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Loans for Shares Program: Influence on Post-Soviet Politics and Economy

Bachelor's Thesis

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Abstract

Privatization has been one of the most predominant and crucial processes during the transformation of post soviet economies from socialist structure to the capitalist market orientation. The main post soviet economy which boosted actions of other East European states was Russia in the beginning of the 1990s (Gidadhubli, R. G. 1993). Russia has implemented several privatization techniques, one of which would be closely analyzed in the following study, loans for shares program. Russia has been accused of having corrupted systems of privatization and loans for shares has been under critique as well, however, the scheme could have been effective in the political arena of the country and in the growth of the Russian economy to a certain extent despite being a corrupted setup.

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Declaration of Authorship

1. The author hereby declares that he compiled this thesis independently, using only the listed resources and literature.

2. The author hereby declares that all the sources and literature used have been properly cited.

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Prague, **01.08.2022** **Mikhail Gogol**

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After the fall of a long-term centralized command economy under the rule of a communist party, Russia, with its new democratic regime, has experienced a vast process of privatization during the 1990s period. After Russia has utilized other tools of privatization, the state officials had introduced the loans for shares program, which aimed to transfer the holdings for some of the major state-owned enterprises to private agents. The research aims to investigate whether the loans for shares scheme was effective and appropriate in its transition of the state-owned industrial companies to non-governmental actors. In order to determine whether the scheme was efficient or not, the research will unpack the entire procedure of the loans for shares scheme in detail, starting from analyzing the key actors, and their relations, who have proposed the program and those who participated in it e.g. main political authorities, private entrepreneurs, red directors and local employees. It is also necessary to investigate how the newly elected managers operated with industrial companies which they acquired. Hence, the research will include a thorough analysis of the productivity of the industrial companies before and after they were privatized specifically through the loans for shares program and how their productivity contributed to the total economic growth of the country, since these industrial companies possessed high potential for the growth of the economy due to their field of production e.g. oil and coal industries. Most importantly, the research will focus on the question whether the loans for shares program was a necessary tool during the privatization period specifically for the sake of the economic growth of the country or the reason of its implementation was purely political. This topic is relevant to the developing countries which might be considering transforming their economies to be more market oriented. This research therefore, will provide an insight into whether the loans for shares is an efficient tool for a successful privatization of enterprises.

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Introduction

It became a common sense both in modern Russia and outside of it, that the process of denationalization of the post soviet country in the 1990s, or as it was later cunningly replaced by the term privatization, has led to bewilderment among the vast majority of Russian citizens, as well as to reasonable questions from many professional specialists in political and economic spheres. In fact, everything came down to global falsification and deception of the entire population of the country, as it was covered in the media. On January 20, 2005, the Public Opinion Foundation conducted a study among the population of the country on the topic: Analysis of the processes of privatization of state property in the Russian Federation for the period 1993-2003. Seeing privatization as a scam on a national scale and, at the same time, not considering its economic consequences beneficial, Russians, for the most part, were assured that, on the whole, the privatization has done the country more harm than good. Even in 2016, this opinion is shared by 55% of citizens (in 1998 - 61%), and only 7% (in 1998 - 8%) believe that it has brought more benefits. 22% of respondents believe that benefits and harms were equal (in 1998 - 17%) (IntelliNews, 2016). Therefore, it is believed that the procedures for the denationalization of post soviet state property and means of production were replaced by the banal distribution of vouchers (or coupons) to the population and a giveaway of state-owned enterprises in the hands of government related officials with little to no positive effect to Russia or its economy.

On July 1, 1991, the Law "On the Basic Principles of Denationalization and Privatization of Enterprises" paved the way for a large-scale redistribution of public (according to the Constitution of the USSR) property in favor of the union nomenklatura (Marxists Internet Archive, 2008). However, the collapse of the USSR did not allow these plans to be realized on a full scale, and the privatization of the assets of the former USSR took place mainly under the control of the leaderships of the former Soviet republics. Privatization in Russia officially took place from the beginning of the 1990s, after the collapse of the USSR, and is associated primarily with the names of Gaidar and Chubais, who at that time occupied key positions in the government.

Privatization and market reforms were generally inconsistent with Russian institutions and culture. But this does not mean that they should not have been carried out until this “correspondence” appears and Russia could not have continued to be an underdeveloped, non-competitive, inefficient state in the grip of the Soviet political and economic system. The market of the country was small and under-developed and required new changes. The collapse of the vertical powers in the areas of directive economy, unified party and army did not allow the Russian market to have other choices. The culture and mentality of the people change when the conditions of life change. Private property, free market trade and exchange were aimed to reshape these conditions, giving impetus to the development of all other institutions and cultures that are different from the Soviet planned economy. These were painful and long operations, but they were inevitable.

Overall, Russian privatization processes are often associated with rampant corruption, with large-scale embezzlement and pyramid schemes, even overseas. However, even if impeccable laws on private property and privatization were adopted, the mentality of the population remains. Citizens will not act according to the law in a country where the law was always on the side of the state and officials (Stanley, A.,1996,). Such behavior is not the result of the right or wrong choice of forms and pace of privatization, but the consequence of granting freedom to people who have lived in a very harsh and brutal environment for decades and do not expect that they will be protected by the courts and the police. They were acting wrong with moral restrictions, but they had legal nihilism. Russia that was created after the fall of the USSR was not a Western European country with established market traditions and inviolability of private property. The following work is aimed to undermine the belief that one of the privatization processes in post-soviet Russia was an act of pure corruption and fraud without any influence and positive consequence on the country. Moreover, the study will analyze how the oligarchs were mostly the main actors in the development of the previously state-owned enterprises that were privatized through the loans for shares program, since the ownership and distribution of the major part of the capital of the privatized enterprises was in control of the red directors. In order to depict the influence of the scheme it is important to firstly analyze the reason why the scheme was necessary for the country, how it affected the country politically, the state of operations of the companies which were privatized through the scheme and compare their contributions to the country's economic growth before and after the privatization. Afterwards, it will be possible to check the total economic growth trend and make final conclusions about the influence of the scheme.

Methodology

The following study is aimed to stress such hypotheses as: Loans for shares was one of the most decisive factors for Yeltsin's re-election, which did not allow the communist regime to return. Loans for shares program has shaped the modern Russia political regime. Loans for shares program, despite being unfair and prejudiced by the people and media, had a positive effect on the privatized enterprises. Loans for shares program was useful for the total economic growth of the country.

