Privatization in One Country: Foreign Investment and the Russian Privatization Dynamic

Richard C. Schneider Jr.
Privatization in One Country: Foreign Investment and the Russian Privatization Dynamic

By Richard C. Schneider, Jr.*

I. Introduction

The following remarks seek to place in context aspects of the Russian economic reforms, privatization in particular, that may seem incomprehensible to many non-Russians. I argue that, in Russia, the privatization program has survived politically because foreign investment has not played a large role in the process. Russians, notwithstanding opportunistic political gesturing and rhetoric to the contrary, have not allowed it to play a larger role.

Two factual anomalies help frame the argument. First, since the parliamentary elections of December 1993, only one true reformer has remained in the Yeltsin government: Anatoly Chubais, the Deputy Prime Minister in charge of privatization and the Chairman of the State Property Committee. In fact, as this article goes to print, President Yeltsin has elevated Chubais to the post of First Deputy Prime Minister, where he will have the responsibilities of overseeing the economy and finance.¹ Chubais and the privatization program have managed to survive the political upheaval that has resulted in the departure of other well-known market reformers such as Yegor Gaidar and Boris Fedorov.² Second, while reports vary, foreign investment in Russia in 1993 amounted to just over $400 million. Poland, a much smaller country with many of the same systemic problems as Russia, attracted about the same amount of foreign investment.³

* Assistant Professor of Law, Wake Forest University School of Law.


2. Some of the most important reformers who have resigned or were asked to tender their resignations include Boris Fedorov, former Minister of Finance, Yegor Gaidar, former Economics Minister, Ella Pamfilova, former Social Minister, and Andrei Illarionov, former economics adviser to Prime Minister Chernomyrdin.

3. Now that Poland has successfully reached a debt restructuring agreement, foreign investment is likely to increase dramatically.
These anomalies raise a variety of questions. For example, how have Chubais and the privatization program survived this long despite Prime Minister Chernomyrdin's disfavor of the “market romanticism” espoused by the reformers and Boris Fedorov’s claim that an “economic coup” had occurred? Why has so little foreign capital been invested in Russia, even though Russians have been engaged in an effort to attract foreign investment since early 1987? Why has privatization not stimulated capital infusions from the West where other programs have failed? This essay contends that the survival of Russian privatization and the low level of foreign investment are directly related.

Privatization may be viewed from several analytical perspectives. One perspective, the economic, imposes itself rather forcefully at the outset. Governments turn to privatization to achieve specific economic results. The success or failure of privatization can then be evaluated on the basis of a relatively established set of economic and market indicators. What revenues has the state treasury gained? How does the privatized company perform? Viewing the Russian experience from an economic perspective at this time would not be particularly instructive. First, the entire economy is in crisis. Second, reliable statistics are difficult to obtain and, once obtained, difficult to compare to privatizations in radically different economic environments. Finally, the goals of the Russian privatization program transcend economics alone.

A comparativist perspective of privatization is fruitful for many reasons. First, governments learn from the achievements of other privatization programs. Mistakes need not be repeated. Second, a comparison of different countries’ experiences enables certain struc-

4. Jonas Bernstein, Reforms in Russia Hold Firm; Some 'Red' Critics Are Closet Converts, WASH. TIMES, Aug. 15, 1994, at A1. Chernomyrdin has moderated his position somewhat since his early statements. While he has not come out as a champion of privatization, he has not tried to roll back the program. The goals of controlling inflation and limiting the money supply to satisfy the International Monetary Fund have preoccupied Chernomyrdin during his term as Prime Minister. See also Richard Gwyn, Leaner Russian Bear Starting to Look Quite Healthy, TORONTO STAR, Sept. 30, 1994, at A17.


6. Another argument explaining the survival of privatization has correctly pointed out that “ unlike price liberalization, monetary tightening, and reduction of government spending, all of which impose painful costs on some people, privatization allocates shares to the people for free or at low prices — typically a popular measure.” Maxim Boycko et al., Privatizing Russia, in BROOKINGS PAPERS ON ECONOMIC ACTIVITY, pt. 2, 139, 147 (William C. Brainard & George L. Perry eds., 1993). Note, however, that the Russian people would not get the shares if they had been sold to foreigners.
tural analyses to be performed so that lessons can be generalized. Certain approaches to privatization may function in developed countries, but not in developing countries. Comparisons made on an industry-wide basis may also generate valuable structural or framework insights. All of these insights assume, however, that the lessons learned are applicable to a different economic and political environment.

While such viewpoints may be useful, this essay will adopt a largely historical-cultural perspective in its inquiry regarding the link between foreign investment and privatization in Russia. Paraphrasing Stalin's remark about socialism in Russia, this essay will look at "privatization in one country." Russia requires such focus because of the depth and continuity of its historical and cultural heritage and because of the uniquely disastrous legacy left by socialism. Culture and history drive politics in Russia, and privatization is essentially a political phenomenon that redistributes control over economic activity.

While the term "privatization" denotes a neutral economic concept meaning to "change [for example, an industry or a business] from governmental or public ownership or control to private enterprise," it also carries ideological and political connotations because it suggests something fundamental about an economy or the direction of an economy. In Russia, the ideological overtones assume an additional nationalistic nuance. For instance, "privatization" is qualified in a lexicon of post-Stalin terminology as:

Just recently, we used the word 'privatization' only with respect to the West. Most often the word was used in negative contexts, and it

7. The doctrine of "socialism in one country" was formally announced by Joseph Stalin in 1924. Stalin built on a theoretical foundation laid by Nikolai Bukharin. The doctrine essentially argued that Russia could build a socialist economy totally on its own even though socialism was not advancing in other countries. See Robert C. Tucker, Stalin as Revolutionary 377-78 (1974); Stephen F. Cohen, Bukharin and the Bolshevik Revolution 187 (1973). In many fundamental respects Russia has also decided to go it alone with respect to privatization, that is without substantial foreign investment. As will be suggested below, the timing of Stalin's remark, coming as it did at the end of the market period known as the New Economic Policy (NEP), parallels in significant ways recent developments in Russia, as the country once again seems attracted by the siren song of central planning after a period of market reform. See Yuri N. Afansyev, Russian Reform Is Dead; Back to Central Planning, FOREIGN AFF., Mar./Apr. 1994, at 21 (Antonina W. Bouis trans.).

8. This article argues that other states in Eastern Europe, while sharing some characteristics with Russia, are arguably not as enslaved to their pasts. Poland may be a case in point.

meant the onslaught by private capital and its political backers against ‘the gains of the working people.’

The Russian privatization program, a pillar of the economic reform plans supported by Western governments, has recently been denounced in the spirit of nationalism by Prime Minister Viktor Chernomyrdin as “the mechanical transfer of Western economic methods to Russian soil.” Moreover, the reform economists most closely associated with the radical reforms initially pushed by the Yeltsin government have been labelled “Western stooges,” a bitter charge made with the intent of rolling back the “Westernized” reforms. Foreign investors are watched closely to ensure that they do not benefit unjustly from the sale of state assets. Such eventualities are perhaps scrutinized most closely by the state enterprise managers who stand to gain large sums from such transfers if the transfers are not made directly to foreigners.

In short, the agonizing, centuries-old Russian debate between the so-called “Westernizers” and the Slavophiles has not left the privatization process untouched. First, the new Shatalin/Abalkin plan proffered to the Yeltsin-Chernomyrdin government recommends a rejection of voucher privatization and more active intervention by the state in the privatization process. Both changes would, of course, negatively affect the ability of foreigners to participate in the privatization program. The recommendations of these perestroika-era economists are offered in the spirit of preserving economic sovereignty against the encroachments of the West.

Secondly, while now-First Deputy Prime Minister Chubais has managed to survive this long, it is hard to predict how long he will remain untouched even in his new position. He is closely associated with the Western-style reforms. Press reports often surface that Chubais may be close to losing his job. Chubais insisted that he

11. Fred Kaplan, Reform’s Rise and Fall; Western-Style Capitalism Tripped by Hard Times in Russia, BOSTON GLOBE, Jan. 23, 1994, at 1.
12. At times such gains come within the legal limits of the privatization program, and at times they are gotten illegally. For the latter, see the description below of the recent controversy over the privatization of the Gorky Automobile Factory, or GAZ.
would remain as privatization minister until the completion of the voucher privatization program in June 1994. He has managed to achieve that goal. If he now goes the way of Gaidar and Fedorov, it will be because of his identification with Western reforms, but his work on privatization will have been largely accomplished.

Foreigners act as lightning rods of hope and repulsion in Russia. Consequently, this essay develops its argument by looking at the Russian privatization program from four perspectives, focusing each on the impact of foreigners. The four perspectives are (i) economic, (ii) legal, (iii) political, and (iv) historical. After commenting on each, this essay concludes with observations on the actual treatment of foreigners in the legal provisions of the current privatization programs. Compartmentalizing an analysis of Russian privatization under four headings enables a complementary view of foreign participation from four perspectives. On the other hand, such a division does not facilitate a purely chronological approach to the evolution of privatization in Russia. A chronological approach, while perhaps easier to follow as a narrative, would make an understanding of the different influences working on foreign participation more difficult. Accordingly, the following comments build on each other but do not develop chronologically.

II. Economic Context of Privatization

As noted above, privatization can be analyzed and judged in a purely economic context. The purpose of presenting an economic viewpoint here is not to provide the means of evaluating the Russian program by economic indicators. Rather, this section will describe some of the unique character of the Soviet economy as the basis for privatization, and the reform plans that competed to develop that basis. Each reform plan, of course, had some vision for the role of foreign capital in the development of a market economy.

Privatization is only one element in an overall reform strategy which has consistently stressed four points since the dissolution of the Soviet Union in 1991: macroeconomic stabilization (stabilization of

16. Foreigners, of course, is eminently vague terminology. For purposes of this article, foreigners and Westerners are used synonymously. The role of foreigners in any of the economic, legal, political, or historical perspectives ranges from actual investment impact (or lack thereof) to the mere idea or abstraction of foreigners in the Russian mind or in the discourses of Russian leaders. Foreigners, of course, also play a direct advisory role at times.
the ruble); the freeing of prices and economic activity in general by ending central planning; comprehensive privatization; and the continued provision of essentials to the impoverished (a social safety net).\textsuperscript{17} Except for exceptional circumstances under which foreign aid may be necessary, ruble stabilization for example, privatization offers the only real port of entry for foreigners aspiring to contribute to (or profit from) Russia's reforms.

\textbf{A. Early Reform Period}

In the heady days at the end of 1991, before "shock therapy" began with price liberalization in January 1992, one might have thought that the perestroika-era advisers would not again be particularly relevant. However, because of the current resurgence of economists and "reformers" whose formation stretches well into the Soviet past, the early battle of the reform plans needs to be briefly reviewed.

