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Soviet Union - Presentation to President Conable - Soviet Economic Study: Enterprise Reform and Privatization Component 10 November 1990

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Soviet Union - Presentation to President Conable - Soviet Economic Study:  
Enterprise Privatization Component

SOVIET ECONOMIC STUDY:  
ENTERPRISE REFORM AND PRIVATIZATION COMPONENT -  
POINTS FOR PRESENTATION TO MR. CONABLE

1. I WILL SUMMARIZE THIS ISSUE BY ANSWERING THREE QUESTIONS: ONE: WHAT DID THE MISSION LEARN -- MEANING IN ESSENCE WHAT BASIC PROBLEMS DID IT UNCOVER? TWO: WHAT CAN BE SUGGESTED TO RESOLVE THESE PROBLEMS? AND THREE: WHAT ROLE MIGHT THE BANK CONSTRUCTIVELY PLAY IN THE REFORM PROCESS?

2. ONE, WHAT DID WE LEARN? THE MISSION FOUND THAT THE ENTERPRISE SECTOR IS IMMENSE, APPARENTLY SUFFERING SEVERE PROBLEMS WITH REGARD TO OBTAINING BASIC INPUTS FOR PRODUCTION, IS INCREASINGLY SHORT OF CREDIT, IS IN AN ACUTE STATE OF UNCERTAINTY WITH REGARD TO THE EMERGING RULES OF THE GAME, AND IS WITNESSING A FALL IN ITS AGGREGATE PRODUCTION.

3. THERE ARE 46,000 INDUSTRIAL ENTERPRISES ALONE, AND THIS PROBABLY UNDERESTIMATES THE NUMBER OF UNITS IN THE SOVIET UNION THAT WE IN THE WEST WOULD CALL FIRMS OR COMPANIES. THE OLD PLANNING RULES -- BY WHICH THESE ENTERPRISES OBTAINED THEIR PRODUCTION ORDERS, THE MATERIALS TO PRODUCE THEIR OUTPUT, AND A SET PRICE AND PURCHASER FOR ALL THEIR OUTPUT -- THAT SYSTEM IS PARTIALLY DISMANTLED AND IT IS NOT WORKING WELL EVEN IN THE PARTS THAT ARE SUPPOSED TO BE STILL FUNCTIONING. THE REPLACEMENT SYSTEM HAS NOT YET BEEN ELABORATED. BASICALLY, GOVERNMENT IS TRYING TO SUBSTITUTE PARTIAL FOR FULL PLANNING. IT NOW COMMANDS THAT ONLY A CERTAIN PORTION OF AN ENTERPRISE'S PRODUCTION GO TO THE

STATE AT A SET PRICE; IT ALLOWS AND EXPECTS ENTERPRISES TO SELL THEIR ABOVE QUOTA PRODUCTION IN A QUASI-MARKET WAY. (THIS IDEA DIDN'T WORK BADLY WHEN APPLIED TO AGRICULTURE IN CHINA, BUT IT DIDN'T SUCCEED IN CHINESE INDUSTRY, AND WON'T WORK WELL IN SOVIET INDUSTRY EITHER.)

4. THE SOVIET GOVERNMENT HAS SINCE 1988 BEGUN TOLERATING A RANGE OF NON-STATE ENTERPRISE PRODUCTION FORMS: FOR EXAMPLE, COOPERATIVES, LEASE ARRANGEMENTS, SMALL PRIVATE PRODUCTION UNITS, WORKER/MANAGER BUYOUTS. THESE ARE WHAT ONE MIGHT CALL QUASI- OR SEMI-PRIVATE OPERATIONS. THESE NEW FORMS ARE LARGE IN NUMBER -- 215,000 COOPERATIVES ALONE, EMPLOYING 5.2 MILLION PEOPLE -- AND THEY ARE BECOMING IMPORTANT ECONOMIC, FINANCIAL AND SOCIAL ACTORS -- COOPERATIVE OUTPUT IS SAID TO AMOUNT TO 5% OF GNP IN 1989. SO FAR, THESE ACTIVITIES ARE THE ONLY EXAMPLES OF PRIVATIZATION. THE BENEFITS ARE CLEAR: THESE NON-ENTERPRISE FORMS CLEARLY USE ASSETS MORE PRODUCTIVELY AND EFFICIENTLY THAN STATE ENTERPRISES, MAINLY BECAUSE THEY PAY INCENTIVE WAGES AND SALARIES, WHILE THE STATE ENTERPRISES DO NOT AND IN THE PAST COULD NOT.

