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Elites in Transition:

Case of Privatization in Veliky Novgorod Russia

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Abstract

This paper is an attempt to develop a critical reflection on the social, political, and economic transformation that Russia experienced in the last couple of decades. I argue that the continuity of elites in Russia is one of the major features of its transition. This paper attempts to illuminate the continuity of elites as a general trend by using the case study of the privatization process in Veliky Novgorod, Russia. This project looks at privatization as an avenue or means of resource allocation by elites during the transition. The data were obtained from 16 structured and unstructured interviews conducted in Veliky Novgorod in the summer 2004 among the representatives of the business and political elites. This paper deals with one group of the nomenklatura elite – top enterprise managers.

Features of the Russian Transition

There is a recognized trend to call the Russian transition from the Soviet regime to the post-Soviet era a revolution. Strobe Talbott, referring to the Russian transition from the Soviet past to the new system, wrote: “The most recent Russian Revolution...was actually three in one: the Russians were trying to transform their country from a totalitarian system to democracy; from a command economy to a market one; and from a multinational empire to a nation-state” (Strobe Talbott, 2002, 53). Mau and Staradubrovskaya examine the “Russian Revolution” in the broad historical context, drawing comparisons between the recent transition in Russia, the Russian Bolshevik Revolution of 1917, the English Civil war, and the Great French Revolution (V. Mau and I. Starodubrovskaya 2001). However, there might be alternative perspectives on the nature of transition in Russia. One of these perspectives is the elite theory thesis of elites’ continuity. Though the question whether Russia experienced a revolution or not is beyond the scope of this paper, I would argue that some aspects of the Russian transition from the Soviet regime to the post-Soviet era can be better perceived through the prisms of the elite continuity rather than a revolutionary change.

The nomenklaura¹ was a vast network of connections, personal relationships, and clans. After privatization the new elite officially acquired the ownership over means of production. Sakwa claims that 75 percent of the new political elite and 61 percent of the new business elite came from the old nomenklatura elite (Richard Sakwa 2002, 451).² Even the so-called liberal reformers who conducted the economic reforms in the 90s did not believe that they would create

¹ The Nomenklatura consisted of the Party members, Komsomol members, and managers of enterprises.

² Sakwa grounds these numbers on the survey conducted by Olga Kryshanovskaya in 1994, 1995 and 1996.

a class of genuine entrepreneurs because corporatization or managers' privatization was a significant part of the privatization reform.

Kryshtanovskaya and White argue: "Formerly the privileges of the nomenklatura had been largely in kind, reflected in the granting of state property for private use, or in money and special services; now they began to acquire an increasingly 'monetary' character, with its members allowed to engage in activities that were prohibited for others and to make profits from such activities" (Olga Kryshtanovskaya and Stephen White 1998, 88). Privatization of the state by the elite was one of the major avenues of resource allocation by the former Soviet elite. State enterprises were turned into commercial enterprises, joint-stock companies, or concerns.

The major element of the Russian privatization reform included corporatization. The goal of this strategy was to let managers allocate the control rights of enterprises that they had managed during the Soviet times. The Russian privatization program divided firms into those that could be privatized and those whose privatization was prohibited like, for example, railroad transport, space exploration, health, and education. Then firms open to corporatization had to re-register as joint stock companies with 100 percent of equity owned by the government, a corporate charter, and a board of directors. The board consisted of the firm's general manager (with two votes), the workers, and federal and local government representation. To privatize a company, the management had to assess its value in order to determine its charter capital (Maxim Boycko, Andrei Shleifer and Robert Vishny 1995, 75). The process of evaluation was an unfathomable source of corruption: managers strove to minimize the value of enterprises in the hope to purchase the shares later.

