

Privatisation in Russia's Food Industry and Agriculture

by

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Herausgegeben von der Leipziger Ökonomischen Societät e. V. Leipzig
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Nachdruck, auch auszugsweise Veröffentlichung nur mit schriftlicher Genehmigung
der Leipziger Ökonomischen Societät

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ABSTRACT

The paper analyses the policy and the results of privatisation in the two most important parts of Russia's agro-food sector, agriculture and food industry. A comparison of the privatisation in these two subsectors shows that privatisation in the food industry has proceeded without any major problems. It is not the case in agriculture, because of the unresolved question of securing full property rights to land. In both subsectors insiders were given certain preferences. As a result food processing enterprises are predominantly, and agricultural enterprises exclusively insider-controlled. It is shown that such a form of corporate governance has a negative impact on enterprise restructuring. In agriculture, restructuring is additionally hampered by the continuing uncertainty over land ownership rights, which constrains the development of an operational land market and discourages investment, since land cannot be used as collateral. In order to foster restructuring in the food industry, economic policy should promote the transfer of shares to providers of capital, as well as management, financial and marketing know-how. In agriculture, efforts should be aimed at giving full property rights to the owners of land shares, including above all the rights of selling, leasing, donating or bequeathing land to any person. The application of the existing bankruptcy law is another inevitable requirement to stimulate enterprise restructuring.

Key words: agriculture, food industry, privatisation, restructuring, corporate governance, land market

1. INTRODUCTION

Private ownership is one of the main principles of a market economy. Markets for goods, factors of production and foreign exchange will operate better if the participating firms are independent, decentralised and profit-seeking - i.e. if they are private rather than state entities. Private firms are more likely to respond quickly and correctly to price signals in domestic and international markets than state enterprises. Therefore, privatisation is a crucial task in establishing a market economy. The aim of this paper is to analyse the policy and process of privatisation in Russia's agriculture and food industry. It discusses common features and differences and derives options for further action to foster privatisation and restructuring in Russia's agro-food sector.

The paper is organised as follows: chapter 2 explains the meaning of privatisation and shows its links with other fields of economic and agricultural policy in the transition to a market economy. Chapter 3 and 4 provide an overview of the privatisation policy applied in Russia's food industry and agriculture and the results that have so far been achieved. Next follows a comparison of the privatisation process in agriculture and the food industry using different criteria (chapter 5). Chapter 6 examines the potential impact of the privatisation policy applied in both sectors on the adjustment of agricultural and processing enterprises to market conditions. The paper concludes with options for further action at both the political and enterprise levels.

2. THE MEANING OF PRIVATISATION AND ITS LINKS WITH OTHER ELEMENTS OF ECONOMIC AND AGRICULTURAL POLICY

In a legal sense, privatisation means the transfer of state or collective property into private hands. In an economic sense, privatisation aims at the transfer of the so-called property rights to private entities, i.e. the right to use (*usus*) and to change goods (*abusus*), the right to enjoy the

profits (*usus fructus*), and the right to transfer goods.

For the marketisation of transitional economies and their structural adjustment privatisation is necessary but not sufficient. Links exist with other dimensions of economic reform - such as macroeconomic stabilisation, liberalisation, the creation of capital markets, and integration with the world economy (see BORNSTEIN, 1994, p. 494ff.).

Macroeconomic stabilisation leads to a framework of aggregate demands in balance with supply, and of relative prices reflecting scarcity, within which sensible restructuring decisions can be made. Tight fiscal and monetary policies curtail subsidies and bank credits at negative real interest rates. Thus, a prerequisite of hard budget constraints is created that then needs to be accompanied by a functioning bankruptcy legislation. Moreover, macroeconomic stabilisation leads to lower inflation, reduces economic uncertainty, and thus lengthens the time horizon for investment decisions. On the other hand, privatisation has short- and long-term implications for government revenues and expenditures. There will be a one-off increase in budget revenue if assets or shares in state enterprises are divested by sale rather than by free transfer, and if the proceeds go to the state treasury rather than to the state enterprise. The budget deficit will therefore decline, unless there is an offsetting increase in government expenditures.

Sales of state assets or company shares to foreign investors can improve a country's balance-of-payments position. In the short run, the inflow of foreign currency strengthens the capital account. In the longer run, in the current account, foreign investment may generate additional exports (or reduce imports) by an amount greater than that devoted to the repatriation of profits.

The benefits of privatisation will also depend on the extent to which mar-

kets are liberalised and competition increases. A high number of market participants increases the pressure on enterprises to improve their performance through efficiency-enhancing restructuring measures. In this context, import liberalisation is an important additional step to expose enterprises to fierce competition.

Crucial for the success of privatisation are functioning capital markets that supply private enterprises with the needed capital for financing restructuring measures, and exercise control over the efficient use of the funds provided. Financial institutions can exercise independent credit judgement in their effort to make profits and to protect their capital position against losses from bad loans. They allocate capital to firms that can use funds most effectively, and exert financial discipline over firms by requiring interest and redemption payments on loans on time as well as by refusing additional credit to firms that fail to meet their obligations.