5. BUT THE COSTS OF THESE FORMS ARE ALSO MAJOR: THE COOPS AND LEASE HOLDERS ARE, IN SOME AND PERHAPS MANY CASES, OBTAINING THEIR SUPPLIES FROM STATE ENTERPRISES AT LOW OR NO COST -- THAT IS, THERE ARE MANY SWEETHEART DEALS TAKING PLACE -- WITH THE OLD NOMENKLATURA AMONG THE PRIME BENEFICIARIES -- AND UNDOUBTEDLY A LOT OF OUTRIGHT THEFT OF RAW MATERIALS IS GOING ON. THE PUBLIC IS AWARE OF THIS AND DOESN'T LIKE IT IN THE SLIGHTEST. THIS "SPONTANEOUS PRIVATIZATION" HAS CAUSED MANY POLITICAL PROBLEMS IN HUNGARY AND POLAND; BUT IT IS HAPPENING ON A MUCH BIGGER SCALE IN THE USSR. MOREOVER, TO REPEAT, THIS IS SEMI-, NOT FULL PRIVATIZATION; AND IT IS REASONABLE TO QUESTION WHETHER THESE

FORMS WILL PROTECT THE LONG RUN HEALTH OF THE ASSETS THEY CONTROL.

6. TWO: WHAT CAN BE DONE ABOUT THESE PROBLEMS? PRIVATIZATION FIRST, BECAUSE THAT IS THE OPTIMAL SOLUTION TO THE PROBLEM OF POOR ENTERPRISE PERFORMANCE, AND THE TOUGHEST NUT TO CRACK. WHAT THE SOVIETS NEED TO DO IS, AT THE SAME TIME, DEEPEN AND REGULATE THE OWNERSHIP CHANGE PROCESSES THEY'VE UNLEASHED. THAT IS, THEY NEED TO ESTABLISH IN LAW A FULL SET OF PROPERTY RIGHTS THAT ALLOWS INDIVIDUALS AND LEGAL ENTITIES TO PURCHASE ASSETS, INCLUDING LAND, AND TO RECEIVE A LEGAL TITLE TO THE ASSETS BOUGHT. THIS ALONE WOULD OPEN THE FLOODGATES TO FURTHER, FULL, BENEFICIAL PRIVATIZATIONS.

7. BUT EQUALLY THEY NEED TO ESTABLISH A REVIEW MECHANISM TO LIMIT THE RIP-OFFS; THAT IS, TO ENSURE THAT ASSETS ARE NOT BEING SIGNED OVER TO INDIVIDUALS OR GROUP OWNERS FOR A SONG. I MUST ADMIT AND STRESS THAT FINDING A WAY THAT WILL BOTH ENCOURAGE AND REGULATE THE PRIVATIZATION PROCESS IS EXTREMELY DIFFICULT. IN POLAND, HUNGARY AND YUGOSLAVIA, GOVT. ATTEMPTS TO CONTROL THE PRIVATIZATION PROCESS HAVE ALL TOO OFTEN RESULTED IN ENDING IT. THAT IS, IN RESPONSE TO A PUBLIC PERCEPTION THAT LARGE SCALE THEFT IS GOING ON, THESE GOVTS. HAVE TRIED TO MANAGE PRIVATIZATION; AND INSTEAD THEY HAVE BROUGHT THE PROCESS TO A HALT. SUCH AN OUTCOME WOULD BE MOST REGRETTABLE IN THE SOVIET UNION, WHICH IS IN DESPARATE NEED OF EFFICIENCY ENHANCING PROCESSES IN ITS ENTERPRISES. SO: FINDING A WAY TO PROMOTE PRIVATIZATION WITHOUT LETTING IT BECOME A CHAOTIC GRABBING OF ASSETS IS A TOP PRIORITY.