When he became General Secretary of the Communist Party on March 11, 1985, Mikhail Gorbachev inherited a deeply flawed and increasingly weakening economy.\textsuperscript{18} The economy had, without significant foreign involvement, managed to flourish by some measures, but then crept toward extinction.\textsuperscript{19} To address these problems, General Secretary Gorbachev engaged quickly in a rhetoric of change. He introduced terms such as "perestroika" and "glasnost" to dictionaries all over the world. Another term, "uskorenie," or "acceleration," while


\textsuperscript{18} Numerous studies have examined the Soviet economy in the recent period both historically and theoretically. Among the best are Anders Aslund, \textit{Gorbachev's Struggle for Economic Reform} (1989); Marshall I. Goldman, \textit{What Went Wrong with Perestroika} (1991); and Ed A. Hewett, \textit{Reforming the Soviet Economy: Equality Versus Efficiency} (1988) [hereinafter \textit{Reforming the Soviet Economy}].

\textsuperscript{19} As Ed Hewett, an expert on Soviet economics has argued: "When Mikhail Gorbachev assumed the Soviet leadership in 1985 he found an economy that was big, was inefficient, and was playing a marginal role in the global economy. Each of these characteristics is striking testimony to how far rich resources and ruthless determination can take a country committed to minimizing its links with the outside world." Ed A. Hewett & Clifford G. Gaddy, \textit{Open for Business: Russia's Return to the Global Economy} 4 (1992) [hereinafter \textit{Open for Business}].
not gaining international linguistic currency, described his early economic reform plans.\(^{20}\)

From 1985 to 1986, the rhetoric of \textit{uskorenie} had little theoretical underpinning. Acceleration was to involve an increase in growth rates, intensive development of technologies, and positive changes in the attitudes of the people toward their roles as instigators of economic development.\(^{21}\) Gorbachev's early reform ideas, however, while envisioning the decentralization of some decision-making, did not fundamentally disturb the crucial role of central planning or state ownership. As economists have also demonstrated, acceleration to recovery did not contemplate any significant overtures to the West or to Western capital or technologies.\(^{22}\) What Gorbachev wanted most of all was to catch up economically without creating any risk of foreign exploitation.

In June 1987, \textit{uskorenie} received programmatic support when the Central Committee of the Communist Party of the Soviet Union (CPSU) adopted a blueprint for economic reform called the "Basic Tenets for the Radical Restructuring of the Management of the Economy" ("Basic Tenets").\(^{23}\) The Basic Tenets relied on four principal elements: maintenance of central planning; performance incentives; greater enterprise autonomy; and more worker participation in management.\(^{24}\) Not surprisingly, the Basic Tenets did not propose privatization as a component of reform during this early period. Rather, the whole package focused on the "devolution of decision-making powers to state-owned enterprises in the context of a vaguely defined combination of central planning and market."\(^{25}\) By the time the Basic Tenets were adopted, however, Gorbachev's own thinking about the...

\(^{20}\) In an address to the 27th Party Congress in February 1986, the Congress during which Gorbachev expressed most strongly his early attitudes toward economic reforms, Gorbachev said "[t]he acceleration of the social-economic development of the country is the key to all our problems: near-term and long term, economic and social, political and ideological, internal and foreign." \textit{Reforming the Soviet Economy, supra} note 18, at 306. Gorbachev's statement sounds quite ironic today since acceleration occurred, but in a quite unexpected direction.

\(^{21}\) \textit{Id.}

\(^{22}\) \textit{Open for Business, supra} note 19, at 26.


\(^{24}\) \textit{Reforming the Soviet Economy, supra} note 18, at 349-50.

\(^{25}\) Ed A. Hewett, \textit{Perestroyka and the Congress of People's Deputies, in Milestones in Glasnost and Perestroymka: The Economy} 309 (Ed A. Hewett & V. H. Winston eds., 1991) [hereinafter \textit{Milestones}]. Recall that, notwithstanding the emphasis on maintaining state ownership, joint ventures with foreign partners had already begun to be established in the Soviet Union, as discussed below.
need for foreign investment had changed substantially. In fact, his
courtesies to the capitalist countries began with a joint venture decree

Why did Gorbachev's outlook on foreign involvement change so
quickly from outright prohibition to protectionism (implying that
some, but not too much, foreign investment would be sought)? With
the aid of a few reform economists, Gorbachev became largely con-
vinced of the necessity of foreign capital to buttress his reform plans.
In an instance of executive fiat quite familiar to Russians, Gorbachev
invited foreign investment by decree despite the preference of most of
the country's economists and bureaucrats for a slower track.26 When
did economists start to catch up and was there a backlash to the sud-
den inclusion of foreigners in the reform calculus?

B. Abalkin Commission

Classic central planning in the Soviet system did not generally
involve economists. In fact, the influence of economists did not match
that of engineers in the state planning bureaus. Economists and eco-
nomic theories implied scarcity and the Soviet government did not
admit the existence of scarcity in the socialist system. Rather, central
planning involved the mere mobilization of resources.27 Therefore,
the appointment in the summer of 1989 of Academician Leonid I.
Abalkin to the post of Deputy Prime Minister and Chairman of the
State Commission on Economic Reform ("Abalkin Commission") of
the USSR Council of Ministers departed sharply in spirit from exclu-
sive reliance on central planning. The appointment also implied an
admission that scarcity did have to be reckoned with at the highest
level of government.28

In October 1989, the Abalkin Commission proposed a more pro-
gressive approach to economic reform than had been set forth in the
Basic Tenets. The Commission did not support a program of priva-
tization, but rather set forth principles of a program for the "destatiza-

26. Particularly novel and potentially unpopular reforms such as the opening of the
economy to foreign investment are typically initiated in a top-down fashion in Russia, with-
out even the pretext of parliamentary involvement. Thus, Gorbachev's initiative came in
the form of a decree instead of a law. Yeltsin's more radical economic measures have also
come in the form of decrees.

27. PEKKA SUTELA, ECONOMIC THOUGHT AND ECONOMIC REFORM IN THE SOVIET

28. OPEN FOR BUSINESS, supra note 19, at 103.
tion"\textsuperscript{29} of certain state property in favor of workers who had entered into leasing arrangements for property with the state. "Privatization" was still too politically charged at the time. Private property concepts were only beginning to be envisioned.\textsuperscript{20} Instead, the Commission took a less drastic step to introduce the concept of non-state ownership in the context of worker control. Despite a desperate need for investment from abroad, the Commission did not build on the role of foreign capital which had already begun in the joint venture program.

In December 1989, the USSR Congress of People's Deputies adopted the proposals of the Abalkin Commission in substance. Prime Minister Nikolai Ryzhkov, who later would distance himself from this approach and propose his own less progressive alternative to the Supreme Soviet, actually presented the proposals to the Congress for adoption. The Abalkin Commission proposals were, however, never formally made government or party policy because of the eventual adoption by Gorbachev of the vague provisions of the Presidential Plan.

By 1990, the Soviet economy was in a steep, some thought irrevocable decline. Everyone agreed that perestroika had failed, but there was much disagreement over how to fix it. The early reforms had proved ineffective, and the command economy was still firmly in place. A consensus began to develop around the need for market reform accompanied by decentralization, price liberalization, and privatization.\textsuperscript{31} New questions were posed: How far? How fast? What

\textsuperscript{29} Destatization (\textit{razgosudarstveniye} in Russian) means a process that is best described by a more or less literal rendering of the Russian term: disentanglement from government. As such, destatization is not a synonym for denationalization or for privatization, which mean the actual return of state property to private parties. Rather, destatization is a process of enterprise positioning that progressively de-emphasizes state involvement. It is the contrary of the French term \textit{etatisation} which means the domination of the economy and of social and political life by the state. Destatization reverses the process. \textit{See John N. Hazard, Gorbachev's Attack on Stalin's Etatisation of Ownership, 28 Colum. J. Transnat'l L. 207, 207 n.1 (1990); European Bank for Reconstruction and Development, International Monetary Fund, The Economy of the USSR: A Study Undertaken in Response to a Request By the Houston Summit; Summary Recommendations 2, 26-27 (1990) [hereinafter Summary and Recommendations].


\textsuperscript{31} As the Presidential Plan itself noted, "there is no alternative to shifting to a market economy." Quoted in \textit{Summary and Recommendations}, supra note 29, at 12. The authors of \textit{Summary and Recommendations} note this development. \textit{Id.} at 11.
state assets should be sold? Should more or different concessions be made to attract foreign capital?

On March 15, 1990, the Third Congress of People's Deputies of the Soviet Union elected Mikhail Gorbachev to the newly created post of President of the USSR. At that time, roughly one year before a privatization law was adopted by the Russian Parliament, the productive sector of the Soviet economy was dominated, as it had been for decades, by state-owned enterprises. According to the study undertaken by the International Monetary Fund and other multilateral organizations at the request of the Houston Summit of the G-7, there were approximately 47,000 state-owned enterprises in the industrial sector in mid-1990. Those enterprises employed almost 40 million people and "30-40 percent of total industrial output [was] accounted for by products for which there [was] but a single manufacturer." According to the Soviet State Statistical Bureau, Goskomstat, approximately ninety-five percent of all productive assets in mid-1990 were owned by the state or were part of the state-controlled collective farm system. Private ownership and cooperative ownership accounted for less than four percent of the ownership of total productive assets.

State domination of the economy was, therefore, near total. No other privatization program has faced so many enterprises requiring privatization. Joint ventures with foreign firms, created pursuant to Gorbachev's enabling decree, were not fully state-owned, but they accounted for very little productive capacity. Goskomstat reported a total of 620 such joint ventures registered in 1990 with a total output of about 3.2 billion rubles (in current prices) compared to a total output in the whole state sector of over 930 billion rubles (in current prices). Joint ventures also employed about 66,000 individuals. The figures reveal the tiny role played by foreign capital in the initial stages of the privatization process. Figures for total Soviet contributions to joint ventures with foreigners, matters which were subject to intense negotiations in any case, are not reliably available. Within the joint ventures in the manufacturing sector, most of the Soviet contributions came in the form of employees and raw materials.

Statistics for mid-1990 are especially interesting as background for a discussion of privatization. First, as discussed below, in mid-1990

33. Philip Hanson, Property Rights in the New Phase of Reforms, in Milestones, supra note 25, at 420.
34. See The Privatization Process in Russia, Ukraine and the Baltic States 37-38 (A. Rapaczynski et al. eds., 1993).
the economic reform plans of Gorbachev and Yeltsin began to diverge in significant ways. Second, the figures are insulated somewhat from the incredible social and economic dislocations experienced in 1991, when Russia and the Soviet Union clashed irreconcilably.

C. Shatalin Proposals

Stanislav Shatalin and a group of economists and economic advisers to Yeltsin and to President Gorbachev, including Leonid Abalkin, Nikolai Petrakov, Grigory Yavlinsky, and Boris Fedorov (the same one who not too long ago resigned as the Minister of Finance of Russia), made up the Shatalin working group. The USSR Supreme Soviet had rejected the Ryzhkov proposals for reform after their submission in May 1990. Yeltsin and Gorbachev, in an interlude of political cooperation, requested Shatalin to provide a common strategy for economic reform to be submitted to the Supreme Soviet by September 1990. The result is commonly referred to as the 500-day plan for economic reform.