3. PRIVATISATION OF THE FOOD INDUSTRY

Food processing enterprises were in principle subject to the general rules of privatisation. However, for enterprises involved in primary processing for special provisions were applied.

3.1 General rules of privatisation

The “Government Programme on Privatisation of State and Municipal Enterprises in the Russian Federation” of 11 June 1992 (EVERS, 1992, p. 362) divided all enterprises into five categories. The first category comprises enterprises which were exempt from privatisation.¹ The next three

¹ This concerns mainly mineral resources, parts of the defence industry, harbours and railways (BORNSTEIN, 1994b, p. 427).

categories include enterprises whose privatisation was discretionary, depending on the decision of either the Federal Government, or the State Committee on Management of State Property (Goskomimushchestvo = GKI), or the governments of the individual parts of the Federation (administrative regions, i.e. republics, oblasts, krays, okrugs).

The fifth category includes enterprises subject to mandatory privatisation. Besides the wholesale and retail trades, the construction industry, agriculture, and the light industry, it also comprises the food industry, whose privatisation follows principally the general rules of the Russian privatisation programme for state and municipal enterprises. Depending on their size, enterprises were subject to the following types of privatisation²:

- (a) sale of enterprises in their entirety through competitive bidding;
- (b) sale of the enterprises which had already been leased in their entirety to the employees (workers and managers) (lease buy-out)³;
- (c) transformation into joint stock companies (JSCs) (corporatisation) with subsequent sale or distribution of their shares in accordance with the provisions of the mass privatisation programme.

In Russia, two types of joint stock companies have to be distinguished, namely open and closed ones. An open JSC grants its shareholders the right to sell their shares to outside persons or parties without the consent of the other shareholders. A closed JSCs is characterised by the fact that the shares belong exclusively to the founders, or that the shares can only

² On different methods of privatisation see also BRAUN (1998); BRÜCKNER (1995); STUCHTEY (1994), WIENERS (1994), SCHULZE (1996).

³ The option for managers and employees to lease their enterprise goes back to the Gorbachev era. The legal basis is the decree on leasing of 1989. The 1 July 1990 Law on Property in the USSR contains buy-out provisions for the employees. This law has kept its validity also in the independent Russian Federation, after the collapse of the Soviet Union (BORNSTEIN, 1994b, p. 421.).

be sold to a designated group of persons. Thus, the shares of a closed JSC cannot be sold freely (RIVINIUS 1996, p. 17).

Types (a) and (b) of privatisation were applied to small enterprises with up to 200 employees and fixed capital of less than 1 million roubles as of 1 January 1992. Large enterprises with over 1000 employees or fixed assets of more than 50 million roubles as of 1 January 1992 were to be transformed into joint stock companies. Medium size enterprises were permitted to choose one of the three types of privatisation described above (LÜCK 1993, p. 2040).

Employees of corporatising enterprises (c) were given the choice of three options for acquiring shares on preferential terms (LÜCK 1993, p. 2038):

Option 1: Employees received 25% of non-voting shares free of any charge. In addition, workers were entitled to buy another 10% of voting shares at closed subscription for cash or vouchers. These shares were to be sold to them at a 30% discount on the January 1992 book value and could be paid for in instalments over three years. Moreover, up to 5% of voting shares could be sold to the management at nominal prices. This option provides for minority insider shareholding, totalling 40% of the shares. The remaining 60% are held by the GKI, which tries to sell the shares to outside buyers. Option c1 is thus a mixed form of free transfers of enterprises to employees, sales to enterprise employees on favourable terms, and sales to outsiders.

Option 2: Workers and managers could buy 51 % of voting shares at a price that was set at 1.7 times the 1 July 1992 book value. The factor 1.7 was chosen arbitrarily and should take into account inflation. Purchasers paid for these shares partly in money and partly in vouchers. The voucher portion was initially set at a minimum of 50 %, but subsequently increased to 80 %. The remaining 49% of shares remains with the GKI.

This option can be characterised as a sort of employee buy-out.

Option 3 is applicable only to medium-sized enterprises with more than 200 employees and fixed capital of 1 million roubles-50 million roubles. A group of employees could make a one-year agreement with the appropriate property fund, approved by at least two thirds of the workers' collective, to restructure the enterprise to avoid bankruptcy while preserving a specified number of jobs. On successful fulfilment of the contract, the group could acquire at par value common shares equal to 20% of charter capital. The employees, including the group, could buy shares, at a 30% discount from par value common shares equal to an additional 20 % of charter capital. Option 3 can in principle be considered as a management buy-out.

The shares that have not been acquired by the employees are transferred to the population at auction, either for vouchers, which were distributed for a small fee of 25 roubles to all citizens on 1 October 1992 at a nominal value of 10 000 roubles, or for cash (see BORNSTEIN, 1994c, p. 437).

Responsibility for the organisation and carrying out of the privatisation has been assigned to two administrations. The GKI, founded in 1991, is responsible for preparing and implementing the privatisation programme. The Federal Property Fund (FPP) is the title owner of the state assets and their legal seller.

