

# Western Privatisation Assistance in the Russian Federation

*The provision of assistance in the privatisation process is a key element of Western technical aid for Russia. The first part of this article describes the influence the largest Western donors have in Russia and the activities they have performed in connection with the provision of privatisation assistance. It then outlines the stage reached in the privatisation process by the middle of 1997. Finally, it discusses a number of ways in which privatisation consultancy by Western donors may develop in future.*

In September 1990 the Supreme Soviet debated the privatisation of the Soviet economy for the first time without ideological constraints; the practical implementation of privatisation in the Russian Federation, which is still in progress today, began in 1992, after the dissolution of the Soviet Union. Since then, several Western donors have been involved to a greater or lesser extent in providing privatisation assistance. Almost 40% of the funds totalling more than US\$ 2 billion<sup>1</sup> provided by G7 countries for technical assistance to Russia has been used for privatisation and restructuring of the economy.

## Western Privatisation Assistance

The activities performed by individual donors in connection with the provision of privatisation assistance are not unconnected with their general importance in the Russian context. Assuming that a donor's importance is determined by the breadth of its involvement and its international or national backing, Figure 1 shows an assessment of the influence of the various donor organisations on the basis of a brief survey of Western experts working in Moscow. Not surprisingly, taking technical and financial help together, the World Bank is seen as the most influential and largest donor organisation. Its considerable influence allows the Bank to insist on the fulfilment of conditions before the disbursement of grants or soft loans; to a certain extent it can therefore directly influence the policy of a borrowing country like Russia.

The development aid organisation of the USA, USAID, is also considered significant in Russia, on account of the scale of the resources provided as well as the political support given by the US Administration. Between the end of 1992 and the end of 1996 USAID provided more than US\$ 1.2 billion in technical aid, excluding loans. Also, the co-ordination between the World Bank and USAID in Russia has been particularly close; it is said that the World Bank often had the ideas, even in the field of privatisation, and that the Americans then took over implementation, as they could be quicker getting a team on the ground.

Other bodies are a long way behind the World Bank and USAID as far as potential influence is concerned. The Europeans, with their multilateral institutions, are not regarded as particularly influential, although TACIS, their aid organisation for transforming economies, also provides substantial funds (about US\$ 200 million/year). The other bilateral donors carry a certain weight only in very specific areas; this is true, for example, of the British Know-How Fund (KHF) and the German Society for Technical Co-operation (GTZ), which provides privatisation assistance on behalf of the German Government. Private donor organisations come at the very end of the influence spectrum. For example, the Soros Foundation, despite disbursing probably not much less than TACIS, mainly in the social field, has practically no political influence.

Against the background of this general "division of power", the main activities and capabilities of the

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<sup>1</sup> According to the Donor Assistance Data Base of the G7 Support Implementation Group, Moscow 1997.

various donor organisations in the provision of privatisation assistance become understandable (Table 1). In general, the more weight a donor organisation has, the closer it is (or was) to the core of the privatisation process. Ranked by their importance for a successful privatisation policy, five separate support areas can be identified. At the highest level, in providing policy advice for ministries and drafting legislation, the main Western actors in Russia have been the World Bank and USAID. Specifically, the Russian Privatisation Centre (RPC), which was established by Presidential Decree in 1992 and was largely responsible for preparing voucher-based privatisation, received both material assistance and personnel from USAID in the early years.

On the other hand, restructuring and investment generation which lead to what might be called "material" privatisation, were the focus of the activities of the EBRD and TACIS. Investment assistance mainly entails the provision of resources for venture funds, which are managed by the EBRD and financed by G7 governments. Interestingly, no attempt has yet been made to establish a systematic link between restructuring and the provision of investment funds, although the Americans, who want to withdraw from Russia in the next few years, are now planning an initiative in the field of investment promotion (the Gore-Tchernomyrdin Commission is working on this).

Other bilateral donors, such as the KHF, have always provided privatisation assistance only in selected areas; for example, it financed a project to prepare a share issue for the St. Petersburg telephone company. The GTZ has been assisting Russian government institutions like the Bankruptcy Agency and the RPC with a focus on material privatisation.