The 500-day plan identified “universal state ownership” ["vseobshchnost' gossoobstvennosti"] as one of the principal reasons for the failure of the socialist economy and causes of the attempts to reform the economy by perestroika, or restructuring. Consequently, the critical phase of the reforms would be known as the “destatization” stage. Completion of that phase would lead directly to a full-scale privatization program. The emphasis of the 500-day plan on destatization and subsequent privatization set it apart from the Abalkin Commission proposals. In this sense, the 500-day plan constituted a turning point in Soviet economic planning.

Like the Abalkin Commission report, however, the 500-day plan did not outline a direct role for foreign investment in the privatization process. Nevertheless, the 500-day plan recognized more directly than previous plans the need generally for foreign involvement in the revitalization of the economy. It specifically provided for the declaration during the preparatory phase (first 100 days) of equal treatment of economic activities whether undertaken by foreign or Soviet entities.

35. O programme perekhoda k rynochnoi ekonomike: Programma minimum — mandat doveriya na 500 dnei, MANDATE, at 1; also paraphrased in Helen Womack, Rumors of Coup as Moscow Deputies Dither over Shatalin, INDEPENDENT, Sept. 23, 1990, at 10 (The premise of the 500-day plan was that the “Soviet people have lost all incentive to improve their lives because the state has robbed them of their birthright—property.”).

It recommended the removal of barriers to foreign investment. Moreover, although it provided no details, the plan mentioned foreign investment in the discussion of the destatization phase (Day 100 to Day 250). Finally, the Shatalin working group recommended that the Supreme Soviet adopt a foreign investment law and a law on free economic zones during the second phase. All in all, the 500-day plan foresaw a substantial role for foreign investment and the need to facilitate that investment by the enactment of special concessions and the according of equal treatment to foreign investors in all other areas.

The 500-day plan brought Soviet economic thinking to a new threshold regarding foreign investment. The process that had been initiated by the promulgation of the Joint Venture Decree had found full theoretical support in the work of Shatalin and his advisers. While the link to privatization remained to be forged, the conceptual gap had been closed. Eventually, the 500-day plan itself got caught up in the reality of Soviet politics. Yeltsin and his “Westernizers” supported and adopted it, whereas Gorbachev and his recidivist colleagues were entirely reluctant to follow its prescriptions. Certainly, one of the flashpoints of the 500-day plan was its reliance on the attraction of foreign capital.

D. Presidential Plan

On September 24, 1990, the USSR Supreme Soviet authorized President Gorbachev to regulate the economy by decree until March 31, 1992. The reform plan ultimately backed by President Gorbachev and adopted by the USSR Supreme Soviet on October 19, 1990, incorporated some of the basic features of the 500-day plan, but lacked specifics. For instance, it did not advocate as thorough a privatization program, nor did it offer a detailed timetable for the actual conversion of state properties. Gorbachev had acted more boldly when he signed the Joint Venture Decree three years earlier. But in 1990, Gorbachev appeared to be unwilling to seize the initiative with

37. MANDATE, supra note 35, at 6; See also Philip Hanson, *Yeltsin in the Fast Lane*, LONDON TIMES, Sept. 10, 1990.
38. MANDATE, supra note 35, at 10. See also Womack, supra note 35.
41. The basic guidelines for stabilization of the national economy and transition to a market economy, the Presidential Plan, was published in *USSR: The Basic Positions of the Soviet Economy*, IZVESTIA, Oct. 27, 1990.
respect to foreign investment. He did not challenge extremists who viewed the West with profound suspicion and hostility. Nonetheless, as one economist has suggested, the Presidential Plan "along with a spate of new laws already on the books, would ultimately destroy the venerable institutions of Stalinist central planning and create new ones suited to a market economy with a substantial state sector."

It is interesting to note that the architects of the Presidential Plan, including Leonid Abalkin and, to a certain extent, Shatalin himself, are the very economists who now seem to have surpassed in stature many of their younger, reform-minded colleagues. They recently proposed economic reforms that would include wage and price freezes and a return to certain aspects of central-planning. Their proposals made to Gorbachev, which were not culminated, seem to have acquired a new life.

E. Western Plans

The Presidential Plan provided the historical jumping off place for the report cited above by several multilateral finance institutions at the request of the G-7 countries. The Summary and Recommendations was submitted on December 19, 1990. It purported to be the official prescription by Western doctors for the critically ailing Soviet economy. Of course, only "Westernized" Soviet reformers were open at that time to prescriptions coming from the West. The more interesting questions concerned the motives, spoken or unspoken, behind the G-7's nostrums. How much sensitivity was there to biases within Russia against foreign strategies for Russia's own recovery?

The Summary and Recommendations rendered generally indirect criticism of the Presidential Plan. While calling for rapid movement toward a market economy, the outlines of the Presidential Plan were described as "gradualist," "vague as to methods," and without "specific time horizon." Nevertheless, the report accurately recognized disadvantages to across-the-board rapid privatization:

[W]hen relative prices are still unsettled, the value of enterprises is difficult to assess. Firms might be acquired at far below (or even far

42. See DAVID REMNICK, LENIN'S TOMB 359-60, 371 (1994).
45. SUMMARY AND RECOMMENDATIONS, supra note 29, at 12.
above) their actual values, and ownership might become concentrated in the hands of a relatively few individuals with money or connections.  

The authors also raised the possibility of a tradeoff between revenues to the state budget from asset sales and the advantages of getting property into the hands of a large proportion of the population through voucher distributions.

The implication behind much of the discussion in the Summary and Recommendations is that foreign investment will not play a major role because of the just-mentioned shortcomings and considerations in the privatization process itself. The report described the meager commitment of foreign capital to the Soviet economy by the end of 1990. It mentioned that joint ventures had achieved very little of the capital inflow hoped for in Soviet planning. The report envisaged a significant role for foreign investment, but largely outside of the privatization framework. To that extent, the report demonstrated a sensitivity to Soviet realities, but its very existence may have produced exactly the opposite of the desired effect in view of the paranoia about Western ideas in Moscow.

After the Summary and Recommendations was introduced and near the same time a coup attempt was launched against President Gorbachev in August 1991, a joint working group of scholars from the United States and the Soviet Union finished a description of what they called the “grand bargain.” The underlying assumption of the grand bargain was that the destinies of the United States and the Soviet Union were so intertwined that neither would succeed in the transition to a new world order without the other. The study claimed that “the clear lesson of recent history is that without deep Western cooperation and assistance, the Soviet Union’s chances of reaching its destination successfully in the foreseeable future will be few.”

The destination of the Soviet Union foreseen in the grand bargain meant democracy and a market economy. The underlying premise of the grand bargain would be entirely antithetical to Russians convinced

46. Id. at 26. These remarks have been borne out by actual experience.
47. Id.
48. Id. at 30.
49. GRAHAM ALLISON and GRIGORY YAVLINSKY, WINDOW OF OPPORTUNITY: THE GRAND BARGAIN FOR DEMOCRACY IN THE SOVIET UNION (1991) [hereinafter GRAND BARGAIN]. The John F. Kennedy School of Government of Harvard University and the Center for Economic and Political Research (Ecenter) of Moscow collaborated in the elaboration of the GRAND BARGAIN.
50. Id. at 8.
that their destiny was to make it on their own. The grand bargain certainly violated the principle of "socialism in one country," which ran throughout the economic planning agenda as the need to establish the independence of Russia from the (pernicious) influence of foreign plans. In fact, it is difficult to imagine a statement more at variance than the one quoted above with even the very mildest forms of Russian nationalism, not to mention the more radical versions.

Nevertheless, the grand bargain comes closest, relative to other major reform plans, to the privatization program eventually elaborated by Yeltsin's reformers. It was co-authored by Grigory Yavlinsky, who served as Deputy Prime Minister of the new Russian Government and Chairman of the Russian Commission on Economic Reform in the early phase of President Yeltsin's reforms. As mentioned above, Yavlinsky also worked on the 500-day plan. The study breaks economic recovery into two phases: phase one involved the creation of the necessary legal and economic frameworks and was to last from 1991 to 1993,51 and phase two focused on the so-called "intensification of structural reforms" from 1994 through 1997:52

Small-scale privatization (small retail stores, trucks, cars, and some agricultural land) was to take place in the short term (mid-1991 through early 1992), followed by the adoption of necessary legislation and the positioning (destatization) of large-scale enterprises for privatization (throughout 1992). The last stage of phase one (1993) contemplated the realization and intensification of large-scale privatization.

Recommendations in the grand bargain regarding foreign investment in Russia paralleled, but did not intersect, their proposals for privatization reforms. Early actions were to include the conclusion of bilateral investment treaties, the adoption of new, progressive foreign investment laws, and the encouragement of foreign investment through monetary stability and the removal of trade barriers. In 1993, as the proposal foresaw the intensification of large-scale privatization, it also recommended that "[p]articipation rules for foreign investors in the privatization of large-scale and medium-scale enterprises . . . be liberalized."53 The gradual, as opposed to sudden, elimination of restrictions on foreigners indicated, perhaps, an understanding of the

51. Id. at 39.
52. Id. at 63.
53. Id. at 59.
By August 1991, Mikhail Gorbachev had seen thirteen reform programs and rejected them all.\textsuperscript{54} Then came the coup attempt of August 1991, which precipitated the total dissolution of the Soviet Union in December 1991. Reform plans came to a temporary halt. President Yeltsin seized the opportunity presented by his overwhelming popularity immediately after the failed coup to affect his own radical reforms. For a few months, no specific "plans" competed with Yeltsin's, although, as discussed below, ideological differences inflamed immediately. Yeltsin's powers were confirmed in early November 1991 when the Russian Parliament conferred on him the authority to legislate economic matters by decree, thereby permitting Yeltsin to inherit the authority Gorbachev was in the process of losing.

The foregoing discussion of economists and competing economic plans must be completed by descriptions of legal and political events. With respect to legal developments, this requires a return to 1987, when Gorbachev signed the Joint Venture Decree.

\section*{III. Legal Context of Privatization}

While economists and bureaucrats debated critical aspects of central planning and the bureaucratic state, strong executives, Gorbachev and then Yeltsin, took concrete steps to open the economy to foreign capital. The legal measures were at first tentative and characterized by a deep ambivalence about foreign investment. In less than five years, however, the Soviet Union evolved from an economy without foreign investment to one which permitted the penetration of foreign capital at all levels, except for certain defense-related industries. In the early stages of this development, the Soviet Union and Russia were indistinguishable. At the end of the process, the two openly competed with each other for purely political reasons to present attractive investment environments. Before the competition could reach a conclusion, however, Soviet actions no longer seemed to matter to anyone except historians.

Alongside the initiatives relating to foreign investment, the Soviet Union and Russia began to lay the legal groundwork for privatization within their separate spheres. The processes were theoretically viewed as complementary. Privatization of large-scale industries would especially require substantial foreign investment. The reasons

\textsuperscript{54} The Road to Ruin, Economist, Jan. 29, 1994, at 23.
Foreign Investment and the Russian Privatization Dynamic

were several: first, large-scale industries needed a massive technological boost. Second, large-scale industries accounted for a large proportion of the “value” of the Soviet economy, and it was acknowledged that only foreigners would have the necessary funds to purchase such “value.” Finally, privatization was to provide revenues for the state treasury and, again, only foreigners had such funds. Such reasoning paralleled the Western view of the justification for privatization.

