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Advice's Effect: The Role of Western Advisors on Russian Privatization Policy

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by
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ABSTRACT

NICHOLAS JAMES GREENE: Advice's Effect: The Role of Western Advisors on Russian Privatization Policy
(Under the direction of Andrew Young)

This paper seeks to investigate the role that western advisors played in Russia's transition to a market economy during the 1990s. In order to answer this question a wide variety of sources were consulted. Scholarly papers, books on the subject, and works by the participants themselves all played. Through my investigation it became clear that advisors played little, if any, role in influencing policy. A host of domestic ideas and political factors were far more important in determining what strategy was pursued.

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Introduction

This paper will examine a very specific question concerning the role that foreign advisors played in shaping the course of Russian privatization. Specifically, it will describe how Russians plotted their own course on the subject of privatization policy.

Western advice was certainly present during the period, and much of it did recommend policies that were eventually adopted. However, those who suggest that Russians were pushed into adopting the "Washington Consensus" would do well to examine the evidence presented in this thesis.

This paper will, through a series of chapters, build up the proper supporting evidence for the statements made above. The first chapter will consider just what the term "privatization" means. Chapter two will provide an overview of privatization history, as well as an explanation of the "Washington Consensus". Chapter three charts the path of Russia's reforms, across the years from 1992 to the ruble crisis on August 17, 1998. Chapter four details the various advice and conditionality given by westerners during that period. It also seeks to determine how great an influence the advice had on Russians policymakers. Chapter five contains conclusions from my research.

Chapter 1: Privatization; definition and justification

In order to carry on a meaningful investigation of privatization policy, the term itself must be defined. There have been numerous suggestions put forth over the years. Thomas Biersteker, in a 1990 article for *International Studies Quarterly*, lists privatization as a three part effort, characterized by the divestiture or selling off of parts of the public sector; sub-contracting or eliminating public sector services; and the creating of incentives for private sector development, e.g., tax incentives and an increased private sector role in agriculture (Biersteker, 486). Dr. Madsen Pirie, the head of England's Adam Smith Institute and a leading British writer on the subject, defines privatization as, "not a method but an approach. It is an approach which sees no substitute for the market to the reality itself" (Pirie, 11-12).

During British privatization, for instance, a normal pattern of "shaping up" companies to get them ready for the market was followed. Frequently, many of the painful changes (layoffs, plant closures, price hikes, etc.) which would have been made necessary by the market were done while the firm was still under government control. This was justified by the need to get the best price once the company in question was offered. This process of reform could last one to two years. In contrast, many participants in the Russian privatization process tended to focus on events, most notably voucher auctions. The mere fact of selling shares in an enterprise would, it was believed, usher in all the necessary changes that in England had been conducted by government as part of the privatization process. These events, voucher auctions primarily, were perceived as transforming a state owned firm into a private one.

Sir Alfred Sherman, a senior Thatcher advisor, chooses to define privatization not by the ownership of an enterprise itself. Instead, he focuses on how competitive a particular market is. Only when corporations that were formerly public are forced to compete can they be said to have been privatized. In the wake of share sales in the "natural monopolies" he goes so far as to say that without competition, the ownership of an enterprise is irrelevant. The following quote comes from a paper by John Burton in *Managerial and Decision Economics* (the original quote appeared in the *Financial Weekly*).

> Insofar as public monopoly is turned into a private monopoly, the state remains there because the monopoly is guaranteed by the state. It is merely the state disguised as private. Insofar as that is the case we haven't had privatization (Burton, 22).

This definition seems overly stringent, although using a traditional microeconomic framework it is not unreasonable. It is interesting to consider that this, the requirement of a strong competition policy and the negative effects of lacking one, is a criticism that will crop up again later in regards to the Russian program.

Writing in Privatizing Russia, Boyco, Shleifer, and Vishny develop a comprehensive model to demarcate who really controls a firm based on a pair of "rights". The first is the right of control, i.e., the right to decide what the enterprise will produce or do. The second is the right to cash flow, i.e., the right to profit or lose from the firm's success or failure. Within this model, any person or group may have authority over either one or both of these rights. When describing privatization, Boyco et. al. say, "The allocation to the managers of control rights that once belonged to politicians is known as corporatization; the allocation to them, as well as outside investors, of cash flow rights is known as privatization" (Boyco, Shleifer, and Vishny, 50). Based on this definition any firm in which both the right to control and profit has been removed from the hands of the state can be said to have been privatized. Unfortunately, this definition cannot be adopted without qualification, due to the propensity of the Russian state to retain large shares of ownership in corporations that it "privatized." While ostensibly the government became a minority shareholder like any other, in many cases the effect was far from simple.

For this paper, the definition put forward by John Burton, Research Director for the Institute of Economic Affairs (London) will be adopted. Writing in *Managerial and Decision Economics* he defines privatization as "any measure by which transfers to private ownership of previously governmentally-owned resources occurs" (Burton, 22). This should not be confused with any other definition which appeared in same paper, such as the one cited above from Sir Alfred Sherman.

The term "mass privatization" should be taken to describe some form of large scale transfer of property to the citizenry. The most common example of such a move is the Russian voucher privatization program of 1992-1994, although others could be considered as well. Mass privatization exists in contrast to case by case privatization, where individual enterprises are sold, usually in the form of stock tenders.

The term "western advisor" should be interpreted to describe a select group of western economists, bankers, and development experts who held actual and quasi governmental advisory posts during the period from the August 11, 1991 coup attempt on Gorbachev until the August 19, 1998 currency collapse. This group includes, but was not limited to, Jeffery Sachs, Andrei Shliefer, Jonathan Hays, Anders Aslund, Richard Layard, and Stanley Fischer. Any following reference to western advisors is intended to refer to those individuals and their contemporaries. Any influence that western *ideas*, e.g., classical economic theory, may or may not have generally had on Russian policymakers is beyond the scope of this paper.

What arguments are put forward to justify privatization? There is a standard set of explanations for why privatization should be followed. Below are a few of the justifications and supporting arguments as presented by various authors on the subject.

In their work Kremlin Capitalism, Blasi, Krumova, and Kruse address just this point. Within a section titled "Why was privatization necessary?" they give two main reasons. First, the economy was collapsing. During the period from the August 19, 1991 coup attempt against Gorbachev until the freeing of prices on January 2, 1992 the Russian people and state had been living in a period of extreme uncertainty and a steady acceleration of disintegrating state control. Because of the peculiar nature of Soviet industrialization these problems were exacerbated. The Soviet state had consciously pursued a policy of building very large projects, both to capture economies of scale and as propaganda showpieces. These massive factories were, at least in some cases, not situated conveniently to their suppliers. Enterprises found themselves now across borders from their previously domestic suppliers and customers. Closer to home, at least for those in Moscow, was an impending food shortage. Yegor Gaidar, Deputy Prime Minister under Yeltsin, goes to great length to emphasize the dire nature of the situation. A whole chapter in his book on the period is entitled, "The terrible winter of Ninty-one" (Gaidar, 128). Having shown that Russia was in desperate need of radical action, they argue that only the freeing of prices and creation of a market could hope to return food to the shelves. It was believed that the only way to fundamentally solve the problem was through the discipline, cost cutting, and austerity that only new private owners could hope to bring.

Blasi, Krumova, and Kruse list as the second reason the fact that legitimate privatization had to be conducted quickly to stop "nomeklatura privatization." That is, illegal seizures by enterprise directors in the name of privatization (Blasi, Krumova, Kruse, 26-35). In the absence of previously controlling central agencies - Gosplan, the Union-wide planning authority, for instance - many enterprise managers were running their firms for their own personal interest.