The privatization program worked out three packages of benefits for managers and workers of the enterprise under privatization. These packages came to be called Options. Option 1 was

the most popular in the Parliament. It presupposed that managers and employees would buy out 51 percent of the voting equity at a nominal price of 1.7 times the July 1992 book value of assets. In the end, a workers' collective guided by its manager had the right under the privatization program to select its benefits option. "Taking the workers' selection into account, the managers then had to submit to their local GKI office (State Committee on the Management of State Property) a privatization plan that described how the rest of the shares were to be sold" (Maxim Boycko, Andrei Shleifer and Robert Vishny 1995, 80). The principal forms of sale were voucher auctions and investment tenders. Thus, the management of the privatized firms had complete control over the strategy of privatization.

Privatization in Veliky Novgorod

Choice of Case

Veliky Novgorod provides an excellent opportunity for the study of regional elites in Russia. It is the capital of the Novgorod region. It hosts both a municipal and a regional administration. Veliky Novgorod is a city in the North-West of Russia, located between Moscow in the south and St. Petersburg in the north. Veliky Novgorod is a city with rich historical heritage. In the Middle Ages Lord Novgorod the Great was a trade center in the North-West of Russia, member of the Hanseatic League (a north European alliance of trading cities), and a republic with a popular assembly. Today Veliky Novgorod is the center of Novgorod region or oblast, which is the region with conducive investment climate that attracts investors with local tax incentives and authorities' support.

Usually scholars of democratization talk about institutional design at the central level. That is why the book of Nicolai Petro on the study of democratization process in Novgorod region

stands out. One of his contributions is that he shifts analytical attention from the study of the structure and efficiency of government at the national level to the regional level (Petro, Nicolai 2004, 3). Petro claims that the local government used local myths, references to the historical background of political independence and economic development to manage rapid social change in Novgorod region.

Officials of both administrations and local businessmen were the target of this research. They provided their insights on how privatization was implemented in Veliky Novgorod. The interviews were conducted off the record. Thus, the respondents' names and positions are kept confidential. The way privatization was held in Veliky Novgorod, though with some specific features characteristic of this city only, reflects the general trend – privatization was often used by the former Soviet managers and other nomenklatura members as a means of resource allocation.

The specific contextual features are important, however, for the purposes of the future cross-regional comparative studies. The enterprises in Veliky Novgorod can be divided into two broad categories: profitable industries like food industry, forest-processing industry, etc. and the so-called defense industry. In the first case of more profitable and efficient industries, the top management usually appropriated the enterprises. The defense enterprises became less efficient due to the collapse of the military industry with its network of demand and supply controlled by the state in the Soviet times. The directors of the defense enterprises hesitated to become owners.

Food Industry and other Profitable Industries

At the beginning of the 90s, the top management of financially viable enterprises usually announced the first or the second models of privatization and then bought shares from the

employees. One of the respondents noted that the top management adjusted better than the rest of the employees:

They were the managers. They had a better vision and they could foresee the outcome. An employee who had the voucher did not know what to do with it. So, they just sold it. To buy an enterprise one has to buy the control package of shares. This trick has been widely used. You have to buy the control package: 30-40%, then you become the member of the Board of Directors. The Chubais' model that everyone would manage an enterprise is a lie. Look at Novobank: it had about 600 shareholders. Were they going to influence the management of the enterprise? No. They had to vote for some decision. All 600 voted negatively, but the tableaux showed that 99% voted 'yes'. How? 600 shareholders represent just 1% of the shares. It is a classic example how these enterprises became to be managed. No one also paid dividends. For example, "Alkon"³ has some revenues. The question is whether to pay dividends or invest into the production. The board of directors votes to invest the money into the production development. They bought additional equipment, etc. Those who invested into the production survived and continued to work.

An example of a successful enterprise and a successful Soviet director who turned into a post-Soviet owner is the timber-processing factory director Slutzker. He has 50 years of experience working in the industry in Novgorod oblast. He was a director before and after the economic reforms and he is successful now. There are several heads of enterprises in Veliky Novgorod that had been working successfully before the reforms and remained in their position after the reforms. Among these directors can be named Nekrasov,⁴ Ivanov,⁵ Bobrishev.⁶ A respondent explained how the directors received the control package of shares in most cases:

The part of shares was distributed among the personnel. At first people thought that they would be owners, but they had this illusion till the first meeting of the shareholders. He would come to the meeting with his five shares that constitute about 0.0000001 of the whole package, so he was not able to influence any decision. People got disappointed and sold them at a lowest price. The earlier the privatization held the lower was the price of shares. The majority of enterprises were shutdown; people did not receive salaries, so they sold their shares.