A. The Joint Venture Decree

Decades of isolation by the Soviet Union from foreign capital ended on January 13, 1987, when the USSR Council of Ministers issued a decree on joint ventures.\textsuperscript{55} Why did Gorbachev choose to end the isolation? While the Joint Venture Decree was calculated purely as a means to attract foreign capital, did it in fact produce other, unexpected counter-results? What were Gorbachev’s expectations?

An explanation offered by an economist closely associated with the early perestroika reforms suffices to give the official view of the policies motivating the Joint Venture Decree. Abel Aganbegyan wrote:

Through the joint enterprises [with foreign firms] we want to attract advanced technology and managerial experience. Furthermore, joint enterprises should eliminate the need for a number of imports and develop our export base, since part of the output of the joint enterprises will have to be sold abroad to cover their foreign currency expenses.\textsuperscript{56}

Academician Aganbegyan hoped for a substantial infusion of foreign capital as a result of the decree. Another, more cynical, but equally realistic, explanation of the early reforms, including the Joint Venture Decree, described the Communist Party as “making an open confession of ideological, economic and financial bankruptcy, while carrying through an extremely complex revolution from above.”\textsuperscript{57} In either case, the effect of the Joint Venture Decree was to import some

\textsuperscript{55} O poriadke sozdaniia na territorii SSSR i deiatel’nosti sovmestnykh predpriiatii, mezhdunarodnykh ob”edinenii i firm kapitalisticheskikh i razvitushchikhstran [On the procedure to create on Soviet territory, and regulating the activities of, joint ventures, international organizations, and firms of capitalist and developed countries][hereinafter “Joint Venture Decree”], a thorough summary of which appeared in PRAVDA, January 27, 1987, at 1.

\textsuperscript{56} Abel Aganbegyan, INSIDE PERESTROIKA 198 (1989).

small measure of flexibility and initiative into the central-planning regime. While the joint ventures formed under the decree operated outside of the plan, they depended on the plan for certain inputs, as legally required, making the Soviet partner indispensable to the well-being of the joint venture.

The very existence of the Joint Venture Decree demonstrated that years of total avoidance of foreign capital had ended. The evolution of the Joint Venture Decree, however, provided an example of the continuing Soviet ambivalence towards foreign capital. The decree initially permitted foreign investment up to a level corresponding to no more than 49 percent of the ownership in the joint venture. The Soviet party had to maintain the majority of shares, and the chairman and general director of the joint enterprise had to be Soviet nationals. Moreover, the foreign partner faced a complicated approval process and could repatriate profit in hard currency only to the extent that the joint venture generated hard currency revenues. Such restrictions prompted many interested foreign companies to invest their capital elsewhere.

The low level of foreign investment and the continuing poor performance of the economy created the need to improve the environment for foreigners notwithstanding Soviet ambivalence about them. The Soviet government tinkered with the Joint Venture Decree for several years after its original adoption. Amendments eventually eliminated the discriminatory restrictions on share ownership and executive nationality, and also streamlined the approval process. The restriction on capital repatriation, however, was never removed from the Joint Venture Decree. The changes showed a new spirit of responsiveness to the demands of foreign capital. They also proved that Soviet expectations had not been met in the original formulation of the decree.

58. The total number of joint ventures with foreign partners registered in the last three quarters of 1987 was 23. When the restrictions began to be relaxed, the number of registrations increased regularly to a total of 168 during 1988, 86 during the last quarter. About 550-750 joint ventures were anticipated for 1989. USSR: East West Joint Ventures on the Increase, Lloyd's List, Mar. 31, 1989, available in WL, INT-NWS File.

59. The Council of Ministers of the USSR amended and supplemented the Joint Venture Decree by further decrees of September 17, 1987, March 17, 1988, and May 6, 1989. Note that the entire joint venture framework was elaborated by decree (postanovlenie) and not by law (zakon). The legal form chosen for economic relations with foreigners, decrees often being easier and less political to adopt than laws, points as well at the ambivalence endured by the Russians in such relations.
The Joint Venture Decree constituted in substance, if not in intent, the first privatization decree. It was never viewed as such by its drafters, nor did the economic reformers really consider it to be a form of privatization. It has, however, been correctly labelled "creeping privatization." Under the Joint Venture Decree, Soviet enterprises were permitted to contribute productive assets to a new legal entity, the joint venture, owned in part by a foreign partner. Consequently, the legal regime for privatization began well in advance of the theoretical norms for privatization that were being developed by the various Soviet planners. While the role of foreigners was downplayed in privatization programs, foreign joint ventures broke new ground in the destatization process.

But what did "ownership" mean in a system that had yet to recognize the right of individuals or legal entities to full private ownership in all classes of property? The loss of total control over the Soviet state assets amounted to a rudimentary form of privatization, but without property law reform, true privatization could not occur.

Gorbachev's failure to legalize private ownership of productive property significantly handicapped the injection of foreign capital into the Soviet economy. Predictably, foreigners wanted certainty in the legal treatment of their investments. But defective property laws have persisted into the most recent period of reform. In many ways, the existence of defective property laws precipitated the "war of laws"

60. See Osakwe, supra note 57, at 12-26.

61. As noted, the Joint Venture Decree was adopted in January 1987, six months before the promulgation of the Basic Tenets, which themselves did not provide for privatization as a component of reform.

62. The inconsistencies of the joint venture regime with other aspects of Soviet laws, especially Soviet property laws, have been pointed out on several occasions. See, among others, Richard C. Schneider, Jr., Developments in Soviet Property Law, 13 Fordham Int'l L.J. 446 (1989).

63. The privatization aspects of joint ventures became evident in two ways when true privatization came into being in Russia. First, the drafters of the privatization laws, decrees, and programs had to decide how to treat the existing joint ventures under the new regime. Second, Western companies and potential Russian partners tried unsuccessfully to avoid the technicalities and procedures of the privatization regime by treating their own negotiations as leading toward the formation of a joint venture rather than as constituting a privatization.

64. As Richard Ericson has written in a broader context, "perestroika had blocked the development of real money, of real property rights, of real markets and their necessary supporting financial structures, and of a legal environment supportive and protective of private (nonstate) economic activity and interaction." Richard E. Ericson, Economics, in AFTER THE SOVIET UNION: FROM EMPIRE TO NATIONS 49, 52 (Timothy J. Colton & Robert Levgold eds., 1992).
that pitted Yeltsin’s reforms directly against the flawed reforms of Gorbachev.

**B. Foreign Investment Laws**

After adoption of the Joint Venture Decree, Soviet lawmakers enacted or adopted a series of laws and decrees intended to open the economy to greater initiative. While these entrepreneurial laws created numerous benefits, they did not fundamentally challenge the dominant role of the state in the economy, namely, its  

By the end of 1990, the Soviet Union and the Russian Federation (still the RSFSR at that time) had adopted economic reform plans that were at variance with each other, both as to the nature of reform to be achieved, as well as the speed at which any reform would be instituted. Only the Russian plan contemplated a fully developed privatization program.

It is interesting to compare the skirmishes in the “war of laws” just before the time when the 500-day plan was presented to Yeltsin and Gorbachev. The Soviets enacted three decrees in August 1990. One was intended to encourage the development of small business enterprises. The other two dealt with more structural inheritances from the Soviet past and were centrally concerned with laying the groundwork for a privatization regime. A USSR State Property Fund was created by a decree adopted on August 9, 1990, and another decree on demonopolization became law on August 16, 1990.

Drafts of privatization laws circulated within the Soviet government in mid-1990. Without doubt, the promulgation of the August 9th and August 16th decrees were intended to be legal preliminaries. Still, it is curious, and a sign of the reigning confusion, that draft privatization laws would be circulating when the Soviet government itself had rejected the soft approach to privatization set forth in the

---

65. A representative sampling of the laws and decrees referred to might include the following: Law on Cooperatives, Law on State Enterprises, Law on Enterprises and Entrepreneurial Activity, Decree on the Fundamentals of Leasing Legislation, and Law on Property.


67. Decree on the Formation of the USSR State Property Fund and Decree on Measures for the Demonopolization of the National Economy.

Ryzhkov plan. Nevertheless, a Soviet draft of basic principles applicable to destatization and privatization was published in early 1991.69

While the Soviets took rather ambiguous and ambivalent positions with respect to their reforms, the Russian Supreme Soviet, for its part, quickly adopted a decree regulating foreign economic activities on Russian territory.70 The decree, coming shortly after the declaration of Russian sovereignty, contained a commitment to seek foreign investment in Russia. It represented an initial, preliminary attempt to get beyond the Soviet-era Joint Venture Decree, which had failed to attract serious investment. It was also the first real effort to use foreign capital as political leverage with the Soviet Union.

In October 1990, President Gorbachev moved quickly to answer the Russian opening and to convince the international community that the Soviet Union intended to be progressive. He signed a decree on “Foreign Investment in the USSR.”71 The USSR Foreign Investment Decree authorized independent foreign capital investment in the Soviet Union. Foreign companies were no longer required to find a Soviet partner. They could invest in any of the enterprise forms permissible under Soviet law at that time. The decree also established the crucial principle that foreign companies would not be subject to less favorable conditions than those faced by Soviet entities. Finally, it relaxed the rules under which profits could be taken out of the Soviet Union in hard currency.

In mid-summer 1991, the increasingly antagonistic political situation between Russia and the Soviet Union, and between Presidents Yeltsin and Gorbachev, overtook economic and legal developments. Nevertheless, less than two months before the fateful coup attempt of August 1991, Russia enacted a Law on Foreign Investment in the RSFSR72 and a Law on Privatization.73 The two laws, adopted within


70. Ob osnovnykh printsipakh osushchestvleniya vnesheekonomicheskoi deiatel'nosti na territorii RSFSR [Decree on Basic Principles for Conducting Foreign Economic Activity on the Territory of the RSFSR], Sovetskaya Rossija, July 20, 1990, at 1.


one day of each other at the beginning of July 1991, represented transparently progressive steps toward complete economic transformation in Russia. Immediately thereafter, on July 5, 1991, the USSR Supreme Soviet adopted its own “Fundamentals of Legislation on Foreign Investment in the USSR.”\(^7^4\) The Soviet Union would dissolve before it could further offset (or complement) the Russian laws.

The proximity of the Russian laws on foreign investment and privatization demonstrated, among other things, that the Russian Parliament considered the two laws to be of a piece. Of course, neither could have been adopted without the strong backing of President Yeltsin. On the other hand, the “war of laws” with the Soviet Union, the desire to assert Russian sovereignty at every opportunity, and the need to seduce the international community away from President Gorbachev, certainly pushed the Russian Parliament beyond what it could have accomplished in a less chaotic environment. Overtures to foreign capital had become politically necessary within Russia. That the laws progressed further than what the lawmakers really wanted (in the absence of the Soviet threat) was borne out in 1993 by the aggressive attempts by the same lawmakers to roll back the privatization and investment initiatives.