The director of a Soviet enterprise was a peculiar creature. He (they were almost exclusively men) was responsible for managing his production unit in order to fulfill a target amount set by the Union-wide five year plan. Due to the nature of the Soviet system, these managers had almost no experience with marketing or sales. In the Soviet system, it was not the manager's responsibility to sell but simply to produce and fulfill the plan quota assigned to him. In fact, the only experience with markets of any sort was either the black markets where managers bartered for supplies during the 1970s and 1980s or the tightly controlled foreign trade conducted by the Soviet government. Furthermore, the Soviet system also made enterprises responsible for providing many of the services which westerners traditionally associate with local government or other more specialized private sector firms. Some examples include housing, schools, hospitals, and vacation resorts. The privatization of large industrial firms did not coincide with a similar shift of those responsibilities to government and other private firms. Instead newly privatized firms, many struggling to remain in operation, had to continue trying to supply the services their communities depended on.

Enterprise directors, who had previously only been asked to fulfill state imposed production quotas, were forced by the fall of communism to confront a highly chaotic environment for which their previous training had not prepared them. Their responses varied from breathless demands for government assistance to outright theft from the properties they managed. The rent-seeking behavior is not surprising, particularly in a legal environment that was almost entirely ineffective, such as the one which persisted in Russia during the period. Reformers believed that, by transferring power into the hands of legitimate owners with a financial stake in responsible management, enterprise directors could be disciplined or removed. Unfortunately, a variety of later events would conspire to prevent this rosy forecast from occurring.

Thane Gustafson, a Georgetown University government professor and the author of Capitalism Russian Style, also supports this second reason for why privatization had to occur in Russia. He says, "privatization policy hurriedly put together to head off a massive wildcat privatization from below" (Gustafson, 26). This "wildcat" privatization was coming in the form of asset seizures and sales by those who lacked title but retained authority, namely enterprise directors. Managers were also known then, and even much later, to use tolling contracts (a contract which covers the marginal cost of production but doesn't take into the price the need for future capital expenditures), captive subsidiaries and suspect deals with family and friends to extract value from the enterprises which they had been trusted to manage.

Anders Aslund, in his work How Russia became a Market Economy, says that privatization policy was driven by the twin goals of creating real meaningful property rights, and preventing any more "nomenklatura privatization". During the Soviet period, the term nomenklatura was used to describe high level managers and directors in the state and party. "Nomenklatura privatization" refers to the illegal seizure of state-owned assets by the senior managers or bureaucrats that had previously been responsible for administering them. Above all else, Aslund says, "The Russian privatizers never forgot that the ultimate purpose of privatization was to create a market," (Aslund, 231-232).

The trio of Boyco, Shliefer, and Vishny provide another set of justifications in their book Privatizing Russia. They argue that privatization was based on three fundamental beliefs among those making policy. First, that Russians would respond to economic incentives the same way that westerners did. Put in the jargon of the time; homo sovieticus was actually the same as homo economicus.

The second idea they identify is that the cause of economic inefficiency in Russia was caused by political interference in the rational decision making of firms. Furthermore, they identified privatization as the most effective way to combat the influence of politicians. This same process has also been identified by the name 'de-politicization.'

The final impetus they identify was the overall need to manage the relationship between stakeholders in the present system and their future roles. Boyco, Shleifer, and Vishny are quick to note that while the state officially owned these firms, by the end of the Soviet period they were hardly the only group making decisions. The need to manage, co-opt, and prevent further damage from other actors within the system is identified as a final influence on privatization policy.

All the above quotes and references present a clear pattern for why privatization was recommended as a reform strategy. Western advisors, and in some cases Russian politicians and technocrats, believed that the quickest way to a market economy, and the only way to entrench democracy and capitalism, was to give everyone a stake in success of the new system. By selling off state property they hoped to impose rational and effective management, to prevent unjust seizures by present stakeholders, and to create a meaningful and open society of owners. This final goal will re-appear in the next chapter, which examines the historical underpinnings of the Russian experience.

Chapter Two: Privatization History and the Washington Consensus

This chapter will specifically focus on the intellectual underpinnings of privatization during the period leading up to Russia's great experiment with it. While the thesis of this paper concerns the specific nature of Russian privatization and the role played by outside advisors, this chapter will take a broader view. Considering privatization, there was a widely accepted set of policy procedures known as the "Washington Consensus." This orthodox model was seen, at least at the World Bank and International Monetary Fund (IMF), as applicable in a wide variety of situations. This set of policy procedures included privatization as a key component. However, it should be noted that in some cases privatization was conducted entirely on the initiative of national leaders, without overt specific pressure from lenders.

The first great "experiment" in privatization began in England. Conventional wisdom tells us that Margaret Thatcher swept into office in 1979 and embarked upon a systematic program of sales and changes which transformed Britain from an ailing nation of striking, grasping trade unionists into a productively humming metropolis peopled by productive home owners and shareholders.

There is solid support for some of this version of history. Madsen Pirie, head of the Adam Smith Institute, says, "Britain has set a firm lead in most areas," (Pirie, 12-13). John Burton, Research Director at the Institute of Economic Affairs in London, agrees saying, "This 'Thatcher experiment' would appear to have acted as a political-economic demonstration effect, causing a wave of imitative privatization policy developments around the world" (Burton, 22). Ascui, McAllister, and Studlar, writing in *Political Science*, similarly argue that, "other political parties and governments, not only in the

Western world but also in the Third world and even the Communist states, remain keenly interested in the experience of Britain as a privatization leader" (Ascui, McAllister, Studlar, 1078). A final verdict comes from G.S. Gupta, who writes, "Britain took the lead in privatization in 1979, and many countries followed her in due course" (Gupta, 26).[1]

While some nations did chose to pursue privatization on their own initiative, they were vastly outnumbered by programs implemented at the "suggestion" of the World Bank, IMF, EBRD, and other multilateral lending institutions. These institutions do not strictly require privatization measures, but the IMF included divesture of enterprises to the private sector in 29 percent of its programs between 1980 and 1984 (Feinburg, 550).

Privatization, particularly when conducted as a part of World Bank and IMF programs rarely comes as the sole policy recommendation. Usually a variety of policy measures are sought by multilateral lenders. While these additional policy recommendations are beyond the scope of this paper, it is still worthwhile to note them. By understanding the "normal" package of reforms, the reader can better appreciate the role that privatization plays.

This package of policies has become known as the "the Washington Consensus"; supported by the US-led development community, it provided a series of prescriptions that, it was believed, would be appropriate in a wide variety of situations. Biersteker, in his 1990 *International Studies Quarterly* article, lists four common components to World Bank and IMF led reforms: currency devaluation and market determined exchange rates; anti-inflationary demand management; the restoration or creation of domestic and

[1] Those seeking more information on privatization around the world in the years before 1992, should see appendix one.

import/export market mechanisms; and finally privatization (Biersteker, 484-485). Sayre Schatz, a Temple University economist, is less explicit in his characterization of commonality, relying on the term "laissez-fairism." He loosely describes "laissez-fairism" as free market pricing and exchange rates, reduced tariffs, and privatization (Schatz, 129).

Joseph Stiglitz, a Nobel Prize winner and former chief economist of the World Bank says, "Fiscal austerity, privatization, and market liberalization were the three pillars of Washington Consensus advice throughout the 1980s and 1990s" (Stiglitz, 53). Stiglitz also provides a brief history lesson, detailing how the three-pillared approach was developed to confront the Latin American debt crises of the 1980s. He is even willing to stipulate that the programs suggested for those limited circumstances were helpful. What Stiglitz criticizes is the blanket application of those policies to nations all over the globe, including Russia. Another criticism of his is the perceived unwillingness of the IMF and World Bank to acknowledge national differences, accept variations from their orthodoxy, and/or recognize the importance of the sequencing and overall timing of actions (Stiglitz, 16-17, 53-54).

An interesting example of the connection from Latin America in the 1980s to Russia in the 1990s can be seen in the person of Professor Jeffrey Sachs. This Harvard economist helped to develop and advance many of the policies used to fight hyper-inflation in Latin America. This paper's bibliography includes one such example, a 1987 paper he presented on Bolivian hyperinflation and the methods for fighting it. Five years later he would be an economic advisor to Yegor Gaidar, the technocrat and Deputy Prime

Minister most responsible for designing Yeltsin's first economic reform package (Goldman, 59).