In order to be able to argue on such hypotheses the study will include the analysis of Russia's political life through the literature review and anecdotal data of crucial actors of the time. The aim of the political analysis is to view the influence of the loans for shares scheme on the political arena of post-soviet Russia. The review will help to identify the actions of the politicians and the reason for the occurrence of the program which would assist in defending the hypotheses, especially highlighting the inevitability of occurrence of the program and its demand by Yeltsin's campaign. The study would refer to "Loans for Shares: Revisited" by Daniel Treisman and "A Normal Country: Russia After Communism" by Andrei Shleifer, influential works about the program, which would be a foundation of judgment of the influence of the program. The study will also include online articles and journals which were picked according to their relevance to the topic e.g. by stating the name of the program in their title or the key figures of the program. The steps of the literature review will include: the collection of resources and analysis of their relevance and necessity to the topic of the study, withdrawal of the most apposite details which would be included in the body paragraphs of the study. All leading to the summary of the extracted elements from the collected resources in order to be able to create a conclusion for the hypotheses. From the extracted literature, it will be possible to see the political importance of the loans for shares program over other factors.

Secondly, the study will include an economic literature review of Russia from the period of 1990 till early 2000, mainly starting with an analysis of chosen enterprises which were privatized through the loans for shares scheme with a goal of viewing the influence of the loans for shares scheme on the enterprises. Economic literature evaluation would start with the identification of the Russian economy, its key features in micro and macro policies during the chosen timespan. The study will also include statistical performance, hence qualitative data, of the chosen enterprises which have participated in the program. The performance was collected from various sources and organized by the researcher for the purpose of examining the factors relevant for stressing the hypotheses.

Privatization processes

Vouchers

Before diving into the loans for shares program, it is important to note what other options the government has implemented, hence examine the methods of Russian privatization in total in order to make the claim why the loans for shares program was inevitable. The key techniques of the privatization by the newly established government included voucher privatization and loans for shares program. Voucher privatization was carried out in 1992-1994. It was preceded by legislative acts of the Supreme Soviet of the RSFSR, adopted in the summer of 1991, which provided for the redemption of state-owned enterprises and their transformation into joint-stock companies. To streamline privatization, the law “on nominal privatization accounts and deposits in the RSFSR” was adopted, according to which every citizen of Russia received a nominal privatization account, to which a specific number of finances intended to be transferred in order for the person who possessed the account to pay for the privatized state property. The law did not allow the sale of privatization deposits to other persons. This law, however, was not implemented, and voucher privatization was carried out instead. Voucher privatization was controversial, since its slogans such as creating an effective owner, increasing the efficiency of enterprises, creating a socially oriented market economy, diverged from the circumstances which occurred. Privatization participants did not have equal rights. Thus, employees of enterprises were granted benefits when acquiring shares in these enterprises, while middle class citizens not employed in the production such as medical workers, scientists or teachers did not have such benefits. In the summer of 1992, vouchers were introduced, which were distributed free of charge to the population and theoretically could be exchanged for a share in the shares of an enterprise. Practically, most of the vouchers were brought up by various speculators and the majority of Russian citizens did not participate in privatization also due to the low interest of participation. Thus, leaving the citizens and its economy in stagnation due to its inefficiency. Therefore, the politicians needed a new tool to help them with the privatization processes. (Appel, H. 1997).

In many ways, privatization in Russia repeated the history of the privatization of church lands in France during the French Revolution. At that time, the lands of the church were confiscated and on the basis of these lands (later the former estates of immigrants and lands belonging to the crown were added to the list of lands) banknotes were issued, which later began to be used as money. The lands were subsequently sold at auctions in which wealthy peasants and bourgeoisie had an advantage over poor peasants, which, as in Russia, led to the stratification of society (Finley, T., Franck, R., & Johnson, N. D., 2021).

A serious and, for political reasons, an unavoidable shortcoming of Russian privatization at its initial stage was the predominance of insider shareholders. Closed subscription for shares for the labor collective, preferential options for the administration of privatized enterprises, privatization checks for all Russian citizens did not go well with the task of transferring enterprises into the hands of efficient, strategic owners.

Loans for Shares

The next stage of Russian privatization was associated with the loans for shares scheme, which resulted in the concentration of significant volumes of Russian industrial and extractive industries in the hands of a narrow group of individuals later called the oligarchs. On the whole, the privatization processes have compromised the very idea in the eyes of the majority of Russian citizens, since the redistribution of property looked, from their point of view, inadequate and lacking a clear motivation, mostly because the key factors of why the scheme occurred, which would be analyzed below, were not announced publicly. In 1995, a difficult economic situation developed in Russia. The budget deficit increased from 8.6% in 1994 to 9.7%, the level of real wages continued to fall, and wages themselves were paid with delays. The state external debt increased by January 1, 1995 to 118.5 billion dollars (about 30% of GDP). The budget was in dire need of money.

On March 30, 1995, at a meeting of the Government of the Russian Federation, President of ONEXIMbank Vladimir Potanin put forward the idea of holding loans for shares auctions. At their expense, it was supposed to replenish the state budget in theory. In practice, the need for an urgent replenishment of the budget (i.e., its acute deficit) was organized by issuing state money loans that were not secured by assets to future oligarchic groups. The funds received were used by the oligarchs to participate in auctions, and the loans were never returned to the state in full.

On August 31, 1995, President of the Russian Federation Boris Yeltsin signed a decree "On the procedure for the transfer in 1995 of shares in federal ownership as a pledge", which proposed using the scheme of loans for shares auctions "in order to provide sources for covering the federal budget deficit and the effective use of blocks of shares, federally owned." September 25, 1995 acting Chairman of the State Property Committee Alfred Kokh signed the first version of the list of state-owned companies subject to privatization (initially it was planned to sell packages of 43 enterprises). The auctions were conducted by the State Property Committee and the Russian Federal Property Fund subordinated to the government of the Russian Federation (Depoy, E., 1996).