The first stage of privatisation, the so-called mass privatisation, ended on 1 July 1994. In the second stage, the so-called cash privatisation, all shares that, by mid-1994, were still in the hands of the state, as well as the shares of enterprises that had not yet been subject to privatisation, were to be transferred in blocks to "strategic investors". The use of vouchers for acquiring shares is only possible during a transitional period

(GÖTZ 1994, p. 3; DIW et al. 1994, p. 22). The three options of employee preferences are still valid, although they have been notably reduced. The instalment periods have been shortened from three years to three months, down payment has been increased, and the share fund for employees of the enterprise (Russian: Fond akcionirovanija rabotnikov predprijatia - FARP) has been abolished (HÜPER 1995, p. 47). The FARP is a special fund for acquiring and distributing additional shares to employees for a nominal contribution). All three options of employee preferences allow a joint stock company to acquire 5 to 10% of its own shares and distribute them to employees (GÖTZ 1994, p. 3).

3.2 Specificity of privatisation in enterprises involved in primary processing

Special provisions giving preferences to agricultural producers were applied to the privatisation of food processing enterprises involved in primary processing, i.e. in direct purchases from agricultural producers. Second-stage food processors, e.g. bread producers buying grain from granaries, were not covered by these provisions. They were subject to the above mentioned general principles of the privatisation programme.

The reason for this provision was that the processing sector is regarded as having a monopsonistic position vis-à-vis agricultural producers (OECD 1997, p. 2). It is argued that, ever since prices were liberalised in 1992, the so-called "price parity" between agricultural input and output prices has been destroyed, meaning that input prices have been rising faster than output prices. As a result, the internal terms of trade of agricultural enterprises, i.e., the ratio of output to input prices, have worsened. Unlike in Soviet times, output prices in many cases do not cover the farmers' production costs, whose financial situation has thus aggravated. The slower rise of agricultural output prices has been attributed to the monopsonistic behaviour of food processors (NOVIKOV 1995, p. 17).

This, however, would be a premature and unjustified conclusion. First it should be noted that price relations in the centrally planned economy did not reflect the relative scarcity of products, but the political and ideological considerations of the central planners. In the agro-food sector, agricultural procurement prices were set by the government and differentiated by geographic region. They consisted of a base price plus bonuses based on quantity, quality, and the financial needs of farms. Weak state and collective farms received price bonuses in an effort to improve their financial position (WORLD BANK 1992, p. 120). With the withdrawal of governmental price-fixing, these artificially created price relationships, which had always guaranteed farmers cover of their production costs, could clearly no longer be maintained and needed to be realigned. If we look at the development of the annual agricultural input and output price indices, input prices did rise faster than output prices until 1994, however, at a continuously declining rate. Only in 1992 was the difference very severe. But this was the year when prices were liberalised, leading to an expected and inevitable single explosion of the artificially low input prices and a much slower increase in the artificially high farm-gate prices. In the following years, the price scissors effect became gradually smaller, and in 1995 the growth rate of agricultural output prices was even higher than that of input prices. Thus, this development of agricultural input and output prices does not allow us to conclude that in general the downstream industry possesses and exercises market power.

In addition to the price movement, there are other arguments which make the thesis of a monopsonistic food industry in Russia unconvincing. These include the lowest concentration ratios in the total industry, a growing number of newly established (small-scale) firms, and difficulties in obtaining agricultural raw material, which means that processors are generally not in a position to offer procurement prices that are too low.

Notwithstanding these objections, the Russian government decided to grant agricultural producers preferential treatment in acquiring shares in order to dilute the assumed monopsonistic power of the downstream industry. Initially, the Resolution of the Government of the Russian Federation No. 708 of 4 September 1992 “On the Privatisation of Enterprises Involved in the Primary Processing of Agricultural Produce, and Enterprises Involved in Production and Technical Servicing, and the Material and Technical Supply of the Agro-Industrial Complex” stipulated that the enterprises should be privatised in accordance with one of the three options of preferences given to managers and workers, and that all remaining shares should be sold at nominal prices (valued at the 1 January book value of assets) at closed auctions to agricultural producers supplying the respective processing enterprise. The maximum number of shares which could be bought by an agricultural producer could not exceed his share in total purchases by the processor. No less than 10% of shares were to be reserved for individual farmers and other newly emerging enterprises (EVERS 1993, 187f.).

When soon afterwards it became obvious that the influence of agricultural producers on processing enterprises was still too weak to safeguard their interests, the Russian Government issued further decrees and resolutions in order to extend the participation of farmers in privatising primary food processing enterprises. The most important legal document in this context is the President’s Decree No. 2205 of 20 December 1994 (published in: EKONOMIKA SEL’SKOKHOZYAYSTVENNYKH I PERERABATYVAYUSHCHIKH PREDPRIYATIY 4/1995, p. 19). It states that all primary food processing enterprises that have not yet been privatised should be privatised through transformation into open joint stock companies, irrespective of their size, according to the first option of preferences given to employees. All remaining shares are to be sold at closed auc-

tions to agricultural producers supplying the given enterprise. Thus, agricultural producers might acquire up to 60% and the employees no more than 40% of the shares. The decree also recommends that enterprises which were transformed into a joint stock company at an earlier stage and do not comply with the decree should organise a second emission of shares and distribute them free of charge among agricultural producers. However, no sanctions are provided for to enforce the implementation of this recommendation.