Land reform should be regarded separately from the privatisation of enterprises. In Russia, it has so far not been a centrepiece of reform. International donors have reduced their activities in this sphere in the last few years because the issue is ideologically charged. The USAID-financed Institute for a Law-Based Economy (ILBE), which specialises in this issue, deals mainly with agricultural land questions.

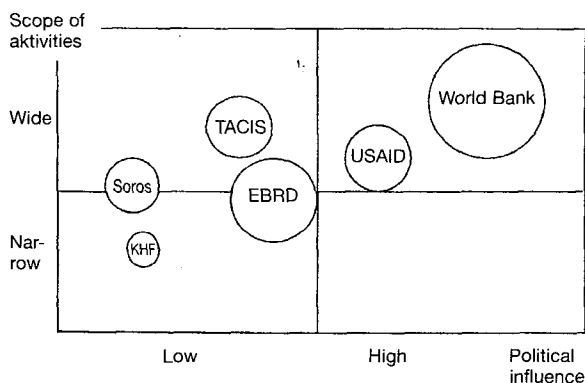
Viewed as a whole, the World Bank has had the widest range of activities in providing advice on privatisation. Now that the Americans have begun to withdraw, the Bank is more than ever the leading donor in this field. At present the World Bank is preparing a major new programme of individual privatisation projects, the so-called case-by-case privatisation, to be carried out in 1998 pending approval by the Duma; the RPC has been involved in pilot projects. The World Bank has also taken over the leading role in promoting corporate restructuring as other donor programmes expire in the next few years. An innovative element of the new restructuring programme promoted by the Bank is that the funds received by participating enterprises must be repaid, on favourable terms.

**Status of Russian Privatisation Process**

It is difficult to determine what would have happened without Western assistance, but it is probably fair to say that it had a positive impact; in Russia, a country which received relatively more technical aid than others in the region, privatisation is quite advanced. However, a distinction has to be made between privatised and unprivatised enterprises, where "unprivatised" means enterprises that are wholly state-owned, irrespective of their legal form. On the other hand, enterprises can have been formally privatised – as joint stock companies, for example – even if some of the shares remain in state ownership.

Because the various Russian state bodies use different definitions for their privatisation statistics, it is impossible to ascertain precisely the point that has been reached in the privatisation process. Nevertheless, on the basis of all the figures available, the privatisation policy in the Russian Federation can be called very successful, at least at first sight. According to Goskomstat, about 1.9 million of the 2.6 million Russian enterprises registered in mid-1997 were already in a private legal form, although some of these were still state-owned (this figure includes newly set-up firms).

**Figure 1**  
**Positioning of Western Donors**



Source: Interviews.

**Table 1**  
**Privatisation Assistance provided by Western Donors in Russia**

Areas of privatisation assistance	World Bank	EBRD	TACIS	USAID	KHF
Policy advice for ministries, drafting of legislation	Highly active, informal influence			Leader until 1993	Only in certain sectors
Implementation of privatisation projects	Technical assistance with individual projects			Voucher privatisation (concluded)	
Restructuring of state enterprises		Improvement of corporate governance			
Restructuring of privatised enterprises	Largest programme so far (ERSP)	Main activity until 1997	Core of TA activities	Withdrew in 1996	
Investment promotion (policy advice, provision of venture capital)	Development of the capital market	Several venture funds		Gore's investment initiative	
Land reform (policy advice and drafting of legislation)				Active through ILBE	In certain regions (Nishni-Novgorod)
Assessment of importance for privatisation process in the Russian Federation	Very high	Medium	Medium to low	High (until 1996)	Low

Source: Interviews.<sup>2</sup>

Slightly more detailed analysis shows that more than 50% of firms in every enterprise category have already been privatised (Table 2). About 70% of trading and service enterprises, most of which are small in size, had already been privatised before the start of the voucher-based privatisation programme, which was completed at the end of 1994. The same applies to small industrial enterprises, around 60% of which have been privatised. There are regional differences, however; some regions have completed the "small-scale" privatisation of trading and service enterprises, while others, such as communist-dominated Ulyanovsk and Chelyabinsk, have only progressed part-way. The depressing city centres of these "laggards" are telling evidence of local resistance to privatisation.