In total, during the auctions on November 17 - December 28, 1995, were put up state-owned shares of 12 oil, mining and metallurgical and infrastructure enterprises. Their loans received in return were denominated in dollars. As the Accounts Chamber of the Russian Federation subsequently noted, only in 4 auctions out of 12 the amount of the loan received by the state significantly exceeded the starting value, from which the chamber concluded that "competitiveness during the auctions was not expected." (Kokh, A., 1998) Competition at the auctions was indeed very low. This happened because many potential buyers were not allowed to see or participate in them. In many cases, several firms owned by the same person or group of persons participated in the competition. For example, two companies, AOZT Reagent and AOZT Laguna, both affiliated with MENATEP bank, participated in the auction related to the Yukos state stake. Moreover, state-owned enterprises were often bought not with their own money, but with money taken as if on credit from the state.

Auctions analysis

The loans-for-shares auctions were held according to the official version in order to replenish the state budget, however in all 12 cases, loans that were due within a few months of the auctions were not returned. As a result, the creditors received ownership of the pledged shares. That leads to the statements that the loans for shares program was a major fraud and it was organized and carried out with the most active complicity of the state. As a result of these fraudulent auctions, state property was transferred into the hands of the oligarchs at an unprecedented low price. According to the media the participants received lower prices. However, this was not necessarily the case.

Table #1

Company	Shares on auction (%)	Market Price 1995 (mil.$)	Final price (mil.$)	Market price 2012 (mil.$)
NK Surgutneftegaz	40.12	n/a	88.9	11200
NW shipping cp.	20.5	10.23	6.05	18.3
Chelyabinsk met.	15	4.3	13.3	n/a
Norilsk Nickel	38	190	170.1	15800
NK LUKOIL	5	150	141	2270
NK Sidanco	51	n/a	130	16900
NLMK	14.84	31	31	1400
Murmasnk shipping cp.	23.5	4.75	4.125	20.44
NK YUKOS	45	150	159	29110
Novorossiysk shipping cp.	20	15.2	22.65	n/a
NK Sibneft	51	100	100.3	10500

Sources: Rozanova, N. (2016). *Theory of Market Industry*

Table #1 includes the prices of the enterprises before they have been privatized through the loans for shares program and the prices for which the actors of the program have received it. According to the table, indeed some of the winners of the auctions have underpaid e.g. North-West shipping company which has received a price of 6.05 million dollars compared to the 10.23 million dollars. Yet, there are cases in which the winning companies have overpaid e.g. NK YUKOS with the final price of 159 million dollars compared to the starting 150 million dollars, which tends to be overlooked by the media and citizens when making claims about the scheme. However, it is important to take into account that Russia was not fully integrated on the global market during the time of the auctions and the prices presented in all sources are an estimate. Moreover, the prices were significantly volatile, it was not possible to make certain predictions of the total price of the industry due to the crises. Even if the participants of the scheme indeed had underpaid, as is presented in Table #1, still the percentage of the so-called "sale" would be too little from the entire price to make such claims that the scheme was a complete scam and fraud. Lastly, USSR was famous for its lack of transparency in its operations and after its fall, the modern democratic regime has continued with this tradition, which makes it even more complex for analysis, hence, it is important which market and which data is used for the calculation of the total worth of the enterprises to make judgements about the discounts (Treisman, D., 2010).

Despite the facts presented above, which portray the extent of corruption and the belief of the citizens of the inefficiency of the Russian privatization processes, specifically the loans for shares program, it is important to dive deeper into the effects of loans for shares scheme on the enterprises and the economic growth of the country in order to fully claim whether the program was an unnecessary fraud for the sake of wealth being of the oligarchs or it became an inevitable and unpleasant savior of those privatized enterprises and Russian economy, which Russia required at that specific moment.

Political sphere

Reasons for the program

The political reason behind the support of the loans for share program is tightly related with the economical reasons, which would be explained below, but most importantly with the most economically powerful individuals. After the collapse of the USSR, the newly established democratic Russia itself was on the verge of a crush. The country was torn apart by economic and political crises, corruption, terrorists and the war in Chechnya. The period in power of Boris

Yeltsin was claimed to be very unstable and volatile. By 1996, Russia was in decline, on the contrary of what was expected to be an unprecedented rise and prosperity. All this sparked the rise of dissatisfaction among the Russian population, the appearance of disappointment in the imposed democratic values, and due to such factors, the rating of the Communist party began to grow (White, S., 1997). A poll conducted in those days showed that only 8.4% of respondents were ready to support Yeltsin in the elections, while 15.8% wanted to vote for Gennady Zyuganov (Darrow, S., 1995). It is important to note that Russia's polls were never famous for their accuracy and transparency.

Overall, Yeltsin's campaign needed strong financial and media support in order to outstand the communist party in such a complex situation where all the odds are against him. Here is where the "Semibankirschina" coalition came to power. The term translates to seven bankers or oligarchs which were in possession of more than half of all of the resources and main production enterprises of Russia. After 1995, a significant part of the country's natural wealth, in particular oil and non-ferrous metals, ended up in the hands of a small circle of businessmen (Freeland, C., 1996). The oligarchs began to create diversified business empires and media holdings by buying up TV channels, newspapers, magazines in order to gain control over the media. However, how was it possible that such a small coalition has teamed up and started to assist Yeltsin's presidential campaign? George Soros, an American businessman, recalls that Boris Berezovsky along with six other businessmen, Mikhail Khodorkovsky, Vladimir Gusinsky, Vladimir Vinogradov, Vladimir Potanin, Mikhail Fridman and Alexander Smolensky, were very closely related to Yeltsin's family and they have agreed to set all competition apart and form the syndicate to support Yeltsin's campaign (Soros, G., 2000).

Execution of the program

The de facto agreement between Yeltsin, political authorities and businessmen was mutually beneficial. The president had almost no financials for the election campaign, and the oligarchs feared that Yeltsin's leave would lead to the fact that they would lose the opportunity to take possession of the enterprises and resources and even lose what they already own, since the win of Gennady Zyuganov would have meant the repeat of the nationalization of the properties. The oligarchs coordinated the tasks with Chubais, who was one of the leaders of the Yeltsin campaign. Chubais controlled the flow of the finances which is why he became the head of the analytical center. Whereas the businessmen demanded that the president would sign an agreement for the loans for shares scheme. As a result, during the elections Yeltsin received 53.82% of the vote and Zyuganov received 40.31%. During the second presidential term of Boris Yeltsin, the position of the seven oligarchs only strengthened, and the country's politics turned into a confrontation between their monopolies (Brudny, Y. M., 1997).