3.3 Results

According to the Russian State Committee for Statistics (Goskomstat) an enterprise is regarded as being privatised when, in the case of a transformation into a joint stock company (aktsionirovanie), the appropriate decision has been made and the privatisation plan has been confirmed by the GKI. In the case of a privatisation via sales, an enterprise is regarded as being privatised when, by a special settlement date, a sales agreement has been signed (GOSKOMSTAT 1996a, p. 261). In addition, enterprises that have been transferred into JSCs, but where the state still holds shares are apparently also considered privatised. In the literature, however, the mere transformation of state enterprises into private legal entities, which is an important preparatory step for the final transfer of state property into private hands, is not called privatisation but corporatisation or commercialisation (BORNSTEIN 1994a, p. 474).

Following the official definition by Goskomstat, by 1997 almost 96% of all food processing enterprises had been privatised, 84% of them were completely in private hands. Nearly 12% of the enterprises were mixed enterprises with state participation in their capital. By 1997 the state in the widest sense of the word, including municipal authorities and public organisations, owned only slightly more than 4% of the processing en-

terprises (see Table 1).

The vast majority of enterprises (90%) was privatised through the transformation into joint stock companies, most frequently according to option c2 of employee preferences, thus giving employees the majority (51%) in total shareholding. This applies to 83% of all food processing enterprises in all sectors; 85% and 82% respectively in the meat and milk processing sectors; and 55 % in the milling industry (see Table 2).

The majority of processing enterprises (78%) have chosen the legal form of an open joint stock company. Almost 14% have become limited liability companies, and 8% closed joint stock companies (EKONOMIKA SEL'SKOKHOZYAYSTVENNYKH I PERERABATYVAYUSHCHIKH PREDPRIYATIY 3/1996, p. 29).

That option c2 should have been the preferred choice may be surprising at first glance, because of the relatively high price of 1.7 times the 1992 book value which had to be paid for the shares. However, because of the high inflation rate, the book value was far below the market value, and workers and managers could thus purchase their shares at favourable conditions.

As a result of the application of this type of privatisation (option 2), agricultural producers did not acquire as many shares in processing enterprises as had been expected by the government. Only 14% of agricultural producers are majority shareholders (APK 4/97, p.12).

An essential reason for the low participation of primary producers in processing enterprises is the fact that a large part of food processing enterprises was privatised as early as 1992/1993, whereas the decree stipulating the transfer of majority shareholding to agricultural producers was only issued at the end of 1994 (VAS'KIN 1996, p. 30). Only a few processing enterprises followed the recommendation of a later transfer of

shares to agricultural producers (EKONOMIKA SEL'SKOGO KHOZYAYSTVA ROSSII 4/1996, p. 3). In other cases, agricultural producers have not taken ownership of their shares in processing enterprises, because they lacked the necessary financial means (SHCHERBAK 1997, p. 6).

In some regions, mostly ruled by communists, local governments have used their authority to make processing enterprises transfer the majority of shares into the hands of their raw material suppliers. In the Autonomous Republic of Chuvash, the local government issued its own privatisation programme even before the President's Decree No. 2205 was published, and has thus settled and controlled the transfer of majority shareholding from processing enterprises to primary producers.⁴ Meanwhile, the latter are reported to be majority shareholders in all privatised enterprises of primary processing (IVANOVA 1995, p. 18, NOVIKOV 1997, p. 16). The same has been reported for the oblasts Belgorod, Orel and Tula, where the majority of shares has been transferred to the raw material suppliers via a second emission of shares on the basis of a resolution passed by the oblast governments (NOVIKOV 1997, p. 16).

4. Privatisation in agriculture

Privatisation in agriculture includes the privatisation of land as well as of non-land assets. Legislation enacted in the Russian Federation since the late 1980s has formed the legal basis for land reform and the restructuring of large agricultural enterprises. The laws address three major issues: distribution of land between state, municipalities and private owners; transfer of land and non-land assets from large farm collectives to

⁴ The corresponding resolution was issued on 8 April 1994. The Presidential Decree No. 2205 about "Particularities of Privatising Enterprises of the First Processing Stage..." was issued only on 20 December 1994 (for more details on the privatisation of the food industry in the Autonomous Republic of Chuvash, see IVANOVA 1995, pp. 17-18, 23).

individuals; and creation of conditions for private activity in agriculture.

4.1 Legal framework for the creation of peasant farms and restructuring of large-scale farms

Still in the Soviet era, legislation was passed that allowed the creation of a non-state enterprise as a co-operative, and which transferred land and non-land assets from state to kolkhozes and sovkhozes. Moreover, the November 1990 Law on the Peasant Farm established the legal basis for individual (family) farming. The Law on Peasant Farm of the Russian Federation of 27 December 1991 provided the basis for individuals and families to leave the collective and state farms with a share of the large farm's land and property, without approval by the managers or the general meeting of members. This law also required each large agricultural enterprise to divide its land and capital assets into shares, and each member, including children and pensioners, to be assigned a land and asset share. The value of the asset shares was determined by the length of time the individual had worked in the enterprise and the amount of work done. Land shares were of equal size for all members. Thus, the so-called collective-shared ownership was born.