<sup>2</sup> For a summary of all technical assistance from Western donors, see DIW: Die wirtschaftliche Lage Russlands – Privater und öffentlicher Ressourcentransfer nach Russland, in: Wochenbericht 4/1997, 23rd January 1997, pp. 80-88.

One significant feature of Russian privatisation is that so-called "large-scale" privatisation is also well advanced. Around 80% of the 21,000 medium-sized and large industrial enterprises, which still employ more than 15 million people, are now formally in private ownership following voucher-based and subsequent cash privatisations. Only about 5,000 of these enterprises were designated as "strategically important" and, temporarily, excluded from the privatisation process.

However, when assessing the share of the private sector in the Russian economy it is sometimes overlooked that the Russian state still holds residual shareholdings in most of the privatised industrial enterprises. The size of the remaining stake, which is held by both federal and regional bodies, differs from region to region and according to the type of enterprise; according to the Russian National Survey, it amounts to around 10% overall (in early 1997). In

many cases final privatisation is already planned; it is estimated that concrete investment tenders or auctions are being prepared for around one-third of these enterprises, whose privatisation will be handled primarily by the Russian equivalent of the German Treuhand, Goskomimuschestvo, (GKI) and its local offshoots.

Still entirely state-owned are about 20 of the 100 (in terms of market capitalisation) largest Russian enterprises, including enterprises such as Rosugol, the Russian coal company, and Rosneft, a large oil and gas firm. About 80 of the Russian enterprise giants have been at least partially privatised. It is estimated that the state has only relatively small shareholdings in about 40 of these firms; in a further 40 it owns up to 60%, but its share is gradually declining. The privatisation of these large enterprises was speeded up during 1997 under the pressure of the budget deficit. Recently 25% of Svyazinvest, 8.5% of the energy distributor UES and the majority of the shares in several oil companies were sold.

In summary, the Russian privatisation strategy, influenced by Western advisors, might be called quick and dirty. There have been undisputable successes, especially when looking at the number of enterprises, including large ones, which are now formally in private hands. On the other hand, Russian privatisation is far

from being completed by the middle of 1997. The state continues to hold shares in many large and medium-sized enterprises and there have been cases in which its holding has increased again as tax debts have been swapped for equity. GKI (or Ministerstvo Gossudarstvenich Imushestv [MGI] as it is now called) is too poorly organised to exert any control over its shareholdings. Private ownership is often not more effective: the fact that in Russia privatisation has often involved a (free) transfer of large parts of the enterprise's assets to insiders, such as managers and workers (Table 3), has created substantial problems. In practice, insider control adversely affects corporate restructuring and the growth in real investment from outsiders. More often than not incompetent managers who control substantial packets of shares are not readily dismissed and a management team that relies on the goodwill of the workforce at shareholders' meetings may be only half-hearted about making the necessary reduction in personnel. It is now a generally accepted view that insider control is one of the reasons why economic recovery has been disappointing in Russia.

#### Provision of Privatisation Assistance in the Future

The intensity with which privatisation has been pursued in Russia has varied sharply, independent of consistent western efforts to push reforms. After

Bernhard Duijm


## Die Wettbewerbspolitik der EG gegenüber vertikalen Vertriebsvereinbarungen

Exclusive dealing agreements, exclusive purchasing agreements, and selective distribution systems are highly controversially discussed in theory and practice. These vertical distribution agreements can have both pro-competitive and anti-competitive effects. They can intensify competition by facilitating market entry or they can be used to divide up markets and thus reduce competition. So, the main objective of the competition policy of the EC, the integration of the European economies, can be affected by vertical distribution agreements in various ways.

This book analyzes the policies of the European Commission concerning vertical distribution agreements from an economic point of view. It examines whether and how the Commission is pursuing the aims of the EC competition policy. It is shown that sometimes the aims are conflicting and that sometimes the Commission subordinates the competition policy to other policies, e.g. to foreign trade policy. Also the procedure of the EC competition policy can be criticized: instead of preventing restrictions of competition block exemption regulations tend to be prescriptive.