Review of the political influence of the program

Therefore, the loans for shares program allowed Boris Yeltsin to come to power and it was among the most crucial decisive factors of Russia’s political vector. Loans for shares program was effective in terms of creating a mutual agreement between the 7 businessmen and political authorities, hence making profitable results for both (Smith, G. B., 1999). However, it is important to establish the economical reasons and effects of the scheme. The scheme can be considered influential from the political point of view, due to the fact that it did not allow the communist power to take the lead once again. Yeltsin wanted to leave the Russian political arena, and the democrats were choosing Anatoliy Sobchak for the president. Moreover, the citizens themselves were interested in the return of the communist regime however, they didn’t analyze the political campaign of the communist party due to the lack of interest and competence in politics. The businessmen who participated in the loans for shares clearly understood what would happen to Russia and its economy if Zyuganov wins the elections for president. Hence, loans for shares helped the democrats to maintain the power. Such a scheme was not ethical and fair however, it was demanded at that point of time and the decisions had to be made quickly. To support the claim that loans for shares scheme was influential on the modern Russia politically, Anna Arutunyan in her “Putin's Mystique” states that “Two circumstances were pivotal in establishing the current balance of power and money in Russia: the loans for shares programme in 1995, and the subsequent decision of a few key members of the moneyed elite” (Arutunyan, A., 2014) . The decision making of the elite, the seven oligarchs, and their quick organization of the programm had created a political effect which has remained up until today. Thus, the scheme conducted by the seven oligarchs is correlated with the political regime which is occupying modern day Russia. In current circumstances, such an influential effect may be viewed negatively. Yet, it is unknown why the government, after the win of Yeltsin did not raise money from the auctions, having all the resources needed (Treisman, D., 2010). Loans for shares program initial consideration, apart from the support of the oligarchs, was to repay the budget, the total amount would be depicted below, and it did not fulfill its first goal, as well as it is unknown why the actors involved did not stress about it.

Economic sphere

Economic background

In the first years of privatization the Russian industry was at the peak of the non-payment crisis, and the state was extremely short of money. In 1995 in quantitative terms Russia started to experience a decline in the process of the privatization process. Russia's federal budget revenues from privatization in 1995 consisted of the following components: auctions and tenders for all blocks of shares sold in 1995 for 1.5 trillion rubles against expected 4-5 trillion rubles from the sale of blocks of shares in 136 of the most efficient Russian enterprises; establishment of convertible bonds of NK Lukoil worth of 1.0 trillion rubles (Gaidar, Y., 1996). Svyazinvest was expected to deliver 1.9 trillion rubles to the budget but the deal failed since it was dodged by the actions of both sides, the board of the Italian operator STET and the creation of loans for shares program which scared off the Italian partners due to the scandal around the transparency of the scheme (Euromoney, 1997). The loans for shares auctions from 12 enterprises itself delivered 5.1 trillion rubles against the previously assumed 2-3 trillion rubles for 43 enterprises, which makes it the most successful program for funding the budget. Without the loans for shares program, the voucher privatization alone was not enough to liquidate the arrears in the payment of pensions, wages to the military, employees of the Ministry of Internal Affairs the FSB, and other working class positions. And that was one of the reasons the proposal for the program was supported. But overall the total federal income from privatization processes was estimated at 7.6 trillion rubles against the expected 8.7 trillion. The government was very desperate for money. Oil in 1995 cost $16 per barrel, Russia's GDP was less than $400 billion. Government revenues were $37 billion, expenses were about $52 billion, and the deficit was $15 billion. That is why the government with little hesitation accepted Potanin's offer to the state a loan of trillion rubles secured by shares in RAO United Energy Systems, Norilsk Nickel, Rostelecom, Yukos and several other companies.

Economic execution of the program

As has been stated earlier, 12 companies were selected for the auctions. The exact companies names and official prices of those that were pledged are: NK Surgutneftegaz went to NPF Surgutneftegaz, with the loan amount of 400 billion rubles, which has been the largest out of 12. It is unknown which of the 7 businessmen actually own it since, de jure, the owner of the company is Vladimir Bogdanov who has bought 40% of the shares during the auction. JSC "North-Western Shipping Company" was bought by IFC for 6.05 million dollars. JSC "Chelyabinsk Metallurgical Plant" sold to the company "Rabikom" for 13.3 million dollars. 38% of RAO Norilsk Nickel shares went to ONEXIM Bank for 170 million dollars. NK "LUKOIL" remained to be in the NK "LUKOIL" and split the shares with the bank "Imperial" in total for 35.1 million dollars. NC "Sidanco" to IFC and ONEXIM bank for 130 million dollars. Novolipetsk Metallurgical Plant again to ONEXIM Bank and IFC for 31 million. JSC "Murmansk Shipping Company" to CJSC "Strateg" for 4.125 million dollars. NK Yukos sold to CJSC "Laguna" and the "Menatep" bank for 159 million dollars. JSC "Novorossiysk Shipping Company" divided between the companies ``Novorossiysk Shipping Company" and Tokobank for 22.65 million dollars. Nafta-Moscow JSC remained in Nafta Moscow JSC and Unibest Bank for 20.01 million dollars. Lastly Siberian Oil Company JSC was sold to “Stolichny” Savings Bank and CJSC Oil Financial Company for 100.3 million dollars. (Overland, I., & Poussenkova, N., 2020)

According to the joint venture, which was created in Russia in 1995, temporarily free funds of the Ministry of Finance of Russia were placed in Imperial banks, whose owner was Sergey Rodionov who was linked with the seven oligarchs on the politicians, in the amount of $ 80 million, with a total amount in two loan agreements to the budget of $ 48.3 million. In the Capital Savings Bank, which was founded in 1989 by Alexander Smolensky who was in the seven bankers coalition, in the amount of $ 137.1 million, with a loan amount of $ 100.3 million, and in the MENATEP banks, whose owner was the infamous, one of the largest beneficiaries Mikhail Khodorkovsky, in the amount of $120 million with a total amount of two loan agreements of $163.125 million (Nesterova, D. V., & Popova, L. N., 1996).

One of the key banks which have participated in the scheme was ONEXIM bank, owned by the crucial actor of the scheme, Mikhail Prokhorov. The bank did not require the money from the governmental budget, because it became the authorized bank of the State Property Committee, and all participants in the auctions deposited their money in it (Lieberman, I. W., 1997). Moreover, even after the auctions, the money was not sent to the account of the Ministry of Finance, but remained in the same commercial banks, although in special accounts. The oligarchs and the politicians decided to create specific accounts directly for the Ministry of Finance of Russia in ONEXIM and Imperial banks which were blocked, and standard currency accounts of the Ministry of Finance of Russia in ONEXIM bank and in the MENATEP bank (Guriev, S., 2005).