Chapter 3: Russian Economic Transformation

This chapter will seek to describe the fundamental shifts that occurred within the Russian economy as it transitioned from a command and control/centrally planned economy to a free market capitalistic model. Privatization played an important part in this transition; however, it was part of a larger network of policy strategies. This chapter will not focus on analysis, but rather will seek to familiarize readers with events and create a framework for the specific advice which is to be presented later.

The point at which Russian economic reform, including privatization, actually began is of some dispute. The "shock therapy" reforms of Yegor Gaidar and Boris Yeltsin began on January 2, 1992. However, these were far from the first attempts to reform or restructure the Soviet/Russian economy. Nor, in fact, were they the first attempts to include privatization amongst those reform policies. The beginning of the reform effort which would lead to Yeltsin's 1992 plan started with the economic reforms of Mikhail Gorbachev. Gorbachev, serving as General Secretary of the Communist Party of Soviet Union from March 11, 1985 to December 25, 1991, sought to re-invigorate and jump start the Soviet Union. Glasnost and Perestroika are well known terms, and their impact, although not necessarily in the way Gorbachev intended, was huge.

As early as 1988 he was edging the system towards a more open and competitive market. His cooperative laws essentially legalized private business, and through a string of reforms over the next year, he allowed privatization of some apartments as well as the leasing of state enterprises and agricultural lands (Blasi, Krumova, Kruse, 19). As early as July, 1990 Graham Allison, former Director of Harvard's Kennedy School of Government and author of <u>Essence of Decision</u>, was suggesting in the *New York Times* that Washington extend technical assistance for "the transition to a market economy, privatization of state assets, reform of industrial ministries, and decolonization" (Allison, *New York Times* Sec A Pg 16, July 5, 1990).

A variety of plans were proposed by Soviet economics professionals. "Most significant were the proposals by Lenoid Abalkin, Stanislav Shatalin, and Grigori Yavlinksy" (Klien and Pomer, 154). These three men were noted Soviet economists working at a variety of prestigious institutes around Moscow. Abalkin served in a variety of government posts in the late 1980s and early 1990s, as well as Director of the Institute of Economics of the Academy of Sciences. Shatalin was a chief Gorbachev economic advisor as well as responsible for directing the research activities of the Politburo Commission on Improvement of Management Systems (Aslund 321, 324 and Gaidar, 26).

The plans prepared by them had at least three factors in common: improving government finance, dealing with the ruble overhang (the excess of savings that only existed because of lack of goods or capital convertibility), and enlarging private enterprise. Their plans differed in detail. For instance, Abalkin supported controlled and limited privatization, while Shatalin and Yavlinsky were in favor of more rapid change (Klein and Pomer, 154-155).

Some of these plans found wide support in portions of the Soviet government. "In September 1990 the Russian Supreme Soviet approved a radical plan to transform the Soviet economy [the Shatalin plan] 213 to 1" (Blasi, Krumova, Kruse 19). During the summer of 1991, "a State Property Fund was set up to handle privatization" (Aslund, 30). That vote was followed up in December of 1990 by the approval of a "law on enterprises and entrepreneurial activity" (Klien and Pomer, 155). Blasi writes "As a result of Gorbachev's enterprise reforms, some economic experimentation was going on at the beginning of the 1990s." However, the scope of Gorbachev's tentative steps would soon be dwarfed by those of a former colleague, Boris Yeltsin.

1991 marked a year of great uncertainty and upheaval within the USSR. Forces, both political and economic, had been unleashed that were beyond anyone's control. A May 30 *New York Times* story quotes Yevgeny Primakov, a high level Gorbachev advisor saying, "What is called for is primarily liberalization, privatization, destatization..." On July 24 the same paper carried a story announcing that the Soviet Union expected to sell a thirty percent stake in VAZ (a large car manufacturer) to Fiat of Italy. Two weeks later, on August 19, a group of hardliners from the security forces and the military attempted to seize power. Gorbachev, then on vacation in the Crimea, was briefly placed under house arrest during the coup. The defense of the government by Yeltsin provided him the popular support necessary to mount his October appeal for special powers and radical reform.

On October 28, 1991, Boris Yeltsin delivered a speech detailing his economic proposals to Russia's legislative body. The speech, the work of Yegor Gaidar, called for a program of radical reform, inspired by Poland's "shock therapy." The Congress was also asked to grant Yeltsin the power to rule by degree, in order to implement the program. The power to issue decrees was granted.

Yeltsin then proceeded to create a government to implement his reforms. This group included the already mentioned Gaidar, as Deputy Prime Minister, and Anatoly Chubais as Privatization Minister. Chubias had previously worked with Gaidar while working on developing Soviet era reform plans (Gaidar, 27). Both of these men would play large roles in following years.

On December 25, 1991 the hammer and sickle flag of the USSR was lowered from the Kremlin for the final time. The first phase in Gaidar's reform plan was a freeing on prices within the economy. On January 2, 1992 the Russian government did that for 80 percent of wholesale goods and 90 percent of retail prices (Brani, 30). Aslund wrote, "the main reform package, which emphasized price liberalization and financial stabilization, was launched at the beginning of 1992" (Aslund, 54). Those two moves are highly characteristic of the Washington Consensus policy package discussed in chapter two. Privatization, the third pillar identified by Joseph Stiglitz, would follow within the year.

On why the pace of reform had to be set so high Gaidar writes, "Putting off liberalization of the economy until slow structural reforms could be enacted was impossible. Two or three more months of such passivity and we would have economic and political catastrophe, total collapse, and civil war. I was convinced of it" (Gaidar, 114). He also goes to great lengths in his book on the period to present the dire situation of the government as it pertained to food. He says that the government believed that, at the pace they were using grain, they would not have enough to last until the next harvest.

The reforms, which were blamed for hyperinflation and the rapid rise in retail prices, were immensely unpopular. The Congress of People's Deputies sitting at this time was still made up of communist holdovers almost exclusively. In order to appease unhappy members "Yeltsin allowed three enterprise managers to become deputy prime ministers between May and June 1992 (Aslund, 54). The need for political compromise becomes obvious in the main privatization law, which was signed into law on June 11, 1992. This law is perceived by many as a deeply flawed document, including its creator, Yegor Gaidar. The point of conflict between the two factions, and the political deal made to preserve the reform drive, are discussed in detail below.

The goals of the main privatization effort were two fold. The basic economic belief, widely held by both western advisors and Russian reformers, was that placing the enterprises in private hands would lead to more responsible management, less waste, and ultimately economic growth (Boycko, Shleifer, and Vishny, 48-49).

The second goal, as expressed by Gaider and Chubais, was to insure that communists could never return to power. On May 3 1992 Gaidar is quoted in the New York Times, "The most important thing is to privatize as rapidly as possible and to try to create a property structure that would be regarded by society as more or less just, that will not create a terrible redistributionary conflict that will undermine political stability." Put more simply, Chubais said at a press conference in January 1993, "if we are victories in the first half of the year, it will be enough to make the process irreversible" (Brady, 76). The perceived necessity of sales at any cost forced the reformers to accept a compromise plan.[2]

The main issue of contention among reformers was the amount of the enterprise (in terms of percentage of stock ownership) to leave in hands of the current management and workers. The goal was to leave just enough stock in the hands of management and workers to provide them with incentives and to ensure their support in the privatization

[2] It is also worth contrasting the Russian political situation with that of Britain during its pioneering privatizations. While Ms. Thatcher was concerned that her privatizations not be reversed she did not have to fear that the entire structure of her government and economy could be dismantled at the stroke of a pen.