**IV. Political Context of Privatization**

Politics both deepen and frustrate economic and legal debates. If economics is a science of scarcity (the “dismal science,” as Thomas Carlyle called it), then politics is surely no science at all, but merely a laboratory of contrary ideas and conflicting goals, an “art of the possible” in Bismarck’s words. While this article suggests one reason for the remarkable resistance of the privatization program to political forces in Russia since the dissolution of the Soviet Union, the Russian politics of privatization have passed through two distinct stages. The first stage, the struggle against the enemy without, lasted openly from the Russian declaration of sovereignty in June 1990 through Decem-

---

\(^{74}\) The purpose behind “fundamentals” of legislation was to provide a framework to facilitate the adoption of more or less uniform laws on a subject in each of the republics of the former Soviet Union. For instance, in the area of foreign investment, the Soviet Union had seen uniformity crumble. Apart from Russia’s foreign investment law, several other Soviet republics had already adopted their own laws on foreign investment. Two of the most significant were the Lithuanian Foreign Investment Act of December 29, 1990, and the Foreign Investment Law of January 17, 1991, of the Kazakh Republic. See *Zakonodatstvo i ekonomika*, no. 14, 1991.
ber 1991 when the Soviet Union disappeared as a political entity. The second stage may be called the battle against the enemy within. This stage, which has lasted from December 1991 through the present, features the conservative forces in Russia battling against the forces of reform. Notwithstanding the number of enterprises that have been privatized in Russia, reports still circulate about efforts to stop the program entirely.  

A. Yeltsin’s Challenge — The Enemy Without

On May 29, 1990, Boris Yeltsin was elected to chair the Supreme Soviet of the Russian Federation. The Russian Federation declared sovereignty on June 14, 1990. Yeltsin made it clear from the outset that he intended to support radical economic reform in Russia, despite the more conservative line espoused by Gorbachev and Prime Minister Ryzhkov. Though the Soviets had rejected the diluted reforms of the Abalkin Commission, Yeltsin and Gorbachev agreed, at the beginning of August 1990, to attempt to compromise their differences over economic policy. They charged the Shatalin working group to propose a blueprint for economic reform by September 1990. This cooperation represented a hiatus from the fierce political struggle between Yeltsin and Gorbachev.

By September 11, 1990, shortly after the USSR’s Supreme Soviet had begun to study the 500-day plan, Prime Minister Ryzhkov denounced the plan and threatened to resign if it was adopted. Gorbachev, while not publicly supporting Ryzhkov, resorted, as mentioned above, to his own Presidential Plan for reform, thereby refusing to adopt the more radical proposals of the 500-day plan. Yeltsin persisted in his more progressive course, still contending that Russia would find its own road to recovery. Finally, on October 31, 1990, the 500-day plan was adopted by the Supreme Soviet of the Russian Federation. The period of potential compromise over the course of economic reform had ended abruptly.

Politics began to dominate discourse over economic planning in the first half of 1991. Yeltsin became preoccupied with his efforts to broaden his base of popular support further by running for RSFSR president. The election took place in June 1991. Yeltsin won victory with 57.3 percent of the votes cast on the first ballot. Niko

---

Ryzhkov, who had resigned as Soviet Prime Minister, came in second with 16.85 percent of the vote. Although many issues came to the forefront in the election, not the least of which was Yeltsin's popular support regardless of his policies, the election can be viewed, in part, as a referendum on the different approaches to economic reform proposed by the two most successful candidates.

As described above, the Russian Parliament acted quickly after Yeltsin's election to adopt laws on the subjects of foreign investment and privatization. The second half of 1991 saw the development of a comprehensive economic reform plan, the appointment of young, reform economists to put the plan together, and the granting to Yeltsin of the power to regulate the economy by decree. The deregulation of prices, perhaps the most symbolic and socially painful of the reform measures, took place on January 2, 1992. Reforms began, during a speech on October 28, 1991, with Yeltsin's promises of "concrete results by the fall of 1992." Notwithstanding the mandate that Yeltsin drew from his election to the Russian presidency, his reform plans met instant and aggressive opposition from "patriotic" nationalists and neo-communists.

B. Parliament's Response — The Enemy Within

Since early 1992, the battle has been pitched between Yeltsin's reformers, backed by well-known Western advisers, and the conservative, or simply anti-reform, forces that identify with the nationalists (led by some combination of Ruslan Khasbulatov, Aleksandr Rutskoi, and Vladimir Zhirinovsky) and the industrialists (led by Viktor Chernomyrdin, Arkady Volsky, and Vladimir Shumeiko). A major symbolic setback for the reformers occurred in June 1992 when Shumeiko and Chernomyrdin were appointed to top government posts. Their appointments were viewed in the West as a major concession to the anti-reform forces. A second clear suggestion of the direction of reform came in December 1992 when the Parliament re-

77. "At the beginning of September [1991], [Yeltsin's] aide Gennadi Burbulis invited Shokhin and Gaidar to Dacha No. 15 in Arkhangelskoye, just west of Moscow, to draft proposals for economic reform in a new, independent Russia." Steven Erlanger, Reform School, N.Y. Times, Nov. 29, 1992, sec. 6 (Magazine), at 40, 78.
80. Shumeiko was named first deputy prime minister and Chernomyrdin was made vice-premier for energy.
jected Yegor Gaidar as Prime Minister and chose, over Yeltsin's opposition, Viktor Chernomyrdin.

The strong victory in the April 1992 referendum regarding the course of reform seemed to renew Yeltsin's mandate, yet the forces aligned against him in Parliament continued to obstruct every reform initiative. Full-scale privatization officially began on October 1, 1992, pursuant to the 1992 privatization program. A planned 1993 privatization program was never adopted by Parliament. Instead, initiatives were passed in Parliament with the intent of upsetting the whole privatization regime. Anatoly Chubais miraculously managed to keep the course of privatization fairly steady, notwithstanding challenges at the federal level, from Parliament, as well as at the local level, such as in Moscow.

At the federal level, President Yeltsin signed a decree on May 8, 1993, aiming to clarify and expand the use of privatization vouchers and to expedite privatization in general. In mid-July 1993, Parliament acted precipitously to undermine Yeltsin's decree and called the whole privatization program into question. Parliament nullified the May 8th decree, pending its review by the Constitutional Court. In addition, Parliament tried to wrest control of state property from Chubais's State Property Committee and to authorize agencies under Parliament's direct supervision to take over the administration of the property.

Then, the conflicting laws and decrees took hold. President Yeltsin issued a decree on July 26, 1993, with the aim of reinstating the May 8th decree. Parliament then nullified the July 26th decree by issuing its own decree on August 6, 1993. Parliament was still awaiting the decision of the Constitutional Court regarding Yeltsin's May 8th decree. Yeltsin again acted on August 10, 1993 to reassert control over the privatization regime with yet another decree. One can only

82. Id.
83. Id.
85. Decree No. 1238 of August 10, 1993 on "Protecting the Right of Russian Federation Citizens to Participate in Privatization." Id. The text of the decree No. 1238 was reprinted in English in New Presidential Decree on Rights of Citizens to Participate in
imagine the political fallout that would have occurred during this period if the conservative members of Parliament could have identified significant abuse of the privatization program by foreign investors.\(^8\)

The fact that such abuses did not occur, partly because of the lack of involvement of foreigners in the process, may have saved privatization. Yeltsin could still argue, however, that he had the mandate of the people.

By September 1993, the Russian Parliament had demonstrated further its obstructionist intent. They couched objections to the privatization program in all manner of rationales, such as that it was a sell-out of the country to foreign buyers. On September 21, 1993, President Yeltsin dissolved the Parliament. He immediately set out to reestablish the reform course by passing several economic decrees and submitted a draft of the Constitution which, if adopted, would ensure his power as president to regulate the economy by decree. That window of opportunity may now have closed as well, in light of the election results of December 12, 1993.\(^7\)

The movement against the economic program outlined by Shokhin and Gaidar in Arkhangelskoye has not abated. Persistent calls for a change in the direction of reform continue to be heard. The virtues of central-planning continue to be extolled in some corners and privatization is still under attack. Anatoly Chubais insisted that voucher privatization would continue into 1994 and end on schedule at the end of June 1994, when the vouchers lost their validity. He was right. Will privatization come under greater attack if foreigners take a larger role in the process once the cash auctions get underway?

At the beginning of October 1990, Shatalin, still convinced that the Soviet Union would adopt his 500-day plan, referred to the powers that would be required to carry out the economic transformation of Soviet society. His words, meant to justify the emergency powers

---

\(^8\) For instance, it would have been very damaging to the privatization program if a sale of valuable state assets at an unfairly low price could have been uncovered. Such an incident occurred in Hungary in connection with the sale of the Hungarhotels to a consortium of foreign investors. See *Hungary: Setting the Pace Through Pragmatic Privatization*, M&A Europe, Nov./Dec. 1990, *available in LEXIS*, World Library, ARCNWS File. The deal had to be declared invalid and Hungary was required by its own political workings to create a new state property agency to avoid the occurrence of similar incidents.

\(^7\) The Duma rejected the Chubais program for post-voucher privatization this summer. See *Russian Fund Launched*, Privatization Int'l, Sept. 1994, *available in LEXIS*, World Library. Many of their objections centered on the enhanced position intended by the program to be accorded to foreign investors.
given to Mikhail Gorbachev, have been forgotten in the debates over the similarly broad powers granted to President Yeltsin to legislate in the economic area. "We are not talking simply about presidential powers, but about presidential-tsarist powers." It is especially ironic that Shatalin should mention Czarist authority at a time when Soviet society was supposed to be moving toward increased openness. His remarks carried the weight not only of political reality, but of historical determination as well.

V. Historical Context of Privatization

Foreign participation in the Russian economy, through greenfield investment or the privatization program, requires some attention to the historical context. The historical context provides a seductive explanation for many of the economic, legal, and political conflicts regarding foreign investment in Russia. The Russian "problem" with foreigners, particularly Westerners, has so preoccupied Russians, particularly writers and philosophers, that it even has a name, "zapadnichestvso," loosely meaning the "Western thing." Western scholars have answered with thousands of pages of speculation on the origins and nature of the "Western thing." As a subject, it vastly exceeds the few paragraphs that follow. With respect to its importance and uniqueness, try to think of an equivalent phenomenon elsewhere.

A Russian philosopher and friend of Aleksandr Pushkin, Peter Chaadayev, wrote a "philosophical letter" in 1829 in which he disparaged Russia and advocated a deep conversion to European culture and civilization. Chaadayev wrote:

[op]one of the worst features of our unique civilization is that we have not yet discovered truths that have elsewhere become truisms, even among nations that in many respects are far less advanced than we are. It is the result of our never having walked side by side with other nations; we belong to none of the great families of mankind; we are neither of the West nor of the East, and we possess the traditions of neither. Somehow divorced from time, we have not been touched by the universal education of mankind.

The Czarist authorities immediately declared him insane, placed him under arrest, and forbade further publication of his works. Some

trace to Chaadayev's life and writings the particular virulence of the split between the so-called Slavophiles, those guarding an aggressively nationalist view of Russia, and Westernizers, who believe that Russia must learn from the West.