Review of the economic influence of the program

Therefore, it can be concluded that lending transactions of the shares of state-owned enterprises can be considered a scam and fraud, since banks actually credited the state's budget with state's finances. The budget did not enlarge nor shrinked and the money, which on paper was supposed to go directly to the governmental budget in order for it to be able to combat the growing deficit in the country, was only deposited in the banks of the oligarchs who had participated in the scheme and was not utilized. Hence, the loans for shares program did not influence the growth of Russia's government budget since the program has used the state’s finances itself. This explains the negative commentaries of the program, however, the loans for shares program had other areas of influence, such as the effectiveness of the privatized enterprises.

Efficacy of the companies

Justification of chosen companies

After the political and economical effects have been stated it is important to begin with the analysis of the efficiency of the program on the privatized enterprises and the economy as a whole. In order to make a statement of efficiency of such a non-transparent and unfair auction it is important to make an analysis of the performance of the companies before and after the loans for shares program occurred. The first company which will be under the analysis is the NK Surgutneftegaz. It was the top oil producing and refinery industry in the ratings up until the early 2000. It was also the most expensive enterprise and had the highest loan from all the auctions. According to the study by Indra Overland, Surgutneftegaz continued to positively grow after the loans for shares program due to the tight relation of the CEO’s with the government who were supporting the directors due to their support during the election of Yeltsin (Overland, I., 2020). Second enterprise for the analysis is Yuganskneftegaz under the rule of YUKOS. There are several reasons why Yuganskneftegaz was chosen. First of all, it was among the top 5 oil producing companies according to its performance. Secondly, it was still one of the relatively most expensive industries during the auctions with the loan of 159 million dollars. Moreover, this enterprise was chosen due to its volatile performance to portray that loans for shares program still wasn't a perfect blueprint to save all Russian industries. Another oil company for the analysis is LUKOIL "West Siberia". The loan wasn't as high compared to the previous two industries, yet its performance was outstanding compared to all others. The last company for the analysis is Murmansk Shipping Company, which was acquired by CJSC "Strateg" for 4.1 million dollars. This company is used in the analysis in order to diversify the performances of the oil production and refinery companies with other types of industry.

Explanation of the analysis

The analysis consists of four tables with the performances of the companies from 1994, which will stand as the base year for the calculations of growth, till 1998, a year in which Russia has entered the default. During the default the country and its central bank had devalued rubles and the data would include losses of the companies, which were not correlated with the scheme and are unnecessary for the analysis. The only outstander is Murmansk Shipping Company, which will have limited years for the analysis due to the absence of the sources for other years. The factors of analysis of the growth of the enterprises are volume of sales, profit and number of employees. Volume of sales indicates the ability of the enterprise to enlarge the production. Profit is an indicator, which is also related to the volume of sales, that portrays the ability of the enterprise to generate finance from its operations. Moreover, from the profit an enterprise is paying the taxes to the government and is able to make long term plans for itself. Lastly, the number of employees shows whether the industry is growing, since it would require more labor force to maintain its performance.

Analysis of the performance

Table #2

Surgutneftegaz	1994	1995	1996	1997	1998
Volume of sales (bil. rub.)	2444.4	13800	20973	24547.9	25770
Profit (bil. rub.)	532.7	4038	4303.1	4697.6	6076
Employees (thousands)	11.1	69.4	69.1	68.7	67.7

Sources: RAEX. *Oil and gas (1995-2021)*. RAEXPRO rating review.

Table #3

Yuganskneftegaz	1994	1995	1996	1997	1998
Volume of sales (bil. rub.)	1635.6	12169	13115	8665.7	7720.4
Profit (bil. rub.)	21.3	4711	-299	-629.6	228.4
Employees (thousands)	8.3	49.9	43	42.3	27.4

Sources: RAEX. *Oil and gas (1995-2021)*. RAEXPRO rating review.

Table #4

LUKOIL West Siberia	1994	1995	1996	1997	1998
Volume of sales (bil. rub.)	1219.6	4447	9947	17790	16378
Profit (bil. rub.)	138.1	723	1227	1078	37
Employees (thousands)	6.9	8.6	21.1	44.2	43.7

Sources: RAEX. *Oil and gas (1995-2021)*. RAEXPRO rating review.

Table #5

Murmansk Shipping Company	1995	1996	1997
Volume of sales (bil. rub.)	748	735	763
Profit (bil. rub.)	82	-	-26.7
Employees (thousands)	6.4	-	5.5

Sources: RAEX. (n.d.). *Transport (1995-2021)*. RAEXPRO rating review.

Table #2 portrays the data of the performance of the Surguneftegaz company. In 1994, it didn't have many employees with only 11.1 thousand people and its volume of sales were moderately low (yet still the highest among all other companies in 1994). After the auction has taken place, the company has significantly increased its number of employees and volume of sales along with the profit e.g. the growth rate of the sales volume between the 1995 and 1996 was 75.9%. Surgutneftegaz was taking the first place of the rating up until 1999.

Table #3 contains the data of the performance of Yuganskneftegaz under the control of YUKOS which was split between the two companies, the CJSC "Laguna" and the "Menatep" bank, which all was controlled by Mikhail Khodorkovsky. Before the auction the company was ranked fifth, with stable sales and profit and a medium number of workers. As with the Surgutneftegaz, right after the auction the company's performance statistics started to rapidly increase. It became the second largest oil producing company for the period of two years from 1995-97. However, in 1997 the YUKOS company was supposed to be merged with ROSPROM, which was a federal agency, hence making the company state-owned again. Therefore, the decline in the sales, profits and employee number should be related to the unstable circumstances of the YUKOS company and Chodorkovky's issues with the government and not to the fact that it was privatized through the loans for shares program since the growth rate of the company was 33.7% only a year after the program took place. Nevertheless, the company managed to retaliate in 1998, however shortly afterwards YUKOS was claimed to be bankrupt, which was again linked with Mikhails's relationship with the government.