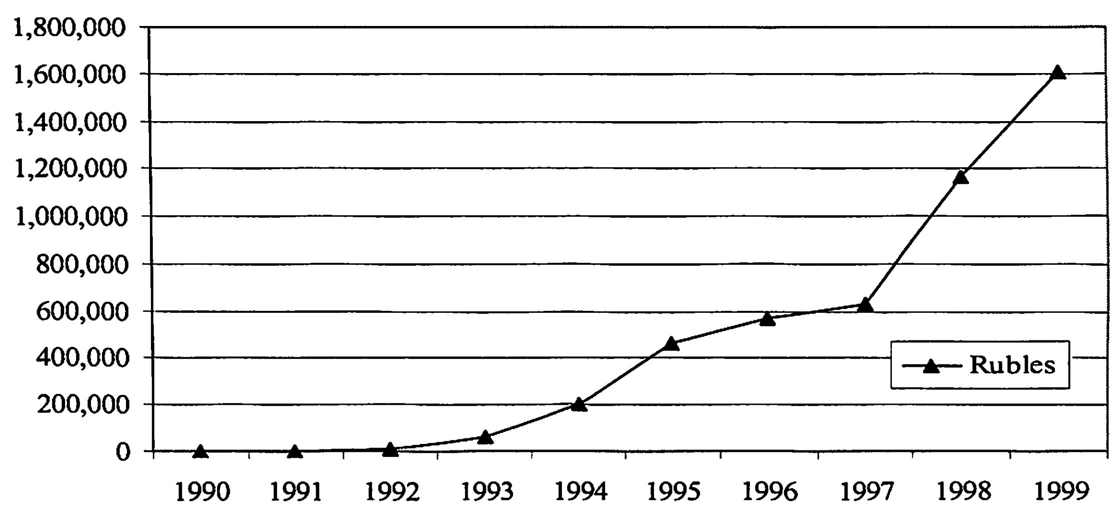
program. The original proposal, 25 percent of enterprises non-voting stock would have been given to insiders. Another 15 percent of voting stock would have been available at discount. Whatever was left over would be sold in voucher auctions by Chubais's property fund (Goldman, 80). Enterprise directors, almost without exception, did not support any plan which would have taken control of their firms from them and given it to outsiders. Through their relationships with the still largely communist legislature, they were able to pressure the government into offering additional options to firms.

Under the second variant eventually accepted, insiders would be allowed to purchase up to 51 percent of any enterprise at 1.7 times book value, as of July 1, 1992 (Goldman, 81). Furthermore, insiders were eventually allowed to fulfill up to 80 percent of their purchase price with vouchers. This second option proved the most popular, with 75 percent of all firms choosing it. The final option allowed insiders to receive 20 percent gratis, with the rights to purchase more at below par over the next three years. Roughly 5 percent of firms chose it. The Russian ruble was at this time experiencing roughly 26 percent inflation per month. This extraordinarily high rate served to discount almost any price, including the 1.7 time multiple of share price fixed in the second privatization option.

This solution was far from what the reformers and their western advisor allies wanted. Goldman describes the second variant as a, "surrender to the plant directors, a price Gaidar apparently had to pay for support in the Supreme Soviet for the passage of his privatization legislation". He goes on to add, "Gaidar admits that the concession on Variant two was a mistake" (Goldman, 81).

Figure 1 shows effects of inflation on purchasing power of the ruble when measured each December using a basket of consumer goods. With 1990 fixed as a base year and a value of 100 rubles used, the chart shows how many rubles would have been necessary to buy the same basket of goods in each proceeding year. The figure does not take into account currency reform, which removed a number of zeros over the years. While this figure does illustrate the extent of inflation, it is important to remember that in 1990 having rubles was not enough to be able to buy things because the Soviet Union was at the peak of its shortage economy. The data for the chart below comes from Marshall Goldman's book The Piratization of Russia. Professor Goldman is an emeritus professor of Russian economics at Wellesley College as well as Associate Director of the Davis Center for Russian and Eurasian studies at Harvard.

FIGURE 1



Price, in Rubles, of a Basket of Russian Consumer Goods: 1990-1999

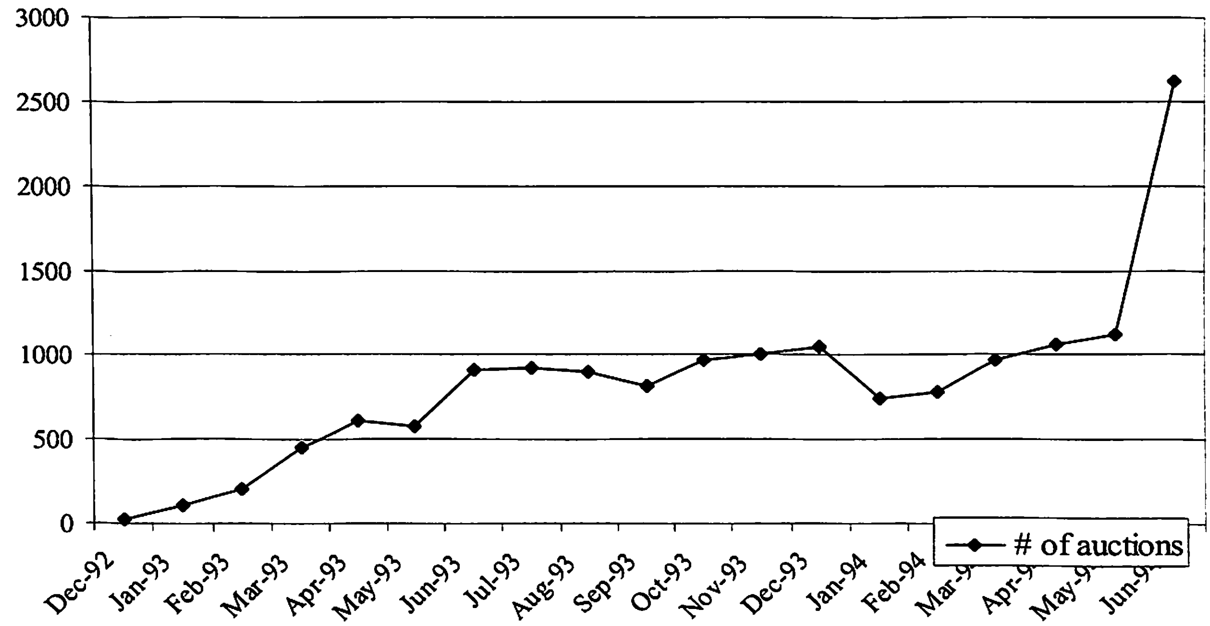
The decision to allow insiders to acquire their own enterprises for virtually nothing was perceived as necessary to achieve passage of the privatization law. It meant that the "red directors" could retain a stranglehold on Russian industry. Far from the economists' goals of shareholder activism and responsible independent boards, Russia was left with a world of impotent minority shareholders.

But that was all in the future. All that was known in 1992 was that voucher auctions were coming. Even under the least generous option, 49 percent of enterprises would have to be distributed in voucher auctions. Fearing that a change in political climate could end the whole process, reformers lead by Chubais, at this point head of the state property fund, raced to complete the first deal before the seventh meeting of Peoples Deputies on December 1. They missed their deadline, but only by twelve days. On December 13 The Bolshevik Biscuit Company earned a place in history as the first Russian company to be privatized in a voucher auction. Over 44 percent of the enterprise was sold to a variety to parties (Goldman, 89-90). This sale, unlike so many later, at least shook up the enterprise in question. Within six months (July 7, 1993) The *New York Times* was reporting that a "recent shareholder's meeting of the Bolshevik Biscuit Factory broke into a pandemonium."

Despite any biscuits which may or may not have gotten broken, the auctions continued apace. By the end of June 1994, 15,052 large and medium sized enterprises had been privatized. This had transferred over twenty one million workers from state plants to private ones (Blasi, Krumova, and Kruse, 192). Whether anything actually changed at many of the plants in question is another matter entirely. The state frequently maintained a large minority position, and thanks to "option two" directors were rarely forced out. Nevertheless, these enterprises had been privatized.

Figures 2 and 3 provide graphical examples of that point. Each month shows the number of voucher auctions that occurred each month. The chart below shows the total and per month totals of employees shifted into the private sector via privatization. Both charts were created with data from Table 5.1 (Pg. 106-107) of Boyco, Shleifer, and Vishny's book Privatizing Russia.