According to Yel'tsins decree "On Urgent Measures for the Realisation of Land Reform in the RSFSR" of 27 December 1991, farm workers could leave an enterprise without permission as before, but now with a guaranteed share of land obtainable without agreement by the enterprise management and the shareholders' meeting. The December decree also required all states and collective farms to reregister under a new legal form (joint stock companies, co-operatives, of limited liability companies, peasant associations etc.).

4.2 The debate on the purchase and sale of land

A great problem in Russian agrarian reform is the question whether and

to what degree the purchase and sale of land used for agriculture⁵ should be permitted. Part of the debate on this issue can be explained by the lack of tradition in the private ownership of land. In Russia agricultural land was usually owned, or at least its tenure was controlled, by the state in the widest sense (tsar and land-holding nobility). Thus, the debate on the purchase and sale of land to some extent reflects the conflict between Russian conservatives, who adhere to this tradition, and western-oriented reformers, who support the idea of an unrestricted land market. On the other hand, the debate mirrors the fight between old and new interest groups. The permission of unrestricted trade in land could create new rural interest groups, who could endanger the power and privileges of the old rural elite, i.e. kolkhoz and sovkhos directors, who at present de facto “own” the respective enterprises and the land these comprise (WEGREN 1997, p. 964f.).

In December 1990 the Second Congress of People’s Deputies of the RSFSR passed the resolution “On the Programme of Reviving the Russian Countryside and the Development of the Agroindustrial Complex”, which allowed individuals to buy and sell land, but at the same time placed a 10-year moratorium on land sales, and only permitted the state to buy land. The above-mentioned decree of December 1991 allowed farm members to sell their land plots to other citizens if they retired from farming, inherited the plot, wanted to set up a private farm elsewhere, or intended to invest the proceeds in other rural businesses. Although this decree went further than any previous legislation, the right to buy and sell land was still restricted.

An attempt to abolish all restrictions was the President’s Decree of 27 October 1993 “On the Regulation of Land Relations and the Develop-

⁵ In contrast to land for agricultural purposes, land used for private plots and other small-scale garden use can be sold freely at any time. In this paper, “land” is used to refer only to land for agricultural purposes.

ment of the Agrarian Reform in Russia". This decree remains the basis for a land market, although it will be superseded by the land code when the latter is finally passed. The decree stipulates that all members of state and collective farms receive a certificate documenting land ownership for a share of the farmland. The most important feature of the October 1993 decree, however, is that it annuls previous restrictions on land sales and allows the owner to sell his land share. After a rural dweller has obtained land shares or actual land, he is basically free to do with them as he pleases. A land owner could give his land away, pass it on to relatives, lease the entire plot, divide it and sub-let parts of it, exchange the plot for a different plot, or sell it (WEGREN 1997, p. 963).

Subsequently, the 1993 Constitution and the 1994 Civil Code did little to specify the procedures for land sales and purchases, which meant that the new land code would be the primary legislative document to regulate those transactions. However, so far now no new land code has been passed. In June 1995 the State Duma passed a draft land code by a vote of 230 to 43 that went against both the letter and the spirit of previous legislation and presidential decrees. It contained restrictions on the amount of land private farmers and agricultural enterprises could lease out to other users; on land use and land use changes (keeping agricultural land for agricultural purposes); and on land sales. It also eliminated the right of pensioners to lease out their land shares. Privatised land held by agricultural enterprises or privately owned land held by individual farmers could only be sold to the state. This draft of the land code was not adopted by the Federation Council, because it was considered too restrictive.

On 7 March 1996 Yel'tsin again confirmed the right to freely dispose of land with the decree "On the Implementation of Citizens' Constitutional Rights to Land". By a vote of 288 to 16, the Duma on its part adopted a

second version of the land code on 22 May 1996; this was even more restrictive, practically forbidding free trade in land. It did not even allow the free sale or purchase of land or the mortgaging of land. Land shares could be exchanged, but only among members of a farm. This version was also rejected by the Federation Council in July 1996.

In June 1997 the State Duma adopted another version of the land code. Although this allowed the private ownership of rural land, it also prohibited the purchase and sale of farm land, and forbade foreigners from purchasing land, although they could lease it up to 50 years. After the president's repeated refusal to sign this, a commission of delegates from both sides was set up to negotiate a compromise, which, however was not reached. So far, Russia still has no land code, which, in turn, has had an impact on the buoyancy of the land market.

The members of the State Duma who rejected Yel'tsin's decrees hold the opinion that, as elected representatives, they ought to defend the interests of the rural population. They have put forward the following arguments:

- In view of the collective tradition in Russia, the rural population is against the purchase and sale of land, which is to remain common property.
- In view of the impoverishment of the village population due to inflation, they are not able to purchase land, which is instead reported to be bought by affluent urban people.
- During the NEP (New Economic Policy) era, agriculture experienced a continuous upturn, although land could not be bought or sold. And this is still the case in China, where agriculture is developing successfully.