Table #4 shows the performance statistics of the West Siberian LUKOIL enterprise. In 1994 it was ranked seventh among the oil producing companies and wasn't showing progress of growth. However, right after the loans for shares program its performance became outstanding. It had the highest growth rate among the top industries, with 698%, in a year after the scheme was completed. It had less employed than Yuganskneftegaz in 1994 yet it managed to outnumber the second largest oil producing company in 4 years. However, it also has faced the decline in the sales volumes and profit in 1998, which can be explained by the fact that Russian economy has faced a financial crisis and LUKOIL was a fastly growing company, it didn't have such good reserves as Surguneftegaz to be able to withstand the crisis without such negative effects. The growth rate during the crisis was -7.9. However, LUKOIL managed to overcome the difficulties which it has faced and became the first oil producing company in 1999 with the sales volume of 30321 billion rubles and over 5 billion rubles profit.

Table #5 includes limited data of the performance of Murmansk Shipping Company which was privatized by CJSC "Strateg". The company was amongst the least expensive industries which have participated in the loans for shares program. The company was not large with only 748 billion rubles sales and 82 billion rubles profit during the start of its privatization through the program. In 1996 the sales started to decline, there is no data on other factors but it would be possible to assume a similar effect on them as well. In 1997, the company began to slowly but steadily grow its sales volume, with a 3.9% growth rate, yet its profits were still negative, due to the fact of its decline in 1996. Such a drop in the performance could be explained by the director of the industry, Nikolai Matyushenko, who has been working in the company for many years until the beginning of 1997. After his leave, the company started to experience new changes and modernization. The problem with the old management would be examined below.

Therefore, it is possible to conclude that the loans for shares program wasn't inefficient for the enterprises which were given away to the oligarchs as was claimed in the media and by the red directors which left their positions. It was believed that the oligarchs treated the "stolen" companies aggressively and ineffectively, stripping them of assets and cash for other projects. However the sales and profit grew much faster in oligarchic companies than before them. And it's not that the oligarchs chose the best companies for themselves, as the tables show, in 1994, initially the performance of some of the companies which they inherited was significantly low. Hence, the loans for shares program was influential on the growth of one of the most important production and refinery companies in the country after the oligarchs started owning them. Yet, they still had faced the difficulties with managing them.

Red directors

The statistics presented above analyze the growth rate from the volume of sales and profit of the three out of 12 companies which were privatized through loans for shares. In those four industries, the growth rate was almost immediately positive right after the scheme took place, except for the Murmansk shipping company's delayed growth. The sales and profits increased dramatically, especially for the LUKOIL, and the enterprises attracted thousands of new workers. However, what can explain such a trend of positive growth, since the program itself was not aimed for such effects, rather its purpose was to divide the enterprises between the businessmen for the sake of their help during the presidential campaign of Yeltsin and their following loyalty to him. Yet, it appeared that the new owners of the industries had a positive effect on the growth and expansion of the companies.

Issues with the red directors

One of the biggest issues which the oligarchs had to face, besides the modest inefficiency of the companies and the debts, were the managers of those industries who were in power before the privatization took place. The managers of the previously state owned industries are entitled as the red directors. They were appointed to management positions during the Soviet era and have remained in their posts till the days of privatization. The term is used to describe a leadership style that emerged during the Soviet era and is characterized by such features as authoritarianism, which was very common during soviet times, incompetence in legal and financial matters, and unwillingness or inability to learn how to operate in a market environment. The term “red directors” is a legacy of the USSR, when the Soviet government sent young communists to enterprises to pursue the line of the party and government. By the 1990s, the meaning was reversed: red directors managed state-owned enterprises as if they were their own property. When voucher privatization began in 1992, they began speculating. Using their position, the directors delayed salaries, taxes, and payments for state raw materials and energy. The profitable part of the business - for example, export or rental of premises - was taken out of the enterprise, enriching the management, local authorities, and often criminal groups all of which the new oligarchs had to deal with. Many red directors were good engineers, but very rarely turned out to be successful businessmen as was the case with the Murmansk shipping company and its director, Nikolai Matyushenko, who despite his long experience in the company could not withstand the new rules of the market. Under the new management, which was assigned by the oligarch, the company started a modernization. On the contrary, one of the most remarkable red directors is Vladimir Bogdanov, who has successfully operated in Surgutneftegaz from the 1970, starting as an engineer and became the CEO up until today. He has participated in the loans for shares program himself, however he is not included in the “Semibankirschina” coalition despite the fact that he is a billionaire himself. His company, as was portrayed in the efficacy of the companies section, was one of the most successful. He knew how to operate it due to the fact that he has climbed to the position of the general director by himself, yet, his relationships with other oligarchs are mostly hidden from the public and it is yet, he has utilized their help during the auctions. His ally was Vladimir Potanin, who was a friend of the owner of the ONEXIM bank, and Potanin had taken care of Bogdanov’s finances during the auctions and in return Surgutneftegaz had its accounts in the bank (Overland, I., 2020). Nevertheless, Bogdanov still used the loans for shares program himself and brought the company to success, hence the loans for shares scheme, along with the relationships with other oligarchs, also has influenced in the growth of Surgutneftegaz

Review of the actions of the oligarchs

However, in the 1990s, most of the enterprises in Russia under the leadership of red directors began to decline: they did not pay taxes and salaries to employees, accumulated debts, and stopped production and the enterprises were in desperate need of modernization. From 1993 till early 2000s, there was a competition at the privatized enterprises for control over them. In the process, either the red directors outstanded the new minority shareholders, or the control was established by external shareholders who had completely replaced the red directors. Sometimes there were some compromises and coalitions, especially after the loans-for-shares auctions. Those red directors who maintained their power remained to be a part of the new Russian elite. Many even received financial support from the oligarchs. However, all this was incomparable with their status in the Soviet economy, when they, whilst not being the owners of the enterprises, still operated it how they wanted. Some of the oligarchs, such as Vladimir Potatin, themselves have never operated in the production and refinery industries. From the memories of the Russian journalist Mikhail Zygar, going into the production sphere has been Potanin's idea for a long time, although he has never dealt with industries before (Zygar, M., 2021). By the start of the loans for shares scheme he was only 34 years old, coming from the Soviet golden youth, the son of the USSR trade representative in New Zealand. He graduated from MGIMO, and worked in the foreign trade system. The acquaintances of the father were very helpful in creating his own bank that conducted foreign trade operations. But by the mid-1990s, Potanin says, he realized that he did not like banking “He did not get any pleasure from empty speculation - he was drawn to production." By 1994, Potanin came to the conclusion that most of the enterprises in Russia were managed completely inefficiently. The old Soviet factory managers, as the rulers, did not know what to do with their enterprises in the new conditions.