FIGURE 2



Number of Voucher Auctions Per Month, 12/92-6/94

Russia, despite the policy prescriptions of its western advisors, was at this time pursuing a loose monetary policy. This policy was directed by Victory Gerashenko, who was appointed as governor of the Russian Central Bank on July 17, 1992 (Blasi, Krumova, and Kruse, XVII). A man of long Soviet banking experience, Brady describes him as a "true believer in the state regulation of the economy" (Brady, 39).

FIGURE 3

Employees Moved from Public to Private Sector, 12/92-6/94

Jeffery Sachs wrote, “Victor Gerashenko may be the worst central bank governor of any major country in history” (*Economist*, 10/16/1993 pp. 90). Yegor Gaidar, for reasons that are still unclear, initially supported his appointment. He has described that decision as “the most serious of my mistakes in 1992” (Goldman, 82).

The policy which western advisors and Russian reformers objected to so strongly was the issuing of credits to industry and agriculture. At this point, the allies of the “red directors" in the Supreme Soviet (the legislative branch of the government at this point) were demanding relief from the tight monetary policy being pursed by the Gaidar government. Washington Post Bureau chief David Hoffman says that “the parliament had installed Victor Gerashchenko as chairman of the Central Bank” (Hoffman, 200). As a creature of parliament, Gerashchenko obliged his perceived bosses. He ordered over 350,000,000,000 rubles introduced into circulation between July and September 1992 in the form of credits to agriculture and industry (Brady, 40).

Western advisors active in Russia at this point did not support the policy of giving credits, rightly seeing the inflationary danger it entailed. Writing in the magazine *National Interest* Sachs says,

> Unlike my experience in many other countries, such as Poland, little of what I recommended was actually enacted. It wasn't pleasant being blamed for high inflation and other ills that resulted from the very opposite of the advice that [Anders] Aslund and I were giving (such as when the Central Bank ran a disastrous hyperinflationary monetary policy in 1992 and 1993) (Sachs *National Interest* online source).

Demands for credits to individual industrial enterprises were placing huge strains on the Federal budget. Combine this with an almost total lack of respect for the law and lax enforcement of tax regulations, and the government rapidly ran into trouble. Vladimir Potanin, the oligarch responsible for Uneximbank (The Universal Export Import Bank, also sometimes abbreviated as Oneximbank) proposed a solution. The new program, "Loans for Shares" would have large banks like his loan the government funds to cover their tax shortfalls. Collateral for these loans would be some of the shares that the government had retained in privatized firms. The program even allowed that if the government did not pay back the loans, the banks would sell their stakes at auction, with the government getting all the proceeds above the loan amount. "Invariably the banks holding the collateral and conducting the auctions emerged as the winners at a price that seldom exceeded the price of the initial loan"(Goldman, 120). Marshall Goldman describes it as "larceny on a grand scale." These rigged auctions served to move the crown jewels of the Russian economy (oil and gas, mining, and national media) into the hands of a few banking/industrial conglomerates.

The usual arguments, familiar from the voucher compromise, were presented to justify these auctions as well. Boris Jordan, the former head of Credit Suisse First Boston's Moscow office, then manager of the Renaissance Fund, said,

> You have to remember that every year until Yeltsin got reelected [1996], everyone in this country, including me, was worried that the communists were going to come back. I don't believe they were thinking much farther than, the communist risk must be taken out of the game. And that's what they were thinking about- they weren't thinking about the economy! (Hoffman, 313)

Whatever the motivation, the results of loans for shares were easy to see. Well connected insiders were able to acquire assets for a song. On November 17, 1995 Vladimir Potanin won the loans for share auction his own bank was conducting to gain a 38 percent stake in Norilsk Nickel. That stake cost him $171,100,000. The minimum bid allowed was $171,000,000. Norilsk Nickel booked profits of over $1.2 billion that year alone. In another, if possibly more brazen, example, Surgutneftgaz (a Siberian oil and gas firm) management warned outsiders not to bid, and even went so far as to close the airport in Surgut on the day of the auction (Hoffman, 315-318).

Whether government officials were right to be worried about the communist threat cannot be known. There is certainly some evidence to suggest that their fears were well founded. In 1992 the Gaidar government had been brought down by a recalcitrant communist Supreme Soviet (the legislature). In the beginning of the election season in 1996 Yeltsin was perceived as a lost cause. Zyuganov, the head of the revived Communist Party, was the toast of the Febuary 1996 World Economic Forum in Davos, Switzerland. Chrystia Freeland, Moscow Bureau chief for the *Financial Times* quotes George Soros's comment to Boris Berezovsky at Davos, "Boys [describing the reformers and capitalists], your time is over. You've had a few good years but now your time is up" (Freeland, 192). Berezovsky himself was one of the more flamboyant oligarchs who specialized in media and political machinations after making a fortune in the early nineties through his association with the Avtovaz auto factory.

Yeltsin won re-election in 1996 on the back of an expensive and at times very questionable election campaign. There would be no renationalizations, and the communist threat appeared to have abated. However, the cost to the Russian economy, political system, and the transition from communism to a "normal" market economy was staggeringly high. Following on the heels of this time of chaos and blatant corruption, one would expect markets to react cautiously. Instead valuations all across the spectrum of Russian assets soared.

The combination of systematic looting, massive tax fraud, and unending government deficits finally pushed the Russian government over the edge on August 17, 1998. The earlier tax nonpayment issue had never really been resolved. Instead the Russian government had been supporting itself through a series of short term bond issues (the Russian acronyms for the two classes of bonds were GKO and OFZ). These short term bonds (three and six month) paid huge rates of return. In addition to making it extremely hard for private enterprises to borrow, these notes placed immense burdens on the federal budget. Eventually the combination of rates and interest payments became unsustainable.

In a move that was seen as much too late, the ruble was released from its dollar peg on August 19, 1998. Over the preceding six months the central government had exhausted its reserves attempting to defend the ruble. The government responded to its own virtual bankruptcy by suspending repayment on both domestic and foreign debt. The predictable results occurred. Banks which had been making huge profits on the GKO market, and which had large portfolio positions holding them were broken by the repayment freeze. The ripples sent through the banking system served to destroy bank after bank. This list included most of the oligarch's banks, and caused the destruction of at least the banking arms of oligarch controlled conglomerates Menatep, Most, Unexim, SBS Agro, and others.

Many authors and commentators have sought to assess who was responsible for setting and guiding policy in Russia during the post Soviet period. For example, Joseph Stiglitz included a chapter entitled "Who lost Russia" in his book, Globalization and its Discontents. Some argue that western advisors were responsible for designing and implementing (some even argue controlling) the process of transition and reform. This paper asks the more fundamental question; what influence did advisors have on the process of reform?

Chapter Four: Advice

What role did western advice play in shaping Russian privatization policy in the period from Yeltsin's rise to the August 19 1998 currency collapse? From the evidence it appears that Russians charted their own course. They accepted advice where it conformed to domestic policymakers ideas and needs, but rejected it when it did not suit them. Furthermore, when accepting assistance from westerners, policy makers maintained control of the process. This view is not universally shared, and dissenting opinions are included throughout this chapter. One example is anthropologist and George Mason University Professor of International Commerce and Policy Janine Wedel, who blames "econolobbyists" for many of Russia's problems today.

While not exclusively limited to privatization advice, one of the largest, and potentially most restrictive, sources of advice from the west was the International Monetary Fund (IMF). The architect of Russia's reform program, Yegor Gaidar, has written extensively about Russia's relationship with the fund, and what effect their advice had on Russia's policy. A member of Boris Yeltsin's cabinet even before Yeltsin took office, he briefly served as Prime Minister. The leader of the "kamikaze cabinet," he is widely credited as the architect of the 1992 shock therapy reform plan (which included mass privatization).