Long before 1829, however, Russia feared that it had been forever overtaken by the technologies and accumulated wealth of Europe. Peter the Great tried to correct the balance in the 18th century by fierce incorporation of Western methods and processes. Even before Peter the Great, in the early 1600's, the Czar Boris Godunov had turned to the West for greater economic contacts. Efforts such as these accomplished some measure of openness, but eventually led to reassertions of intense nationalism and backlashes against foreigners. So the cycle went, and apparently it continues. This is the reason that many scholars of Russian history viewed the durability of the perestroika reforms with great skepticism.

The perspective of the West, however, must also be incorporated to gain a better insight into the Russian dynamic with the West. The West's motives for enabling numerous and enduring contacts with Russia have usually been summarized by references to economic perspectives (Russia viewed as a land of enormous consumer potential) or to security concerns. These motivations are real enough, and they are not new. More basic though, and perhaps the real reason behind the appeal of the ultra-nationalists in Russia, is the perceived Western arrogance about its own cultural and philosophical superiority. Russia is a tabula rasa on which to try out ideas that haven't received their due here, or new ideas that require a proving ground. Russians admit their fallibility, but not their inferiority.

Russians have longed to discover the key to the universe and have turned to the West for insight during several historical periods. Yet, they exhibited real impatience with the laborious methods and structures of Western economic and cultural processes. Westerners, for their part, were only too quick to flatter themselves that they could solve Russia's problems. Neither side appreciated the incongruity (and perhaps futility) of these repeated cultural and social grafts. Marxism-Leninism itself blatantly exemplifies the inadequacy of Western approaches to Russian problems. Are Professors Sachs and Aslund only the most recent examples of this phenomenon? Will Boris Yeltsin soon go the way of Boris Godunov? Are Rutskoi and

Zhirinovsky going to be the ultimate beneficiaries of this paradox? In any case, did the West have a choice?

With this background of *zapadnichestvo* in mind, the 19th century should be described in a bit more detail. At that time, the Russian economy began to enter the modern commercial world, only a generation or so behind the West. *Zapadnichestvo* acquired an especially economic nuance in the 19th century. In 1863, the Minister of Finance under Alexander II wrote that if:

only with the help of [foreign] loans the plant owner maintains the operations of his plant, the trader increases the volume of his trade, and the landlord improves his farm, then no matter how large the portion by which their benefits are reduced to pay the [foreign] bank, the aid that they receive will clearly enrich the country with new production and will also increase the revenues of the [state] treasury.\(^2\)

This is exactly what is being said today by Yeltsin's reformers. It has been argued that Russians needed to turn to foreign capital because of the scarcity of capital in Russia (due partly to a failure to develop fully the legal structures required by investment) and because of the "timidity [nereshitel'nost'] with which native capitalists approach new enterprises."\(^3\) Nevertheless, foreign investment faced numerous obstacles in Russia throughout the 19th century. Many obstacles were legal in nature, including bans on investment in some industries, onerous registration requirements, shareholding requirements, and similar limitations. Other restrictions came unpredictably from the will of the Czar himself. A foreign company would simply be required to cease operations for any reason or for no reason if the Czar so ordered.\(^4\) These restrictions existed into the 20th century.

The erection and maintenance of such restrictions against foreigners took place in the context of a general debate over the need for, and control over, foreign influence. Economic historians regard the period from 1905 to 1914, namely right up to World War I and the 1917 Revolution, as a period of relative strengthening of the Russian economy and increases in economic relations with foreigners. The disastrous economic consequences of the war and the abolition of private property and nationalization that took place under the Bolsheviks arrested and reversed the trend. Lenin himself used the

---

93. *Id.*
94. *Id.* at 120.
economic benchmarks of the period from 1912 to 1913 as measures to judge the economic performance of socialism during the War Communism period and during the period of the New Economic Policy (NEP).\textsuperscript{95}

The NEP period served as a model, often more as ideological justification than economic theory, for many of the perestroika reforms. In early 1921, the Soviet economy had reached such a low point that Lenin decided to abandon the policies of strict nationalization and centralization that had characterized the so-called War Communism period. He began to free up agriculture and legalized limited free trade. In May 1921, Lenin revoked the decree nationalizing all small-scale industry. In July 1921, Russians were given the authority to organize small industrial enterprises. During the NEP period, which lasted until the late 1920s, the economy was characterized by a mix of activities, “with an overwhelmingly private agriculture, plus legalized private trade and small-scale private manufacturing.”\textsuperscript{96}

Lenin also reversed policy on foreign investment during this period. Even in 1921 and 1922, discussion of opening doors to Westerners evinced many nationalist reactions, which history has taught to expect and current events bear out once more. Nationalists asserted: “We chased out our own capitalists, and now we call in foreign capitalists.”\textsuperscript{97} Nonetheless, a decree authorizing the granting of foreign concessions within the Soviet Union was adopted on March 8, 1923.\textsuperscript{98} The decree resembled in many respects the Joint Venture Decree of January 1987 that ushered in the changed attitude toward foreign investment during perestroika.\textsuperscript{99}

Lenin’s opening to foreigners rankled the nationalists disproportionately relative to the opportunities it created. Very little actual capital infusion took place during the 1920s in comparison to the size of the economy.\textsuperscript{100} As Stalin began to consolidate power in the late 1920s and early 1930s, the period of foreign concessions died out along with the whole NEP experiment. Instead, Stalin imposed an economic plan, implemented from above, designed to construct “so-

\textsuperscript{96} Id. at 86.
\textsuperscript{97} Id. at 89.
\textsuperscript{99} See generally Id.
\textsuperscript{100} “In 1924-5 only 4,260 workers were engaged in thirteen significant 'concession-enterprises.' All sixty-eight concessions which existed in 1928 accounted for 0.6 per cent of industrial output.” Nove, supra note 95, at 89.
cialism in one country," a doctrine that began to gain currency in 1925 and 1926. The phrase evokes impatience with, and fear of, foreigners, as well as the belief in a true Russian destiny that can only be attained without foreigners or foreign influence.

VI. Yeltsin's Privatization Programs

How have the influences discussed above been reflected in the actual provisions of Yeltsin's privatization programs? What restrictions have faced potential foreign investors in Russia's privatization effort? If the restrictions are few, then, all else being equal, one might suppose that investment would increase as a result of the privatization effort itself. If investment has not increased through the privatization program, the reasons for the failure should be examined. Or, are those questions typically "Western" ones? Should the real question be instead, "how has privatization lasted this long amidst a general retrenchment, and achieved, to date, the transfer of well over half of existing state assets to private firms and individuals?"


It must be emphasized that the foregoing list is highly selective. Numerous other laws and decrees, including laws involving currency, securities, banking, trade, ownership, and land would have to be listed to provide a complete picture of the legal environment for foreign investment. Such a listing is beyond the scope of this article, however, because of the limitation here to convey a less complicated view of the nature of restrictions facing foreign investors. A more detailed description of the entire privatization process can be found elsewhere. See, e.g., Frydman et al., The Privatization Process in Russia, Ukraine and the Baltic States (1993) and Russell H. Pollack, Andrew A. Bernstein, and Lydia I. Minakova, Foreign Investment in Russia: The Perspective of the Russian Government and Problems Faced by Western Investors, 654 PLI/COMM 507 (1993). Of course, most sources, except the popular and financial press, will not include coverage of the 1994 Privatization Program nor of the Post-Voucher Program adopted on July 22, 1994.

The following comments on actual legislation will delineate the interaction between foreign investment and privatization. They will demonstrate that the rhetoric of openness to foreigners necessitated by political expediency had not been realized in the privatization laws until it was too late. Nonetheless, it must be borne in mind that the failure to match rhetoric and statute with respect to foreign capital has permitted the survival of the privatization program as a whole.

The burden of the past and the realistic attitudes of Yeltsin's economic team kept the Russian privatization program from being aimed principally at attracting foreign investment. Instead, its primary goal was to transfer as much state property into private Russian hands in as short a period of time as possible. The program was viewed as a measure of democratic reform more than a measure of economic reform. Moreover, there was an element of "expropriation in reverse;" that is, property had been confiscated in 1917, and it was to be returned to the workers and small landowners in the course of the Second Russian Revolution. Such property could not, therefore, be sold to foreigners without threatening the privatization program as a whole.

The confluence of (i) democratic objectives and the concern for returning property to Russians with (ii) nationalistic fears of foreigners left very little room for the foreign investor in the scheme of privatization. The foreign investor was not forgotten entirely, but was certainly demoted. Of course, such demotion ran contrary to the goals of paying real value for the privatizing enterprises (Russians would be able to pay only in devalued rubles) and of replenishing the state treasury with hard currency. Those objectives, however are typically Western. They might characterize privatizations in Britain or France, or even in Mexico, but they do not ring true in Moscow.103

Early voucher privatization. The Russian Foreign Investment Law provided expressly for foreign participation in the privatization program.104 The details of the participation were left to be worked out in other legislation. Instead, most of the relevant provisions focused on the requirements that a foreign investor use the currency of the Soviet Union in privatization transactions. It set forth preemptively the terms on which foreign investors could exchange hard cur-

---

103. Of course, while the objectives may not ring true in Moscow, they may admittedly make the most pure economic sense.
rency for rubles. The provisions clearly implied that the foreign investor would not only be asked to pay real value for state assets, but that the currency exchange would be a costly one and, in all likelihood, not made at a commercial rate.

The Law on Privatization simply did not address foreign investment. It did not set down any provisions to restrict foreign investment, nor did it lay down procedures for foreigners to participate in the privatization process. The substantial amendments to the Law on Privatization that were adopted on June 5, 1992, when Russia had come fully out from under the Soviet heel, also did not address foreign investment. The purpose of privatization was to "transform the basis of ownership of the means of production."¹⁰⁵ Foreigners, as stated above, were not viewed as integral to that purpose. Moreover, they were probably viewed as contrary to that purpose because the transformation was sought within Russia and not modeled on a class of foreign owners.