A survey conducted in the Novosibirsk Oblast (SCHULZE, TILLACK, DOLUD,

BUKIN 1999)⁶ revealed that resistance to an unrestricted transfer of farmland is widespread among the rural population. The unrestricted transfer of farmland was approved of by only 3 out of 181 respondents. The sale and purchase of land were approved of by nearly 20 %, on the condition that land speculation was prevented. These 20 % included half of all private farmers interviewed. The overwhelming majority of members of large farm enterprises and also their directors were against free land trading. Their main argument was that land was a gift of nature and should belong to all villagers, followed by the opinion that land speculations could not be prevented, and finally the fear of drastic economic disharmonies in the village. Out of the 142 persons rejecting land trading, 81 held the opinion that the land should be common property of all members in a village. This attitude may be an expression of the traditional Russian understanding of land as the collective property of a village.

4.3 Results of privatisation

As a result of the adopted privatisation legislation and with financial support granted by the government, individual (peasant) farms have been created. Their number increased rather quickly to 270.000 in 1994 and stabilised at about 285.000 until 1995. At present the number is estimated at 280.000 farms or even less. At the beginning of 1998 the average size of 56.8% of all peasant farms was 20 ha, 33.4% had an average size of 20 to 100 ha, and only 9.8% of farms were bigger than 100 ha. Altogether the number of peasant farms was not as high as had been expected by the reformers (at least 1 million) (OECD 1998). Reasons for this failure were mainly the rapid deterioration of the economic situation, which drastically increased the risk of economic activities; the simultaneous decline of financial support for peasant farms; resistance to the

⁶ The questionnaire was designed by SCHULZE, TILLACK, EPSTEIN (1996).

foundation of peasant farms by the management, at least in the first years; and the conservatism of the rural population, which had been underestimated. Many employees were no longer interested in establishing their own private farms due to their advanced age. These reasons were also those most frequently given in the above-mentioned survey in Novosibirsk. In detail the arguments against establishing a peasant farm in the Novosibirsk Oblast can be ranked as follows:

- Uncertainty of the future and fear of risk (64.1 %)
- Working on a collective farm is better than working on a peasant farm (64.1 %)
- Lack of capital (52.4 %)
- Difficulties in purchasing the necessary machinery, equipment and resources (45.5 %)
- Reluctance to change life style and habits (33.6 %)
- On a collective farm, the income varies less than on a peasant farm (33.1 %)
- Lack of legal background (27.6 %)
- Fear of losing the social privileges (social benefits) granted by the collective farm (23.4 %)
- Advanced age and health problems (21.3 %)
- No economic or legal knowledge (19.3 %)
- On a collective farm incomes are higher than on a peasant farm (15.9 %)
- Reluctance of other family members to form a peasant farm (9.7 %)
- No opportunity to purchase productive land (8.9 %)

- No opportunity to purchase and sell land (6.9 %)
- Negative attitude of the villagers towards individual farmers (6.2 %).

The reorganisation of large-scale farms has generally not proceeded beyond re-registration of the original farm under a new form, and very little has changed in terms of the institutional structure of the farm, management practices, and agricultural techniques. By 1996 enterprises had been transformed into 12,862 closed joint stock companies or limited liability companies, 320 open joint stock companies, 2,227 agricultural cooperatives, 2,183 so-called collective farms, 751 farmers' associations; another 2,400 had been transformed into other legal forms. The old legal status was retained by 6,025 kolkhozes and 3,592 sovkhoses (APK, 1998). This means that in about 30% of all large-scale farms, "common" collective (not collective-shared !) property or state-owned property has been retained. Collective-shared property comprises 53% of all agricultural used land. The respective figure for state and other large-scale farms is 73.3%, for peasant farms 6.2%, and for individual household plots 11.4% (OECD 1998).

At the same time, an increased individualisation of production can be observed (LERMAN 1998). In 1997, for example, the share of production from private household plots already reached 48% (5.1% of the agricultural area), from large-scale farms 50% (81.4 % of the agricultural area) and from peasant farms 2% (6.2% of the agricultural area) (MINSEL'KHOZ 1998). A further rise in the number of private household plots can be expected. For example, in Novosibirsk 16% of the interviewees intended to further extend their private plots. Yet the large portion of private household farming is only possible thanks to the considerable services by large farm-enterprises.

This type of farming with partial income from the large enterprise and, in

addition, work on private household plots, seems to carry the lowest economic and social risks for workers and employees of large farm enterprises. It may also conform to the collective tradition of the Russian peasants.

5. COMPARISON AND EVALUATION OF THE PRIVATISATION PROCESS IN THE FOOD INDUSTRY AND IN AGRICULTURE

Chapters 3 and 4 indicate that privatisation in agriculture and the food industry proceeded quite differently, in terms of the chosen methods of privatisation, and also the results. Whereas privatisation of the food industry has almost been completed, not much progress has so far been achieved in agriculture. The main reason for this is the ongoing debate about the purchase and sale of agricultural land, between president and government on the one side and parliament on the other. This has led to uncertain and restricted property rights in this sector, which are obstructing the development of an operational land market. In agriculture mainly collective-shared property has been formed, or collective and state property have been retained. In contrast, no restrictions of property rights exist in the food industry, because 78% of the enterprises are open joint stock companies. Only in the remaining 22% do owners face restrictions concerning the transfer of shares; these are, however, in compliance with the laws on limited liability companies and closed JSCs (RIVINIUS 1996).