Gaidar does not criticize the IMF for its role in the early stages of Russian reform, saying that the organization was not designed to handle such a massive transformation (Gaidar, 152). An unwillingness to blame the IMF for failing to do something he clearly believes they never had any hope of accomplishing is present throughout the time he has written and discussed his role in Russia's transformation. This is a point he makes time and again, beginning with an *American Economic Review* article: "It is senseless to set up essentially political tasks for the IMF and require the later to resolve them: the IMF, by its nature, does not fit in this role" (Gaidar, 13).

He does offer some criticism for the handling of the ruble zone issue. This was the question of whether the Commonwealth of Independent States (CIS) would retain a common currency (the ruble) or would have individual national ones. The IMF was initially in favor of holding the ruble zone together, but after seeing the chaos that having 15 central banks and one currency caused, they reversed course. He goes on to say, "In time, the IMF gained a much better understanding of post socialist problems and was able to adapt to conditions here" (Gaidar, 153).

In 1997 Gaidar wrote concerning IMF actions of a later period, surrounding the "Black Tuesday" of October 11, 1994. That date marked the first post stabilization collapse of the ruble (Blasi, Krumova and Kruse, XVIII and Aslund, 320). Quite contrary to traditional complaints about the tyranny of IMF constraints, Gaidar says, "The experience of the 1994 Russian economic policy [soft money] is one more piece of clear evidence that any softening of requirements to a monetary program endangers the borrower" (Gaidar, 15). Joseph Stiglitz agrees. He writes, "Russia knew, however, that when it came to the inevitable charade in which IMF would threaten to cut off aid, Russia would bargain hard, an agreement (not often fulfilled) would be reached, and the money spigot opened up again" (Stiglitz, 155). At least in this context neither Gaidar nor Stiglitz are willing to blame the IMF (an institution of western advisors). This general attitude is highly common; Russian leaders were willing to listen, but they followed their own course whenever possible.

A rancorous debate has come to surround the IMF's role in assisting Russia's move to a private economy, an important component of which was privatization. Such luminaries as Alan Greenspan and Joseph Stiglitz have criticized IMF policy recommendations (Stiglitz, 133-165). Greenspan, in a 1997 speech that questioned the pace and sequence of privatization said, "The essential structure of a market economy is missing" (Greenspan, 3). This criticism can be at least partially answered by the fact that Russian reformers were afraid if they did not move quickly enough to entrench capitalism it would be erased.

This overriding need to both widen and deepen the appeal of reform programs cannot be overestimated. Time and again decisions were made by policy makers to accept sub-optimal solutions in order to forestall a perceived threat to democracy and the free market. A good example from earlier in this paper is the case of privatization variant two. Variant two allowed enterprise insiders (directors and workers) to purchase 51 percent of share before they were ever offered to the public. While the purchasers were required to purchase their shares (as opposed to variant one) they did so at inflation eroded prices and with up to 80 percent vouchers. In order to co-opt red directors and workers into supporting the program of privatization, a plan that was not the product of advice and did not please even its own authors was supported. Another example is the structure of the "loans for shares" auctions which were conducted in 1996. These auctions were designed to fill budget shortfalls. While they served to give away highly valuable assets for almost nothing, the needs to stop wage arrears and the political costs of selling to foreigners meant that the auctions were perceived as a necessity.

The loans for shares plan was originally created by a pair of western investment bankers: Boris Jordan and Steven Jennings. These men had served as advisors during voucher privatization, and were then running their own investment firm, Renaissance Capital. Vladimir Potanin, an oligarch, asked Jordan to come up with a way for the state to raise money by using shares as collateral.

From this seed, the highly questionable auctions that were to follow were grown. Hoffman says, "Jennings told me that he insisted (to Potanin) that the deals must be completely transparent and open to international competition. If not, he (Jennings) said, "it will be a disaster." Jordan agreed, saying that Potanin took their paper "but destroyed the concept" (Hoffman, 306-307).

In retrospect, the damage which high speed privatization in the absence of strong competition and legal environments can cause is clear. Whether this damage is greater than that which would have occurred had, for instance, communists won the 1996 presidential election cannot be known. This fear, of a return of unreformed communists to power, can be seen again and again as the underlying cause of policy decisions.

Stiglitz himself devotes a chapter of his work Globalization and its Discontents to the problem of Russia's transition and the IMF's role within it. He says, "The IMF told Russia to privatize as fast as possible" (Stiglitz, 157). Stiglitz goes on to list a myriad of problems which he believes were caused by IMF conditions and advice leading Russia to make bad policy decisions. This would certainly be a damning critique, if it was clear that Russian policy makers paid any heed to western advisors. Stiglitz himself says, "Russia would bargain hard, an agreement (not often fulfilled) would be reached, and the money spigot opened up again" (Stiglitz, 155).

As early as 1994 IMF director Michel Camdessus said that steps Russia should take include, "bankruptcy legislation, the commercialization and privatization of state-owned enterprises, and the breakup or regulation of monopolies" (Camdessus, IMF website) Privatization was advised, but within the context of a list of suggestions, hardly as the sole solution to all of Russia's problems. In the same speech Camdessus also listed as important changes tight fiscal policy, a liberalization of prices to bring them in line with world prices and the creation of a social safety net.

As was noted earlier during the discussion of central bank policy a loose monetary policy was pursed. Bankruptcy laws, both because of the statues that regulate the process and the limitation of the court system, should still not be described as reformed. Domestic prices, particularly of energy and raw materials, were not subjected to international price discipline by the willingness of firms to accept each others debt, the limitations of export quotas and the willingness of certain major suppliers (particularly Gazprom) to accept barter payment or in many cases no payment at all for the delivery of energy.

Instead of believing that Russia was bound by one piece of IMF advice, while ignoring all others, it seems at least as plausible to suggest that the imperative to privatize quickly had nothing to do with IMF advice. Domestic politics and the ideological ideas of the privatizers seem like a more realistic explanation.

The criticism by Stiglitz elicited a sharp response from Anders Aslund. He said, "Stiglitz is a striking embarrassment to himself and the World Bank. Without knowing anything, he mouths any stupidity that comes to his head." (*The Economist*, 9/18/1999 p

81) What is clear is that Russia was not unduly constrained by IMF conditionality. In fact, in the view of Gaidar, more conditionality would have been a good thing.

This paper focuses specifically on the question of western advisors in relation to privatization policy. Here again, westerners advised, but Russian policy makers were driven to make choices based on domestic political considerations, particularly the need to prevent a communist return to power.

The following quote comes from Marshall Goldman in his 2003 book The Piratization of Russia: Russian Reform Goes Awry. In it, Goldman gives his account of the influences on Gaidar as he set privatization policy.

> "Gaider had come to this concept [shock therapy and rapid privatization] as a result of his studies as well as from a series of discussions with economists from both Eastern Europe and the United States. Among those interacting with Gaider at one stage or another were Jeffery Sachs, Andrei Shliefer, Jonathan Hays, all of Harvard University, Anders Aslund of Sweden, and, later, The Carnegie Endowment and Richard Layard of the London School of Economics. IMF officials and Stanley Fischer in particular had long advocated something similar" (Goldman, 59).

Most of those names will be present below, as well as their writings on the period.

In his 1995 work How Russia became a Market Economy Anders Aslund, a Swedish economist and transition expert says, "The 500 day program established the need for fast, massive privatization" (Aslund, 226). This quote references a plan prepared for Mikhail Gorbachev during the summer of 1990 (Aslund, 324). The group, lead by Sergei Shatalin shows a domestic source for ideas on privatization, particularly a shock therapy model. Yegor Gaidar, who served briefly as Prime Minister under Yeltsin, and Anatoly Chubais, the head of the State Privatization Office both worked with and were supervised by Shatalin. (Gaidar, 27, 52)

"The Russian decision makers looked at privatization in Poland primarily to learn what pitfalls to avoid and at Czechoslovakia to learn how to do it. At the same time, they were acutely aware of Russian peculiarities, such as the highly corrupt state administration" (Aslund, 229).