8. CONCERNING PERFORMANCE IMPROVEMENT: ONE CANNOT SELL 46,000 ENTERPRISES OVERNIGHT; IT WOULD BE HARD ENOUGH EVEN TO GIVE THEM AWAY ALL THAT FAST, ASSUMING

ONE COULD FIND COMPETENT PEOPLE TO TAKE THEM OVER. THUS, THE SOVIETS URGENTLY REQUIRE METHODS TO IMPROVE PRODUCTIVITY AND EFFICIENCY IN THAT MASS OF ENTERPRISES THAT WILL, FOR BETTER OR FOR WORSE, TEMPORARILY OR INDEFINITELY, STAY IN STATE HANDS. A POSSIBLE SOLUTION IS "CORPORATIZATION," A PROCESS THAT ESTABLISHES COMMERCIAL PROFITABILITY AS THE PRIME GOAL FOR ENTERPRISES, AND THEN CREATES MECHANISMS THAT REDUCE POLITICAL INTERFERENCE IN THE RUNNING OF THE COMPANIES SO THAT THEY CAN ACHIEVE THE PROFITABILITY GOAL. THERE HAVE BEEN A FEW -- NOT TOO MANY ONE HAS TO ADMIT -- EXAMPLES OF THIS PROCESS BEING APPLIED SUCCESSFULLY: IN NEW ZEALAND, KOREA, AND TO A MORE LIMITED EXTENT IN PAKISTAN.

9. THREE: WHAT CAN THE BANK DO TO HELP? IN THE SHORT RUN, THE BANK CAN PROVIDE VALUABLE AND NEEDED ADVICE, INFORMATION AND TECHNICAL ASSISTANCE. THE BANK CAN ASSIST SOVIET REFORMERS IN LEARNING AND APPLYING THE LESSONS OF ENTERPRISE REFORM AND PRIVATIZATION IN OTHER COUNTRIES IN GENERAL, AND THE EAST AND CENTRAL EUROPEAN SOCIALIST COUNTRIES IN PARTICULAR. THE BANK IS THE BEST AVAILABLE CLEARING HOUSE ON INFORMATION OF THIS SORT; WE NOT ONLY KNOW WHAT IS GOING ON, BUT WE HAVE BEEN ACTIVELY INVOLVED. MORE GENERALLY, SOVIET AUTHORITIES ARE WOEFULLY SHORT OF INFORMATION ON, AND COMPREHENSION OF, THE PRINCIPLES OF NEO-CLASSICAL ECONOMICS (THE SITUATION IS MUCH WORSE THAN ELSEWHERE IN EASTERN EUROPE). THEY ASK SUCH FUNDAMENTAL QUESTIONS AS "WHAT IS A NATURAL MONOPOLY?" AND "WHY WILL HIGH PRICES ATTRACT NEW ENTRANTS INTO AN AREA OF PRODUCTION?" MANY SOVIET REFORMERS ARE FEVERISHLY SEARCHING FOR SOLUTIONS TO THEIR EVIDENT PROBLEMS, BUT THEY ARE BASING THEIR IDEAS ON THE INTERVENTIONIST, DIRIGISTE PRINCIPLES THEY GREW UP WITH. DIALOGUES BETWEEN SOVIET OFFICIALS AND BANK STAFF CAN BE OF GREAT BENEFIT, AS WE HAVE ALREADY SEEN ON THIS MISSION.