As to the privatisation methods, privatisation in the food industry was generally carried out via sales, though with preferential treatment for employees. In agriculture, land and non-land assets of state and collective farms were transferred to the shareholders principally free of charge. An evaluation of the privatisation methods applied in both sectors is given in Table 3, with regard to their impact on the state budget, management efficiency, inflow of capital and know-how, and the acceptance of privati-

sation by the employees (see also SCHULZE 1996 and 1999).

The most positive impact on budget revenues is usually achieved through the application of competitive bidding. Privatisation methods granting preferences to employees generally lead to lower budget revenues (therefore: "more negative"). A transfer of ownership free of charge clearly has negative consequences for the budget, because no revenues at all are received in return. It can, however, have a positive effect, if e.g. sovkhoses were loss-making. Although the state receives no revenues by giving the enterprise away free of charge, it is no longer obliged to fund the sovkhos and thus can cut budget expenditures. Kolkhoz property has never been state property, and it is therefore regarded as having a neutral effect on the state budget.

Management efficiency can be regarded as high in enterprises where managers own the majority of shares, because there is no or only a reduced principal-agent problem. If workers are the majority shareholders, this may have a negative impact on management efficiency, but also on the inflow of capital and know-how, because of the reasons described in chapter 6 below. However, broad participation of employees helps to gain their political support for privatisation.

From a purely economic point of view, and in spite of all the problems described in more detail in the following chapter, the privatisation methods applied in the food industry can be considered more advantageous than those applied in agriculture.

6. THE IMPACT OF PRIVATISATION ON EFFECTIVE ENTERPRISE RESTRUCTURING

Restructuring of enterprises includes changes in the institutional structure of a firm, its management structures, and the adjustment of its production programme to consumer demand. The likelihood of efficient en-

enterprise restructuring will increase as more property rights are transferred to responsible economic agents. Another key determinant for restructuring is effective corporate governance, i.e. a mechanism which stimulates the management of privatised enterprises to carry out efficiency-enhancing restructuring measures (BLASI, SHLEIFER 1996, p. 78).

The privatisation methods applied in agriculture and the food industry have led to strong insider control. In agriculture, due to the distribution of shares to farm members only, enterprises are completely insider-controlled. In the food industry not all but still the overwhelming majority of enterprises are insider-controlled because of the preferred choice of the second option of employee preferences. Under such conditions, entrepreneurial measures, which are aimed at increasing the competitiveness of the enterprises and which may lead to profound changes within the firm, are generally difficult to implement, because insiders can be expected to have a different objective function from conventional (outside) shareholders. Employees may wish to raise their wages (as well as dividends) and increase their job security rather than enhance the long-term efficiency of their enterprises if this is associated with the loss of income and jobs. In addition, the evolved structure of ownership and corporate governance may have negative effects on investment activities, mainly for two reasons. Firstly, the transfer of shares to employees on very favourable conditions, and the distribution of the remaining shares in exchange for vouchers have led not only to a reduced inflow of capital, but also to a broad dissemination of assets and thus to a fragmentation of investment resources. Only if capital is concentrated in the hands of a limited number of shareholders can effective owners, who are interested in the financing of long-term restructuring, be created, and entrepreneurial behaviour be developed. Secondly, insider-controlled enterprises generally suffer difficulties in raising outside capital, because of the

agency problems faced by lenders. As long as they have no real possibility to control the efficient use of investment resources, lenders will be reluctant to finance long-term restructuring measures (BERGLÖF 1995, p. 65).

Problems with restructuring the food industry may also arise in those enterprises where state shareholding is still considerable, and in enterprises where farmers hold a controlling majority of shares. It is doubtful whether government authorities will be able to effectively control the management. Instead, there is the danger that the managers of denationalised enterprises will concentrate their activities on rent-seeking rather than on profit-seeking. In addition, outside investors, especially foreign ones, may be deterred from investing in such enterprises (GÖTZ 1997, p. 29). In those food processing enterprises that are controlled by agricultural producers, it is not certain whether groups of producers, who generally have great difficulties surviving as viable primary producers and financing their own development, could take on the task of developing and running a successful processing enterprise. Even the conflict of interests regarding the pricing of raw materials might not be solved. Experience with farmers' co-operatives in western countries shows that farmers will not necessarily deliver their produce to a processing enterprise in which they have ownership interests if someone else offers more favourable marketing conditions (LAURINKARI 1990, p. 581). Finally, such favourable treatment crowds out other investors, including foreign interest that would inject much of the needed investment capital, management and marketing expertise (OECD 1996, p. 12).

In agriculture the major impediment to restructuring are the uncertain property rights for land and the missing land market. More certainty in property rights for land and an operational land market would give Russian farms the freedom to restructure, and to adapt to the size and type

of organisation best suited to meet consumer demand. Outdated land tenure limits the profitability of farms, making new investment extremely unlikely.