While there certainly were westerners involved, they were not in policy making positions. Aslund continues, "the main explanation for successful western assistance to Russian privatization is that the leading Russian privatizers, Chubais, and his deputy Demetry Vasil'ev, knew what kind of policy they wanted. They instructed their advisors about a policy framework, and the advisors were not permitted to act as an interest group." He continues "Their job was to provide the government with useful advice within the parameters of the government policy" (Aslund, 247-248).

The 1995 work Privatizing Russia by Maxim Boyco, Andrei Shleifer, and Robert Vishny is another example of advisors telling the story of privatization. The authors go into great detail about both the process by which the Russian government made its decision for voucher privatization and the specific method by which it was conducted. During this discussion advisors are mentioned rarely.

The first mention of advice runs directly counter to the policy which was eventually adopted. "Indeed, the assorted investment bankers giving advice in Russia...advocated case-by-case privatization through cash sales" (Boyco, Shleifer, and Vishny, 70). In direct contrast to this advice the Russian government chose to adopt mass voucher privatization. The next mention of western advisors is a similar case of rejection, although not of direct advice. "The idea of revaluing Russian companies using proper accounting methods and adjusting for inflation appealed to many westerners" ((Boyco, Shleifer, and Vishny, 75). Instead Russian leaders chose to set the June 1 1992 value as the "correct" value.

The justification given at the time was that revaluing the every Russian company would take too long and would leave the process open to massive corruption. While a certain measure of chaos and chicanery was anticipated by the designers of the voucher auction process, the belief was that by making the process as simple and transparent as possible it could be kept to a minimum. Requiring a massive bureaucracy to set a value for each and every company would have made the process highly opaque and extremely expensive in terms of bribes demanded.

Once again, advice was disregarded because of the perceived problems of Russia's domestic situation.

The final mention is a description of how a third option for privatizing enterprises would function. This option was not popular with those responsible for designing the privatization plan, and had been added at the behest of the legislature. In order to discourage enterprises from adopting it, the statue had purposely been written in "typical Russian bureaucratese" and that "Chubais's advisors did not volunteer to clarify the language of these regulations" (Boyco, Shleifer, and Vishny, 79). Chubais and his associates chose not to clarify it in order to discourage enterprise directors from adopting it. The fact that advisors are mentioned rarely, and most often having their advice ignored, is striking.

In that chapter about process and formulation of the voucher strategy the authors also say, "they did what they were supposed to do, namely assure that there would be no turning back on privatization" (Boyco, Shleifer, and Vishny, 84). The creation of a durable and large class of private owners was seen as one of the most effective guards against any return of the communist party to power. Whatever arguments might be made on the grounds of economic efficiency, this justification was one of the most important.

Gaidar, the primary policy advisor to President Yeltsin, provided some illumination into how his thoughts on the subject developed. "In general, most of my colleagues and I, including Anatoly Chubais, were skeptical of introducing special payment notes- later known as "vouchers" (Gaider, 75). "We wanted to do things the way they do them in western countries (case by case sales) but we would miss the window of opportunity when a breakthrough in restructuring property relations was still possible." Again, the feeling of time pressure forced Russian policy makers to adopt a prescription that they were not completely comfortable with. Also, as was noted above, the swift voucher auctions ran counter to western advice at the time, that is, privatize through cash sales. The plan that was adopted bears a much closer resemblance to those created by the young reformers during the waning days of communism than plans being suggested by western experts or implemented at that very time in Poland.

These words from western and Russian participants indicate that Russians examined evidence of their neighbors, as well as pre-existing plans, and settled on the best course of action they believed was *available* to them. This same conclusion has not been reached by all who have examined the evidence, however.

One highly stringent critique of both the advice and advisors comes from Dr. Janine Wedel. In her book, Collision and Collusion, she levels a variety of charges at most participants in the Eastern European transition economies. These charges range from incompetence all the way to corruption, insider dealing, and influence peddling (Wedel 59, 123, 151).

Wedel places a great deal of weight on a series of meetings that allegedly occurred during the late summer and fall of 1991. These meetings had Jeffery Sachs, Andrei Shleifer and Anders Aslund meeting with Yegor Gaidar and Anatoly Chubais at a dacha outside Moscow. These dacha discussions of policy are supposed to have paved the way for the power later wielded by the "Chubais clan." It is interesting to note that in his book on the period Gaidar does mention spending the summer working at the dacha, but makes no mention of Sach's visits. Whether he failed to mention the visit to hide the nefarious influence of westerners, or because it simply was not that important, it is impossible to say.

Wedel points out that "Jonathan Hay and his associates actually drafted many of the decrees" (Wedel, 112). This ignores the fact that Jonathon Hay was in the employ of the Russian government at this time, and that he was operating within the instructions of his superiors, Russian policy makers.

She goes on to claim in a later chapter that noted investor and philanthropist George Soros used a large loan to the Russian government to obtain preferential rights in the bidding for a 25 percent stake in Svyazinvest, a new telephone holding company. David Hoffman, *Washington Post* Moscow Bureau Chief, spends a chapter in his book

The Oligarchs describing this auction. He finds that the transaction was one of the only legitimate privatization auctions to occur.

Finally, it should be noted that Goldman, hardly an admirer of Sachs and company says, in reference to Sachs, "Ms. Wedel seems obsessed with attacking the man." He also calls some of her charges, "excessively emotional, even reckless" (Goldman, 60). Nevertheless, her charges of undue influence are worth considering, even if they do not appear to have any weight.

In general, there is no consensus on the role of western advice in the formulation of Russian privatization policy. Some Russian and western participants maintain that the process was guided by Russians. Others, including some advisors and observers, contend that western advisors were responsible for guiding and shaping privatization policy throughout its course. Time and again western advice was rejected or modified in the interests of domestic political and policy implications. Western advice to conduct case by case privatization was ignored because of the need to purchase public support of the privatization program. One of the most important pieces of advice was to pursue a tight monetary policy. This was abandoned in order to mollify domestic critics of the Yeltsin regime. Even "loans for shares" began life as a western created plan, only to be reshaped by domestic business interests in a bid to gain greater wealth and control.

Russian decision makers had their own pre-existing ideas, as far back as the late Soviet period, about the desirability of a mass privatization model. When it came time to implement those policies they certainly accepted western advice and assistance, but only as it served the goals that Russians had set for themselves. Perhaps most importantly, these economic decisions were also political ones. The ability to pursue reform had to be passed through a frequently hostile legislature while preventing an anti-system party from achieving electoral success. These considerations were paramount in the minds of policy makers.

Chapter Five: Conclusions.

What role did western advice play in shaping Russian privatization policy in the period from Yeltsin's rise to the August 19 1998 currency collapse? From the evidence it appears that Russians charted their own course. They accepted advice where it conformed to domestic policymakers ideas and needs, but rejecting it when it did not suit them. Furthermore, when accepting assistance from westerners, policy makers maintained control of the process. Each major period of Russian reform includes examples of this phenomenon.

During the initial planning for privatization a mass privatization voucher model was adopted. This is in contrast to the experience and advice of western advisors. However, it is in perfect keeping with preexisting domestic plans such as the "500 day plan."

The Russian government repeatedly ignored or avoided complying with IMF conditionality and requirements. Contrary to the advice and urging of the IMF Russia pursued a loose monetary policy and failed to reform its bankruptcy or trade rules. Much has been made of the fact that the IMF urged rapid privatization as well. However, that is the only piece of advice Russia seems to have accepted. The question must be asked whether Russia truly accepted the advice, or just happened to pursing a policy that conformed to what was being advised.

Even the most egregious example of the *"piratization"* of Russia, the loans for shares auctions, began life as a piece of western advice. Boris Jordan helped create the plan itself, and insists that his recommendations required that the auctions be transparent and open. This advice was not taken, and Russia ended up using a series of notoriously corrupt auctions to transfer billions of dollars of wealth in return for almost nothing.