Six days after the amendments to the Law on Privatization were adopted, the Supreme Soviet of Russia adopted the 1992 Privatization Program. The program established, in much greater detail than the Law on Privatization, the procedures for the privatization of state and municipal enterprises. The principal objectives of the program sounded more like those typically associated with privatization programs, including the attraction of foreign investment.¹⁰⁶

The 1992 Privatization Program authorized foreigners to participate in all aspects of privatization under the same conditions as those applicable to Russian investors, except with respect to small-scale privatizations and privatizations in the natural resources sector. This would have been immensely advantageous to foreign investors had share distributions of privatizing companies been made without preference. Foreigners, however, were not allowed to participate in the early stages of share acquisition of an enterprise, but were limited in effect to minority participation through auction, tender, or investment bidding.¹⁰⁷ Otherwise, foreigners were authorized expressly to partici-

¹⁰⁵. Law on Privatization, supra note 73, pmbl.
¹⁰⁶. 1992 Privatization Program, art. 1, introduction.
¹⁰⁷. 1992 Privatization Program, art. 8.1. It should be noted that the 1992 Privatization Program outlined a four-step procedure for the sale of shares in a "commercialized" state enterprise, "commercialized" referring to the process by which a state enterprise is converted into an open-type joint stock company, pursuant to Decree no. 721 of July 1, 1992 on "Commercialization of State Enterprises." The four steps are: (i) free distribution of employee preferred shares to workers in certain enterprises; (ii) sale of common shares to employees in a closed subscription; (iii) sale of common shares in a voucher auction; and
participate in all other aspects of privatization under the same conditions as those applicable to Russian investors. The program expressly tried to preempt the imposition of any other legal limit to foreign participation.\textsuperscript{108}

The relegation of foreigners to a minority stake in the privatization process surprised both foreigners and, to a certain extent, the reformist factions within the Russian political system. It had been anticipated that foreigners would be given a generous stake in certain privatizing enterprises, particularly the large, attractive ones, specifically to generate hard currency for the state treasury. The distributive priority was given to Russians, however, partly as a result of the need to satisfy workers and other political constituencies. This Russian priority, understandable both as a political compromise and as a way to engender a propertyed, democratic class of citizens within Russia, nonetheless operated to frustrate foreigners who were unable, except indirectly, to purchase control blocks of shares in the privatizing companies.\textsuperscript{109} Were it not for the cultural fears of "selling-out to foreigners," the goals of democratization through privatization and attraction of substantial foreign capital would not have been in conflict.

The political battle to keep control blocks out of the hands of foreigners was joined as well by the large Russian industrialists who aimed to maintain control of enterprises during privatization, perhaps with an eye to later "selling out" to foreigners themselves.\textsuperscript{110} Consequently, most foreign companies have avoided the privatization regime altogether. Instead, companies wait to negotiate deals with

\textsuperscript{108} Article 8.1 of the 1992 Privatization Program stated "[n]o other restrictions [other than those mentioned] on foreign participation in privatization shall be imposed."

\textsuperscript{109} Another practical obstacle to foreign investment in the privatization program comes from the inability to negotiate the sale of shares with one buyer. The prohibition of negotiated deals and the decision to make every deal an open competition in either an auction or an investment tender were intended to reduce the likelihood of fraud. Unfortunately, forcing sophisticated foreign investors who are quite used to such negotiated deals into open competitions works to reduce the amount of foreign investment in the program.

\textsuperscript{110} The failure to wrest control of these enterprises from the nomenklatura has, of course, resulted in no small amount of criticism within Russia. It has also magnified the likelihood of abuse by enterprise managers. For example, the auction in January 1994 of shares of the Gorky Automobile Factory, or GAZ, in Nizhny Novgorod had to be declared invalid on February 22, 1994, because it was discovered that the director had used 46.5 billion rubles (about $28.6 million) in state-issued credits to buy up shares in the privatizing company through a number of sham companies. See Celestine Bohlen, \textit{A New Russia: Now Thrive the Swindlers}, N.Y. Times, March 17, 1994, at A1.
workers and management after the initial distribution of shares in the privatization framework is complete. An obvious disadvantage to waiting, however, is the risk that another neutral investor or a competitor will somehow get in the door first during the privatization stage.

In light of such restrictions and other limitations, the privatization program has basically failed in its promise of welcoming foreign investment. In fact, numerous technical, legal, and circumstantial obstacles existed for the foreign investor. First, because the Russian government was compelled to adopt the legal framework of a market economy relatively overnight, many of the new and old laws and decrees conflicted. The tax system, currency regulations, and securities laws, for example, all conflicted to one degree or another with the privatization program. Such conflicts, while not insurmountable by the venturesome investor, worked to handicap investment and always created legal uncertainty.\footnote{Many of these conflicts are discussed in Perkins & Jarosz, supra note 81.}

Second, foreign investors encountered enormous problems in acquiring the information needed to study investment opportunities. The Russians have tried to address this problem in several ways. A decree by President Yeltsin in December 1991 created a Committee for Foreign Investment within the Ministry of Economics and Finance.\footnote{Decree on the “Committee for Foreign Investment of the RSFSR Ministry of Economics and Finance,” December 14, 1991, discussed in Vneshnyaya Torgovlya, Russia: Foreign Capital Investment—Interview with Leonid Grigoriev, Chairman of Foreign Investment Committee, ReuTERs INFO. SERVICES, June 20, 1992, at 2, available in WL.INT-NEWS File.} It was the task of the Committee to attract and facilitate foreign investment both within and outside of the general privatization program. The Committee, however, did not function particularly well, notwithstanding an enormous amount of press regarding its activities. The Russians also recruited various Western professional advisers to help them attract foreign investment. Again, while such efforts met with great fanfare, they produced little in the way of concrete results.

The Committee for Foreign Investment was finally terminated because of its lackluster performance and replaced in September 1992 by a new agency, the Russian Agency for International Cooperation and Development. This new agency was to act independently of the Economic and Finance Ministries. Yeltsin also gave it more authority to coordinate state policy broadly in the areas of aid and investment coming into Russia. Most recently, it was transferred to the jurisdic-
tion of the Ministry of Foreign Economic Relations.\textsuperscript{113} It is too early to tell whether the new agency will really fulfill its mandate. Statistics disclosed at the beginning of 1994 on the amount of foreign investment in Russia were not encouraging.\textsuperscript{114} More recent statistics, however, show a marked increase in foreign investment for 1994.

The political turmoil, as described above, precluded adoption of the 1993 privatization program by the Russian Parliament. Why was agreement on a program not reached? Even though the draft of the 1993 privatization program did not mention foreign investment among its principal objectives, it would have significantly broadened the rights of foreign investors in the privatization program.\textsuperscript{115} Such being the case, it ignited the xenophobia of the conservatives. The provisions of the 1993 privatization program relating to foreign investment eventually carried over in substantial part to the 1994 privatization program, but the 1994 program was adopted by Presidential decree only after Yeltsin had dissolved Parliament.

\section*{A. Late Voucher Privatization}

After the dissolution of Parliament in September 1993, President Yeltsin had a short period to enact economic decrees without significant impediments. Two significant decrees adopted during this period include a decree of September 27, 1993 on the “Completion of Work Regarding Foreign Investment,” and a decree enacting and putting into effect, as of January 1, 1994, the new privatization program.\textsuperscript{116}

\begin{itemize}
\item 114. According to ITAR-TASS, Russian Government authorities reported that foreign investment in 1993 in Russia exceeded $400 million, while in 1992 only $290 million was invested from abroad. The Agency for International Cooperation and Development reports that almost 12,000 entities in Russia are owned in part or in whole by foreigners, yet the aggregate share in industrial output for such enterprises is only about 2.5% of the total. Viktor Petrenko, \textit{Foreign Investments into Russian Economy on the Rise}, TASS, March 9, 1994. For the sake of comparison, roughly the same amount was invested by foreigners in Poland in 1993. \textit{See} Thomas T. Vogel, \textit{Poland Gets Generous Pact to Cut Debt}, \textit{Wall St. J.}, March 14, 1994, at A10. In any case, $400 million annually falls far short of the $20 billion to $40 billion annual figure pegged in the Gaidar reform plan. \textit{See Yeltsin Speech to Concede Low Expectations of West Aid}, \textit{J. COM.}, Feb. 23, 1994, at A2.
\item 115. Draft 1993 privatization program, art. 9 (on file with author).
Both decrees were adopted by Yeltsin before the new Parliament began its first legislative session on January 11, 1994.

It can be debated, as it has been in Russia, whether it is necessary to accord special treatment to foreigners in order to attract their capital or sufficient to create a level playing field by giving foreign investors “national treatment.” Special treatment has greater potential to inflame concerns over “sell-outs” and the loss of economic sovereignty. Nevertheless, it cannot be ignored that (i) foreign capital is not an inexhaustible resource, and (ii) fierce competition exists to attract that limited resource, especially due to the recent independence of countries in Eastern and Central Europe and of the former Soviet Union.117

The September 27th decree, directed specifically at foreign investment, is the next stage in the ongoing efforts by reformers to amend the Russian Foreign Investment Law. Such efforts have crested at various moments in the reform process but the law itself remains unamended. Unsuccessful attempts were made by Western advisers to suggest amendments to the Committee on Foreign Investment when it existed. Draft amendments were circulating in the Supreme Soviet in 1992 and 1993, but the political capital needed to pass them never existed.118

The September 27th decree builds on the concepts in play regarding amendment of the Russian Foreign Investment Law. First, for a three-year period from the moment of its adoption, it immunizes any foreign company or joint venture from application of any unfavorable law or other normative act which would have a negative impact on the company or joint venture.119 Secondly, the decree establishes the im-

117. Alexandr Shokhin, the current Economics Minister, addressed these concerns in a defensive article in NEZAVISIMAYA GAZETA on October 31, 1992. He wrote that “[w]orld experience indicates that a country does not have to create any special concessions to attract direct foreign investments; all that is needed is a lack of discrimination against foreign investors, a stable economic and political situation, and the appropriate financial infrastructure. . . . The state regulation of foreign investments in Russia has as a goal not only encouraging capital investments from abroad but also safeguarding Russia’s economic security and sovereignty.” Alexander Shokhin, Shokhin Updates Policy on Investment Exports, CURR. DIG. OF THE POST-SOVET PRESS, Dec. 9, 1992, at 12.


119. Decree No. 1466, art. 1.
important principle that foreign investments are regulated only by federal laws and Presidential decrees, shielding such investments from conflicting or less favorable regional or local legislation. The decree also requires new legislation favorable to foreign investors, the establishment of free economic zones, and the awarding of concessions.

Finally, the decree directly links foreign investment to the privatization program. It provides that the laws and decrees governing privatization must be amended to grant foreign investors treatment equal to that accorded Russian investors in the privatization program. Overall, however, the decree contemplates the extension to foreigners of conditions that are more favorable than those available to Russian companies. Thus, it does not accept the principle that nothing more than the elimination of discrimination against foreign investors is needed to promote foreign investment.

President Yeltsin also used the dissolution of Parliament to sign the decree putting into effect the 1994 Privatization Program. The 1994 program gives every sign, textually at least, of being the last of its kind. Its main objectives include the “completion of privatization involving the use of privatization checks,” the “completion of the privatization of most ‘small-scale privatization’ facilities,” and the “completion in the main of the privatization of large and medium-sized enterprises in industry and construction.” In contrast even to the draft of the 1993 program, the 1994 program includes the attraction of foreign investment as one of its main objectives.