Nevertheless, despite the peaceful offers from the businessmen to the red directors of leaving their working positions in exchange of fiances or other positions in the oligarchs companies, where the red directors would not have any source of power and decision making, sometimes the old directors started to push the businessmen away from the enterprises which they have legally obtained through the loans for shares program. The old directorate of Norilsk Nickel, clinging to its privileged positions, did not want to allow even limited management of the enterprise by Potanin’s ONEXIM bank, which received the aforementioned limited right following the results of a loans for shares scheme. Therefore, such behavior has affected the world prices of nickel on the global market, which started to rapidly decline to the 1980s level (Thompson, M., 2006).

After the Moscow court solved the disputes between the Potanin and Filatov, the prices started to rise. The confrontation of the businessmen with the red director, due to the loans for shares program, has caused a global effect on the nickel.

It is argued that the best beneficiaries from the loans for shares program were the red directors. First of all, because those of them, who participated in the loans for shares program, such as Bogdanov, have received the biggest sale during the auction. Secondly, because they have remained untouched in their positions. However, as was portrayed in the table #1, the sale was not so massive as to make the red directors the biggest winners of the program. Moreover, Potanin's case with Filatov makes it clear that in case of any confrontation or differences in the views, the oligarchs could easily replace the red director because of their connections with the executive power.

Therefore, the new owners of the enterprises, the seven oligarchs, have influenced the change in the management style of their companies in order for them to withstand the new market laws and rules in modern Russia. Yet, not always the oligarchs legitimately solved their disputes with the incompetent red directors, even with Potanin's case, the high court was on his side due to his tight connections with the ruling political party. However, despite the unethical actions, the oligarchs intentions were to modernize their industries and generate as much profit as possible. The loans for shares program was influential on the change of the old, inefficient, incompetent and unskillfull management which was limiting the potential of the biggest Russian enterprises and replacing them with the new ones. Such a change could have a positive effect on the total economic growth of the country.

Total growth of the country

After the loans for shares program took place, the privatized industries began to generate more sales and profit as well as they started to pay more taxes from the bigger profits to the state budget. All such factors have influenced the total economic growth of the country and its GDP rates. As the country entered to experience the privatization processes and restructure of its political regime, its economic growth began to rapidly decline. The leaders of the reforms, from the very beginning did not have any precise and thorough plans for the successful privatization, they had to quickly react to any arising problem without the time to prepare how to combat it. After the completion of the auctions, the economy started going towards major economic crises, it wasn't directly related with the scheme, since the main factors were inability of the ruling authorities to handle the upcoming issues.

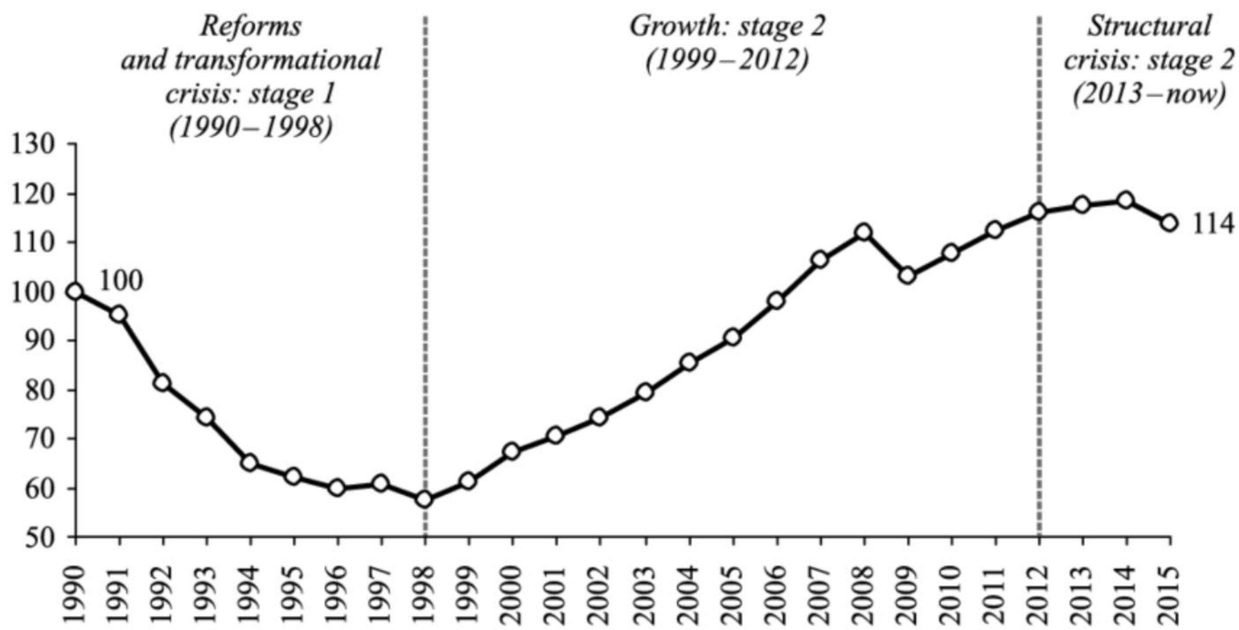
Influence of the crisis

In 1998, a severe financial and economic crisis erupted in Russia also due to the backdrop of the crisis in Asia and falling prices for oil and other natural resources. The difficult situation in the economy was furtherly worsened by inefficient monetary policies, the inflation was held back by an overvalued ruble exchange rate (about 6.2 per dollar), and the budget policy was too loose. On August 17, 1998, a default was declared on debt obligations and the ruble was devalued (Hoffman, D., 1998). A week later, Yeltsin dismissed the government of Sergei Kiriyenko, and the head of the Central Bank, Sergei Dubinin, resigned in early September. By the end of 1998, the dollar exchange rate had exceeded 20 rubles (the currency corridor had to be canceled). The inflation rate in 1998 was 84.5% against 11% in 1997, real incomes and living standards of the population fell sharply. All leading to a decrease in the total economic growth of the country. However, Russia was not the only country which has experienced the economical crisis, from the beginning of 1990s several countries underwent economic crisis due to multiple reasons such as Sweden in 1990 and its collapse of banking and high unemployment (Hassler, J., 2015).