What explanation then can be given for the choices that were made by Russian policy makers? Were they simply corrupt? The evidence suggests otherwise. Domestic politics were highly unsettled during the period in question (1992-1998), and the danger of a communist return to power was never far from the minds of the reformers. Each seemingly irrational step can be traced to some domestic policy decision.

When enterprise managers and workers were allowed to capture over half their enterprises in voucher privatization the explanation was the need to build a political consensus behind privatization. When a tight money central banker was replaced in the middle of the drive to stop hyperinflation, the explanation was a need to mollify Yeltsin's critics in the legislature. When the crown jewels of the Russian economies extractive industries were sold for a pittance the explanation was a need to raise funds to pay back wages in anticipation of the 1996 presidential elections.

Western advisors did play a role in helping to shape privatization policy, but no where near as important a role as the traditional understanding of the story would suggest. Russian policy makers shaped their own policy, seeking input from westerners surely, but never directed or controlled by them.

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APPENDIX

Appendix I – Additional examples of privatization

The claim that privatization marked a radical and different policy completely foreign to British politics is certainly easy claim to make. The term itself wasn't even included in the dictionary in 1979, on the eve of the first Thatcher victory. However, a closer reading of the events that followed show that privatization wasn't the primary goal of the administration, at least initially. Ascui, McAllister and Studlar say "'privatization', however, played a relatively small role in Thatcher's initial program." (Ascui, McAllister, Studlar, 1990; 1080) Relatively few enterprises and shares were sold during the first Thatcher term, amounting to roughly 500 million pounds per year. Even those sales were conducted of relatively healthy companies in competitive industries that had never really become part of the public sector. (Burton, 1987; 23-24) It should be noted, however, that the above figure does not include the sale of state owned housing to tenants. Mitchell also goes on to point out that due to British governmental accounting rules, sales of privatized assets could be counted as *negative* financial flows, and help the government hit its targets for public sector reduction.

Mitchell launches a stringent attack on the entire "story" of Thatcher led privatization by saying;

> "Despite the retrospective presentation of privatization as some coherent, well thought out plan of action, it was a program which the Conservatives staggered towards as they encountered difficulties in financing capital expenditure programs, allied with a recognition of the potential of the populist nature of privatization." (Mitchell, 1990; 21)

This argument runs directly counter to what Crewe and Searle claim. Based on their analysis of survey results from the era before Thatcher, they find that very few people actually identified with the policy solution of privatization. Even among Conservatives fewer than 50% agreed with the notion of de-nationalization (Crewe Searle 374). In particular consider this quote from the above, "When after 1974, she and Sir Keith Joseph began to articulate the ideology, they very self-consciously moved away from the electoral center" and "Not since Gladstone has a prime minister held so many personal political convictions and sought to use the office to persuade the electorate of their truth" (Crewe, Searle 374-375). It is difficult to understand how a government could simultaneously "lurch towards" an idea that less than a majority of their own followers supported and simultaneously have been propounding it for over five years. While certainly some of the issue can be explained away by differences in terminology there still exists a fundamental difference in the view of the story.

Based upon the research assembled for this paper, it seems clear that Mrs. Thatcher intended from the beginning of her political career to undertake radical changes in the role of the state in business. Whether that specific policy solution proposed in 1975 was privatization is unknown. Still, to say that Thatcher fell into privatization because of accounting rules and a budget shortfall seems a highly problematic claim.

Privatization as such hit its stride during the Thatcher government's second term, resulting in over 5.5 billion pounds per year being added to the public coffers (Mitchell 24). Massive chunks of previously public monopolies were transformed into private corporations subject to regulation. As we have already, seen some scholars remain ambivalent about the value of transforming one type of monopoly into another. Nonetheless, the government and the market clearly supported the measures.

With the great share sales of the second and third terms, the Thatcher government transformed the English economy. One clear example is trade union membership, which peaked in 1979 at 54% of workers. At the end of 1987 it had fallen to 42% of the workforce (Towers 174). For the first time ever stock holders were expected to outnumber trade union members in the 1987 general election. This radical transformation of the British populace, and economy, is the largest lasting legacy of the Thatcher Revolution.

Britain was not the only nation during the 1980s to adopt privatization measures as a means of improving growth and services. As was previously mentioned, states from all over the world considered the British example, and by varying degrees adopted proposals to emulate them.

Malaysia offers an interesting comparison to Britain. Both states voluntarily adopted privatization measures as a means to improve efficiency and services, save public monies, and end the "subsidy mentality." (Milne, 1986; 1374) The example of Britain was followed in the method by which Malaysia began their program, that is, under the direction of a strong central leader. In 1983, Dr. Mahathir, the Premier, proposed a package of six proposals meant to stimulate growth. One of these proposals was privatization. When commenting in 1986 Milne says that the policy is "radically changing the economy."

The list of firms that Malaysia sought to sell was a long and varied one. For instance, Milne includes everything from airlines and ports to telecommunication and television. Housing, mail, water, and electricity were just a few of the many properties on the list (Milne 1375). This is another example of a natively organized and directed drive to divest the state of economic properties through privatization, well before the fall of the fall of the Soviet Union.

It must be noted, however, that the Malaysian case is not a total copy of Thatcher's Britain. Faced with a radically more complicated religious picture, as well as widespread poverty, Malaysia is pursuing goals which differ drastically from those of industrialized Britain. One specific example is one of the goals of privatization; to raise money for the expansion of the manufacturing sector (Milne 1378). Another difference is the ethnic dimension of the varied Malaysian population. The following highly unique arrangement has come into effect:

> Another facet of privatization that has emerged is that, apart from management, the forms of ownership by Bumiputeras, are changing. While in the past large institutions such as MARA and PERNAS not only *managed* but also *owned* on behalf of the Bumiputeras, an increasing percentage of such holdings is now vested in the Permodalan Nasional (National Equity Corporation) and its main subsidiary, ASN (Amanah Saham Nasional, National Trust Scheme) in which individual Bumiputeras have shares (Milne 1376).

The nature of the Malay population caused these special institutions (minority property funds) to be created in the post independence system. Now they have found a way to adapt their institutions to a changed situation. This method of share distribution, while dissimilar on the face to Russian voucher privatization, has the same goal. It sought to insure that everyone at least had the opportunity to participate in the ownership economy.

A third example of nationally led privatization effort comes from Iraq. Immediately following his takeover of the government in 1979 Saddam Hussein promised rural populations an increase in production from the countryside. While changes immediately followed, actual revision to ownership were not formalized until Law 35 of 1983. The change made by that document allowed private citizens to accumulate and lease land in excess of the previous official ceiling (Springborg 16).

In an effort to show just how extensively the prescription of privatization was applied throughout the world, consider the following two examples. In 1984 and 1985 Bolivia experienced arguably the worst inflation in history. Between April 1984 and September 1985 Bolivia experienced at least 50 percent inflation *per month* (Sachs, 279). In response to this crisis a New Economic Policy was proposed by the newly elected President Paz. At a time when his nation's currency was truly desperate straits, President Paz took the time to include "privatization of public enterprises" in his list of economic policies (Sachs, 280).

It would be hard to locate a nation more different from Bolivia than Bhutan. The small Himalayan nation is tucked between two giants, China and India. This archaic monarchy has largely existed beyond the scope of the modern economy. Consider that "until the late 1970s, the production of gimmicky stamps by Bhutan's postal service was the principal source of foreign exchange" (Samarasinghe, 568). With that fact in mind, consider the following statement;

"...partly guided by the IMF, which Bhutan joined in 1981, the government is implementing a cautious policy of privatization in order to keep government expenditures under control and at the same time encourage an entrepreneurial class." (Samarasinghe, 1990; 574)

A nation that experienced brutal hyperinflation and needed desperate credit from the international community, and a nation with an industrial sector which can be measured in the thousands of employees were given the same advice by the World Bank and IMF.

Whether this advice was given for ideological or fact based research reasons remains to be seen. What can seen clearly is at least two facts. Nations do adopt privatization as a policy prescription on their own. Furthermore, those that don't (and which require IMF assistance) will almost certainly have it recommended to them.