³ A local spirit factory.

⁴ Director of the meat-processing factory the director of the meat-processing factory.

⁵ Director general of the chemical plant "Akron."

⁶ Director general of the spirit factory "Alkon."

Another respondent stated that the directors, if the enterprise was appealing, would encourage the employees to sell shares to them, rather than to the outside party. The message was that a person from outside would close an enterprise and lay off people. Why would an outside investor close an enterprise? The top management was seeding panic to manipulate the employees. This respondent also noted that practically all former Soviet directors of food industry enterprises in Veliky Novgorod became owners of these enterprises. Food industry has obvious advantages: revenues are quick to receive, there is always a local demand, and raw material is local as well.

Frequently the heads of the enterprises were able to persuade people to sell the shares to them since they managed these enterprises before, so the assumption was that they would be good owners. Though the majority of red directors did not know much about the market, most, however, became quickly oriented. Some would become owners and sell their enterprise; some would invest into production and expand it. One of the respondents said:

A director is not a blue-collar worker. I know one director who was able to accumulate (probably with dummies) about 85% of all shares. The rest belonged to the engineers, etc, whom he needed and had a good relationship with. The director had an important impact on this decision what kind of the joint stock company to chose. They acted differently though. Some felt that there was not going to be an outside investor to this enterprise. So, they would create a closed joint stock company, divide the shares between themselves and wait till the potential buyer appears. Others felt that enterprise could die out without external investment, so they chose a second model of privatization and turn it into an open joint stock company encouraging external investment.

There were objective obstacles to the development of even potentially profitable enterprises: economic uncertainty, inadequate tax burden and other regulations imposed by the state, competition with cheap imported goods, etc. Certainly the success of many enterprises can be attributed to the personal traits of some former Soviet managers, their entrepreneurial talents. For example, the directors of the local meat and spirit factories opened their own shops to sell

their products. Another factor that influenced an economic success of enterprises is a good relationship with the local authorities. This good relationship could not appear overnight though – it was based on years of cooperation and networking under the Soviet system.

Another successful enterprise is the huge chemical factory that produces fertilizers. This enterprise exports its products abroad. The story behind the privatization of this enterprise is that its owner Kanter is considered to be one of the richest people in Russia, an oligarch. How an outsider was able to buy the shares in this factory is a commercial secret. The fact that he was a member of the local administration commission that assessed the assets of the enterprise for further privatization definitely casts light on this mystery. These commissions were usually organized at the local administration, which obviously prompted corruption.

There is no doubt that personal characteristics of the “red directors” were also influential. Naturally some were more successful than others. Another respondent noted:

The Soviet person (*Homo sovetikus*) was rigid in terms of obtaining a new knowledge. No creative thinking. They got used to come to work at 9 am in the morning and leave at 6 at night, to do something almost mechanically, following the certain ritual. The Soviet power made them like that. But there were people who were receptive to new knowledge. Yeltsin, for example, despite some of his horrid traits was very receptive to new training and new knowledge. A person from a provincial town (Sverdlovsk) made it to the Supreme Soviet as a deputy and was able to learn a lot from the smart people around him. The Governor⁷ was also easy to educate. At the point when he became Governor he had practically no education whatsoever, practically no life experience, no political position. He sat close to the Interregional Deputy Group at the Supreme Soviet listening to the smart people. He says now that he was a member of this group, but he was not. Under the Soviet regime there were people who could learn quickly, but they could not turn their knowledge into reality, since they were not free to act. However, they had gone through a very good experience. They are like cognac. They became very good professionals in very narrow fields unlike the new generation of managers who don't know how to produce anything.