Analysis of the country's performance

The following chart is indicating Russia's gross domestic product:

Figure #1



Source: Akindinova, N., Kuzminov, Y., & Yasin, E. (2016). Russia's economy: Before the long transition. *Russian Journal of Economics*, *2*.

In 1997 Russia's governmental budget was experiencing a large deficit once again, loans for shares scheme was not a panacea solution of the problem in 1995 and it continued. Yet, the program wasn't a factor in the crises. Because of the program in 1997, the economy showed the first signs of a sluggish recovery, as can bee seen on figure #1, a very slight increase from the year 1996 to 1997. However in the beginning of 1998 such factors as interest rates on loans and government obligations began to rise rapidly, and the stock market began to fall, leading to the lowest GDP rate since the fall of communism.

The crisis led to devastating effects on the businesses and private banks. Among the large and influential businessmen, those who, in addition to banking assets, had the industrial assets, especially from the loans for shares program, had suffered less. Taking advantage of the moratorium on debt repayments and in some cases, as happened in the case of Menatep Bank, by bankrupting their own banks, they managed to preserve assets and later partially or completely repay debts to creditors. The central bank did not favor such actions by the oligarchs and has persecuted some of them, such as the YUKOS case (*Destruction of Evidence*., 2017).

Influence of the program on the total economy

It appears that the loans for shares program was not very influential for the total growth of Russia's economy. It did cause an increase in its GDP rate after the implementation of the scheme, however Russia's economy was already going into a crisis state and such increase was not helpful. The scheme assisted the oligarchs in terms of helping them to go through the crises, since they had major assets and have repaid the debts, which could have been a decisive factor on the country's economic resurgence. However, this was only in the short term influence of the scheme. In the long term, the enterprises started to rapidly recover after the crises. Oil has been one of the main Russian export resources. As in 1999, the leaders in terms of exports were Lukoil, Yukos, Surgutneftegaz, TNK and Tatneft. In total, they provided 72 percent of Russian exports worth of 13,466,763.11$ (WITS). And in 2000, oil exports increased even further by 12.6 percent and amounted to 125 million tons for the amount of 23,647,000.44$ (WITS). According to Figure #1, Russia's GDP entered the 2nd stage of growth after the crisis and the privatized oil producing and refinery enterprises, under the modern management of oligarchs in collaboration with wise red directors contributed to the growth. Therefore, the loans for shares program could have been one of the many influential factors on the total growth of the country's economy in the long run.

Conclusions

Loans for shares program, as well as the total privatization process, has been considered a failure and a disaster for the Russian economy and its citizens. Yet, this study has revisited the facts once again and undermined the common beliefs by deeply analyzing the program with the assistance of the literature review.

The thesis started by description of the methods of the privatization in order to portray the inefficiency of the previous steps. Loans for shares program has been viewed by the politicians as the last savior after they have seen the failure of the vouchers. Hence, the occurrence of the program was inevitable, considering the circumstances the actors who made final decisions were in high demand of the new tool which would help them with the issues, mainly to replenish the budget deficit. After the loans for shares program was approved, the study analyzed the influence of the scheme on the political arena of modern Russia. Loans for shares program has de facto helped Yeltsin's party to win the elections and not let the communist party come to power again. 7 Businessmen understood the threat of the communist party to their private business and made an agreement with Yeltsin and his authorities about the replenishment of the budget in return for the biggest and influential enterprises of the country. However, the main aim of the program was still not achieved. In the economical effects of the program, the study has portrayed the scale of the problem with the budget deficit and by how much exactly the loans for shares program would have decreased the deficit. Yet, the money received from all the auctions technically did not go to the budget. The fact of unfairness and unethical actions of the actions themselves should not be included since the program was proposed by the oligarchs themselves therefore, it is morally not wrong for them to participate in it by themselves without letting anyone to join. However, what is unfair, especially to the citizens and governmental institutions, is that the program did not fulfill its main objection, saving the federal budget's deficit by paying it the loans. One of the main reasons for the negative perception of the scheme by the public and foreign companies, as was with the Italian operator STET, and politicians, is that the loans for shares program has used budgetary funds instead of delivering the finances to the budget. Thus, leading to the fact that loans for shares program was not influential economically, in terms of solving the budgetary issues despite the fact that there was a financial possibility by the oligarchs to complete their obligations.

Another belief that the oligarchs had stripped the assets of the privatized companies has been undermined in the efficacy section, where a performance of certain companies which has participated in the auctions were analyzed leading to the conclusions that the new management, along with some wise red directors has caused a positive effect on the growth of the industries. Not all red directors were wise enough to continue their roles as the CEO's and that has led to several confrontations between them and the oligarchs. There were few cases, such as Bogdanov in Surgutneftegaz, where the red director, using the loans for shares program, has improved their company even more. Hence, the loans for shares program was influential in terms of replacing the old inefficient management or giving some of the efficient one's more power for the sake of the well being of the company.

Lastly, the influence of the loans for shares program on the total growth of the country was analyzed. Despite the quick growth of the privatized enterprises, the GDP of the country was on a constant decline, mostly because of the coming crises which was inevitable for such a new and unstable economy. For the short period from 1995-1998 the program was not influential, yet, there can be a correlation between the enlarging performance of the privatized companies and the growth of the GDP rate after the crises, hence, the program could be influential in the long run.

Loans for shares program can still be considered a fraud and a scam, partially because it did not complete its first and the most important goal, to finance the budget deficit, it helped the democrats win which has shaped the infamous modern Russia political arena, and the auctions themselves were closed only for the members of the elite. All these facts have been present and they are the justification of the influence of the program. Indeed, the influence is negative from the moral point of view, especially in the political sphere, yet, this thesis has portrayed how one agreement, in 1995, between seven influential businessmen and a politician with his authorities has reshaped the political arena and the ownership of the top russian industries for many years up until the modern times. Thus, making it an influential scheme for both post soviet and modern Russia.

Limitations

The limitations of the study are related to the lack of transparent data on the performance of the companies during the 1990s period in post soviet Russia. The data had to be extracted from various online sources which were applicable to the study, yet the accuracy of the data is arguable due to the lack of transparency during the 90s. Another limitation is the dependency of the analysis on the anecdotal data from the main actors who have participated in the scheme or have covered the scheme e.g. businessmen, political authorities and journalists, therefore there is space for bias and inaccuracy.

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