7. OPTIONS FOR FURTHER ACTION

As transition progresses, Russian economic policy will have to try and eliminate some of the impediments to restructuring described above. In the food industry, in a so-called post-privatisation period, the deficiencies in the ownership and corporate governance structures should be removed. One way to achieve this goal is to leave the formation of efficient ownership and corporate governance structures to competition, i.e. to the self-regulation and self-coordination of economic agents. This would imply the development of efficient ownership structures via a redistribution of shares on the capital market. This, however, requires the creation of an appropriate institutional framework. Firstly, a working capital market has to be established. Secondly, an adequate incentive mechanism is necessary, which is able to motivate the enterprises to actually transferring their shares. The required tool already exists in Russia, in the shape of bankruptcy law. So far, however, the law has not been applied. As a result, most food processing enterprises have not felt the necessity to improve their financial situation via active restructuring measures, which could also be financed by selling shares.

The development of efficient ownership and corporate governance structures via competition may be a long-term and time-consuming process. An alternative approach would be the passing of legislation that stipulates changes in the ownership structure. For example, the rights associated with employees' shares could be modified, or the preferences for employees in the privatisation of the remaining enterprises could be abolished. Such changes have already been discussed by the govern-

ment (RÜSTER 1997, p. 241). This, however, would require amendments of the existing Privatisation Law, which are unlikely to be approved by the current majority in the State Duma. An even deeper intervention would be the issuing of laws prescribing some type of redistribution of shares.

In agriculture, efforts should be directed towards giving full property rights to the owners of land shares. This includes above all the right of selling, leasing, donating or bequeathing land to any person, taking into account the so-called societal restrictions on individual property rights. Non-land assets should be subject to the legal framework for limited liability companies, closed joint stock companies and co-operatives. Beyond this, there should be no other restrictions.

Just as in the case of the food industry, the threat of bankruptcy or liquidation must become real in order to stimulate enterprise restructuring. However, it is doubtful whether for insolvent enterprises bankruptcy procedures will be initiated. According to Russia's minister of agriculture, at present merely 20% of the Russian large-scale farms are able to solve their problems themselves, another 20% have hardly any chance of survival, and the remaining 60% are reported to manage the problem only with appropriate support from the state (AGRA-EUROPE 22/98, 2 June, Short Communications 2). This may cause shareholders to take their shares, extend their private household farms, and later turn them into peasant farms. In order to increase competitiveness, large-scale farms must find new organisational forms, reduce the number of workers and employees, and give more individual responsibility to the remaining workforce. The creation of subsidiary companies for processing and marketing might be sensible, since, in these fields of operation, more profit can be made than in agricultural production. Setting up small processing units near the agricultural production sites, which is already quite

widespread practice, is probably more profitable than acquiring shares of existing processing enterprises in the food industry, whose efficiency is generally still quite low.

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Table 1: Ownership Structure in the Russian Food Processing Industry, 1993-1997 (share in total number of enterprises)

Type of ownership	1993	1994	1995	1996	1997
State	22.8	10.2	5.4	2.8	2,5
Municipal	5.8	2.2	2.2	1.4	1,6
Public organisations	0.3	0.3	0.2	0.1	0,1
Private	54.5	57.7	63.7	81.9	83,8
Mixed without foreign capital	16	27.3	25.4	10.9	9,7
Mixed with foreign capital	0.6	2.3	3.1	2.9	2,3
Privatised*, total number	71.1	87.3	92.2	95,7	95,8

*according to the official Goskomstat definition (see beginning of this chapter)

Sources: Goskomstat 1995, p. 316, Goskomstat 1996b, p. 504, Goskomstat 1997, p. 337., Goskomstat 1998, p. 389.

Table 2: Share of privatised enterprises in the Russian Food Industry as of 1 January 1997 (in %)

	Privatised enterprises				
	Total share	Of which			
		Share privatised through transformation into joint-stock companies	Share of privatised enterprises with agricultural producers controlling majority of shares	Share of privatised enterprises having conducted a second emission of shares	
		According to option 2			
Total food industry	92	90	83	14	4
Meat industry	92	92	85	9	5
Dairy industry	92	89	82	16	3
Milling industry	90	88	55	14	1

Source: OECD 1997, p. 14; APK 4/97, p. 12; Zel'dner 1997, p. 14.

Table 3: Evaluation of the privatisation methods applied in the food industry and agriculture

Criterion	Privatisation Method						
	Com- petitive bid- ding	Lease- buy out	Option 1	Option 2	Option 3	Privati- sation of sov- khozes	Privati- sation of kol- khozes
Impact on state budget	positive	neg. to . pos.	neg. to pos .	neg. to pos.	more positive	nega- tive to pos.	neutral
Manage- ment efficiency	positive	more nega- tive	more nega- tive	more nega- tive	more positive	more nega- tive	more nega- tive
Inflow of capital	more positive	more nega- tive	more nega- tive	more nega- tive	more positive	nega- tive	nega- tive
Inflow of know-how	more positive	nega- tive	more nega- tive	more nega- tive	more positive	nega- tive	nega- tive
Accep- tance by the em- ployees	more nega- tive	positive	more nega- tive	positive	more nega- tive	positive	positive

Source: Own table.