderate social conflict, but many of the main purposes of the privatization were not achieved.

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