In the section treating foreign investment, the 1994 program stipulates that:

[f]oreign investors can take part in auctions (including check auctions), tenders, and investment tenders, as well as buying privatization checks for use as a means of payment in the privatization

120. Id. art. 2.
121. Id. art. 3.
122. Id. art. 4. Decree No. 1466 specifically mandates a program to attract foreign capital to defense industry conversions and requires the preparation of a list of other investment priorities.
124. Id.
process provided that mandatory subsequent notification is given to the Russian Finance Ministry.125

The principal clarification for foreign investors over prior law was in the use of the privatization vouchers.126 Many questions had arisen over whether the vouchers could be obtained by foreigners, on what terms, and whether they could be used in the privatization process during the voucher auctions. Prior approval for use of the vouchers had to be obtained from the Finance Ministry. These uncertainties, in essence, relegated foreign investors to shares which could be acquired only after the closed subscription and voucher sales were completed, usually approximately 20 percent or less of the enterprise capital. With the adoption of the 1994 program, however, foreigners can now easily participate in the check auctions themselves, perhaps acquiring substantially more than 20 percent.127 Broadening participation at the check auction stage made sense, in part, because the validity period of privatization vouchers ended on June 30, 1994. The problem is that the clarification came too late in the voucher privatization process to create much of a benefit. Auctions are now held on a cash basis only.

A hidden advantage of buying more shares at the auction stage is that the foreign investor will not be required, thereby, to take on additional obligations toward the enterprise in the way of investment commitments, maintenance of specific employment levels, maintenance of certain social facilities, such as schools or housing, or provision of additional services. The undertaking of such additional obligations was often the price for winning in an investment tender. On the other

126. The voucher program was announced in July 1992. Approximately 150 million vouchers were distributed to Russian citizens. Each voucher had a face value of 10,000 rubles and expired at the end of June 1994. The vouchers could be used in a variety of ways, but they were intended to permit every qualifying Russian citizen to participate directly in the distribution of state assets by exchanging the voucher for shares in a privatizing enterprise. See Russia to Hustle Sell-Offs, WALL ST. J., March 2, 1994, at A6.
127. Significant clarification regarding the ability of foreigners to participate in voucher auctions occurred in the summer of 1993. The Russian Central Bank issued instructions permitting “non-residents” to purchase rubles in Russia for business and investment purposes, including “privatization deals.” See Instruction on “Procedures for Opening and Keeping by Authorized Banks of Non-Residents’ Accounts in Russian Currency,” art. 2.1, COMMERZBANK, Aug. 4, 1993. The so-called “I” accounts of non-residents permit foreigners to use rubles to obtain privatization vouchers. The prior laws and regulations did not clearly permit this, so foreigners either had to depend on an already established joint venture or wholly-owned investment in Russia that generated ruble revenue, or they had to risk obtaining rubles in ways that were not officially permitted under the laws.
hand, if a foreign investor can acquire a larger stake, more than 20 percent, of an enterprise by combining purchases at a check auction with an investment tender, some additional obligations may be acceptable.

Restrictions still remain on foreign investment in certain service sectors, such as food, small businesses, the defense industry, natural resource and oil industries, and transport and communication industries.128 The 1994 privatization program repeats the stipulation that “no other restrictions on foreign investors’ participation in privatization” may be imposed.129 Recourse to such defensive language in the decree speaks for itself.

While the September 27 decree and the 1994 privatization program without doubt did much to encourage a positive investment environment, calls from the nationalist and industrialist political camps to unwind the privatization program and to stop the “give away,” in short, to end the period of “market romanticism,” continued to ensure that foreigners would not come to the Russian markets to nearly the level required to achieve a healthy investment climate.130 These same political camps in the Duma managed to defeat the post-voucher privatization program offered by Chubais in July 1994.131 The main reasons offered for voting against the program included, of course, the concessions made to foreigners, and the continued monopoly of Chubais and the GKI over important privatization decisions.

B. Post-Voucher Privatization

In a typical gesture of political necessity mixed with arrogance, President Yeltsin overruled the Duma on July 22, 1994, with respect to post-voucher privatization.132 The press reported that Yeltsin was

128. 1994 Privatization Program, supra note 125, art. 10.1.
129. Id.
130. The Russian Government has taken other steps to create a proper environment for foreign investment, including, for example, the conclusion of bilateral investment treaties like Investment Incentive Agreement, April 3, 1992, U.S.-Russia, 31 I.L.M. 777, and the Treaty Concerning the Encouragement and Reciprocal Protection of Investment, June 17, 1992, U.S.-Russia, 31 I.L.M. 790.
forced to make certain "unspecified" compromises with conservative Parliamentarians to prevent too much controversy by signing the decree. As with much of the privatization program since it began, the program continues notwithstanding the objections of the hardliners. The predictions of Anatoly Chubais that the program would outlast its opposition have been realized.

Similar to the experience under the Joint Venture Decree, the legal framework for privatization has generally evolved in directions of greater openness for foreign capital. Given that the post-voucher program is supposed to usher in the conclusion of privatization, it would seem to be the place to offer the last significant concessions to foreigners without the fear of jeopardizing privatization as a whole. But has it all come too late? Have too many of the good Russian enterprises already been privatized so that the new concessions to foreigners will make little practical difference? Isn't there a negative correlation between the opportunities legally available to foreigners and the availability of attractive privatizing enterprises?

The benefits to foreigners in the post-voucher privatization program may be summarized as follows:

—Yeltsin mentions new tax breaks in the decree of July 22, 1994;
— the share benefits to worker collectives are less attractive than in the voucher stage of privatization, meaning that workers will, presumably, buy fewer shares and leave more for foreign investors;
— the absence of voucher auctions also means that fewer shares will go into the population and more should be available for strategic foreign investment;
— expanded opportunities for land privatization will be attractive to foreign investors;
— investment and commercial tenders remain options for purchasing shares, but it is unclear whether private or negotiated deals can now be contemplated. Section 2.6 of the post-voucher program provides for "privatization without restrictions" and Section 3.4.2 on investment tenders makes a typical reference to legislation to come,

President Enforces Goskomimushchestvo's Program, RUSSIAN PRESS DIG., available in LEXIS, World Library, SPD file.
134. Section 3.4.1 of the post-voucher program.
135. Id. sec. 3.4.
136. Id. art. 4.
but Section 2.11 clearly states that no decision may contradict or expand on the methods of privatization already in place:

—foreign investors will find it very attractive that 51 percent of privatization proceeds may remain in the privatized enterprise;\textsuperscript{137}

—more explicit language about post-privatization support has been included;\textsuperscript{138} and

—the expansive powers of the GKI (exercised generally in a manner favorable to foreign investors) have not been cut back in any way.

Many of the changes in post-voucher privatization favor foreign capital, and that was the principal rationale for opposition to the program in the Duma. Yet the ambivalence toward foreign ownership of former state property continues. Perhaps in part because of the pro-foreign capital provisions in the 1994 program and in the post-voucher program, foreign investment has recently been reported to be increasing.\textsuperscript{139} Does this mean that resistance will increase to the point that investments already in place will be threatened in some way? Or does it mean that the role of foreign capital invested in privatized companies will now evolve into something less threatening, that is, only one component of the large Russian economy?

\section*{VII. Conclusion}

The foregoing comments demonstrate several points. First, privatization in Russia has taken place in an extreme economic environment. The total dominance of the state over productive property, pervasive central planning, the absence of any market sector, significant corruption and capital flight, inflation and a valueless ruble all worked against the gains that privatization could have achieved. The normal goals of public sector reforms, such as maximization of revenues from the sale of state assets, improved allocative and managerial efficiency from true ownership, and attraction of foreign investment could not be readily achieved under such conditions.

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{137} Id. art. 6 and app. 1.
\item \textsuperscript{138} Id. art. 5.
\item \textsuperscript{139} While total foreign capital invested in Russia in 1993 was reported to be around $400 million, investment from abroad is now reported at about $500 million \textit{per month}. \textit{Foreign Investment Pours In, Fin. Times}, Sept. 9, 1994, at 2, and \textit{Warning on Russian Economy, Wall St. J.}, Sept. 12, 1994, at A13. The article from the Wall Street Journal nonetheless declares premonitorily that “[f]oreign participation in Russia's economy has become a sensitive political issue, with hard-liners frequently accusing the government of selling out.”
\end{enumerate}
\end{footnotesize}
The negative impact of economic conditions was worsened by the strained political and legal situations. Factions disagreed fundamentally over the course of reform, and consensus could be fashioned only by executive action and only for short periods of time. Conflicting and incomplete legislation, occasioned in part by the irreconcilable struggle between Russia and the Soviet Union, but also by the perceived need to draft virtually all of the legislation required by a modern market economy overnight, compounded the problems, and certainly made foreign investment even less of a prospect.

Finally, as though the economic, legal, and political problems were not enough, the historical and cultural ambivalence over Western influence no doubt filtered in at all levels of the process in subconscious ways that will never be fully understood. Western companies encountered obstacles at almost every step of the process. Moreover, by the time most of the obstacles to foreign participation in privatization had been cleared away, the Russians were able to make very little of real value available to be privatized. Substantial restrictions on foreign investment still exist in natural resources and former defense industries. Foreign banks have not been permitted to compete on a level playing field either through buying shares in privatized Russian banks or through investment in new entities.

This article began by noting two points: the endurance of the privatization program and the extraordinarily low level of actual foreign investment. After more than half of a century of isolation from foreign capital, laws permitting foreign investment have evolved in generally favorable directions since 1987. Foreigners were supposed to participate in privatization, but they have not. While the laws evolved, many of the attitudes did not change. Westerners are still viewed with a great deal of suspicion. That suspicion has tended now towards overturning many of the fundamental economic policies of the Yeltsin government. However, the major reform transforming the structure of the economy through privatization, continues. It may be

140. Boris Fedorov has recently written “Up until now, little attention has been devoted to the role of foreign participation in the privatization process in Russia. In fact, Russian officials are often excessively cautious, if not outright hostile, towards foreign investment. This is evident for example in the restrictions on foreign investors, and the incessant talk about the danger of foreigners buying everything too cheaply. This reluctance existed long before the start of the current reforms and must be tackled as an unavoidable reality.” Boris G. Fedorov, Privatisation with Foreign Investment, in CHANGING THE ECONOMIC SYSTEM IN RUSSIA 112 (Anders Aslund & Richard Layard eds., 1993).
Can Russia survive economically without foreign investment? Most economists, Western and Russian, argue that only massive foreign investment can revitalize the economy. It seems likely, for the reasons stated in this article, notwithstanding legal accommodations and the rhetoric favoring inclusion of foreigners in privatization, that significant foreign investment will have to await a later stage in the transformation. “Privatization in one country” may be the political price to be paid to achieve privatization at all.

141. A poll completed around the time of the December 1993 parliamentary elections bears out the ambivalence traced in this article in the economic, legal and political contexts. The sample consisted of 34,000 Russians, 1,000 from each of the 32 regions and Moscow and St. Petersburg. When asked whether the West has the goal of weakening Russia with its economic advice, 28% were sure of it; 26% were not sure, but agreed that it was probable; 17% said that it was probably not true; and only 11% said that the West was not involved in such a nefarious plot. Out of the same group only 14% fully support foreign investment, while 60% think that it should be permitted only under strict government control or that it is in fact harmful, “but sometimes useful.” Yet, out of that same group, 42% think that privatization should continue at its current pace or be accelerated. Only 30% think that it should be either slowed or reversed. See Jerry Hough, Schlock Therapy: The Russians Don’t Want or Need Our Advice, WASH. POST, Jan. 30, 1994, at C1. Again, the likely explanation for this lack of consistency in thinking about reform is that foreigners do not play a role in privatization.