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the first wave of privatisations between 1992 and 1994, the process lost much of its momentum until the appointment of Anatoly Chubais as First Deputy Prime Minister at the beginning of 1997. The prospects for the next few years are promising; in July 1997 the Duma passed a privatisation law for the first time, thus creating a legal basis for further privatisations, which hitherto had been regulated only by Presidential Decree. A new privatisation pro-

gramme that will be given the status of a law is also being prepared and can be expected to be approved within the next twelve months. Moreover, in August 1997 the increasingly controversial head of the Privatisation Authority, Alfred Koch, was replaced by Maxim Boiko, who has played a prominent role in privatisation from the outset as General Director of the RPC.

In principle, there remains a need for privatisation assistance from Western donors if the objective of privatisation is defined as the establishment of efficient ownership structures. It will take several years at best to dispose of the state's many remaining small residual shareholdings and the 5,000 or so large industrial enterprises still entirely in state ownership; true material privatisation, including restructuring and investment generation, has only just begun. One of the main tasks of privatisation policy in the years to come, will be to induce enterprises to adjust actively to market conditions. In particular, in future privatisations greater attention must be paid to questions of corporate governance.

It is unlikely, however, that the Russians will accept further involvement by Western organisations in the core areas of privatisation, that is to say in policy formulation and the setting of guidelines for privatisation programmes. The major privatisation projects of the last two years were all carried out without Western involvement, partly because of a growing nationalistic sentiment. An exception may be made in the case of the World Bank, which now has a number of senior staff of Russian nationality. They can gain access to the decision-makers in the Russian Government much more easily than Western experts; advice from experts who do not speak Russian, which was the case four or five years ago, is hardly conceivable now.

As a consequence, the focus of Western donors' involvement in the provision of privatisation assistance to Russia will change; they will concentrate increasingly on material privatisation, in other words restructuring and investment generation, as political considerations and national sensitivities are of less significance in these fields. In any case, donors are well advised to design their programmes in such a way that they are mutually beneficial and not merely give-aways. This also means an increasing role for the private sector; as markets begin to influence decision-making at the enterprise level state-run privatisation or restructuring programmes will become a thing of the past.

**Table 2**  
**Status of Privatisation Process in Russia (1997)<sup>1</sup>**

	Privatised (state holding < 100%) (all figures are approximate)	Unprivatised <sup>2</sup> (100% state- owned)
Trading and services	1.7 m	0.6 m
Small industrial enterprises (< 500 employees)	140,000	90,000
Medium-sized and large industrial enterprises	16,000	5,000
of which:		
- with remaining state shareholding	15,000	
- share sales planned	5,000	50
100 largest enterprises (in terms of market capitalisation)	80	20
of which:		
- with state interest < 20%	40	
- with state interest > 20% and < 60%	40	
<b>Total</b>	<b>1.9 m</b>	<b>0.7 m</b>

<sup>1</sup> All registered enterprises.

<sup>2</sup> Including "leased enterprises" at all levels of government (municipal, regional and federal).

Sources: GKI, Goskomstat, Russian National Survey, estimates.

**Table 3**  
**Ownership Structures in Joint Stock Companies,  
1994-96<sup>a</sup>**

Shareholders	Average percentage holding		
	April 1994	March 1995	June 1996 <sup>b</sup>
Employees	53	47	35
Management	9	13	16
<b>Total insiders</b>	<b>62</b>	<b>60</b>	<b>51</b>
Large external investors	11	17	28
Small external investors	10	11	11
<b>Total outsiders</b>	<b>21</b>	<b>28</b>	<b>39</b>
<b>State</b>	<b>17</b>	<b>12</b>	<b>10</b>
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>

<sup>a</sup> Large and medium-sized industrial enterprises.

<sup>b</sup> Estimates.

Source: Alexandr Radygin, V. Gutnik, G. Malginov: Postprivatizionnaja struktura akzionernogo kapitala i korporativnij kontrol, in: Voprosi Ekonomiki, 1995, No. 10, pp. 47-69.