The general trends of the privatization process of economically viable enterprises in Veliky Novgorod included insider privatization, as a result of which the former managers became major shareholders. The extent of success depended, of course, on the personal

⁷ Prusak, Governor of the Novgorod Oblast.

credentials of the managers. The most successful obtained additional education, attracted investment, and expanded their business. Many of the former Soviet managers were enthusiastic to acquire new education, broaden their horizons. They traveled abroad to see how capitalism works in practice or earned a business degree. Many sent their offspring to Western colleges.

Defense Industry in Veliky Novgorod

One of the major features of the Novgorod privatization scenario was that in the Soviet times the predominant industry in Veliky Novgorod was an electronic industry, which was part and parcel of the defense industry. Novgorod hosted huge state-funded defense enterprises that employed about 50,000 of city inhabitants. The population of Veliky Novgorod is roughly 280,000, which means that one out of three was employed by this industry. After the collapse of the centrally-planned economy the privatization of these enterprises encountered objective difficulties. Due to strategic concerns the state decided when and how to privatize these enterprises. Procrastination and uncertainty created a favorable climate for corruption.

Even if allowed to be privatized, these factories were not appealing to an outside investor. When the defense industry crumbled with its centrally-controlled system of demand and supply, the defense-oriented productions were left without funding. They had outdated equipment on their hands and the products that no one wanted to buy anymore. Convention requires investments. Who would invest into the production that needs major restructuring in the economy where money due to the collapsed bank system is the scarcest resource? When asked about the result of the privatization of the defense enterprises in Veliky Novgorod, one of the local officials stated:

Privatization was going on in accordance with the legal principles worked out by the federal center. We did not invent anything. It is still in progress. There is no way out for them.

They just can not survive. Every year the federal center comes up with the list of enterprises that have to be privatized. We have a list of these enterprises. So, when a potential investor comes, we say that we are ready to sell them. It is impossible to restructure the economy of such a huge country. The conversion was probably not very successful here in the Novgorod oblast, because the defense industry dominated here, but now no one wants to invest into it. One has to restructure and reequip these enterprises anew. Huge investments are in need.

The industry just fell apart, as one of the respondents noted. In contrast to food industry, for example, which had a niche of its own even in the Soviet times, the defense industry and electronic industry had about 90% of demand coming from the State. “We are talking about a constant state investment, constant demand, year after year,” the respondent stated. The defense-oriented enterprises were always in the preferable position under the Soviet regime; they had a stable customer in the form of the state. After the collapse of the Soviet system, all enterprises had to look for the market for their products. One of the respondents noted:

The defense enterprises found themselves in the worst position than the rest of the industries: no one needed their products any more. Conversion needs money. There was no market for their products. Some enterprises though started to look for this market, but you could not sell anything without state’s approval. Thus, they are dependent on the Center. Since the defense ministry demand became smaller, all these defense enterprises have to severely compete for the state as a client.

Trade liberalization, when Russia opened its market for imported goods had a detrimental effect on the industries involved in high tech development in the Soviet era. Another respondent argued: “There was a period when the market was flooded with imported food products, with colorful wrapping, etc. But very soon people started to buy local food products because they are more organic. In terms of the defense industry and electronic industry, to produce TV screens when the market is filled with Sony, Panasonic, etc., which are cheap and good in quality, is not profitable. It is impossible to compete. It is like inventing a bicycle all over again. In the electronic industry to convert the production is more difficult than in the food industry.”

There is a local legend in Veliky Novgorod about Gaidar, who came to visit Veliky Novgorod at the beginning of the privatization process. Gaidar, paying a visit to one of the defense enterprises, declared that he would invest his voucher into the factory “Spektr.” No one among the interviewed knew whether Gaidar kept his word or not. Even if he did, it must have been one of his most failed investments. Another respondent, a journalist who might be expected to be impartial, observed: “Practically all “red directors” stayed in their positions. If they did not it was only due to the new state of the market. The radio electronics enterprises died a natural death. When enterprises died they turned into an investment polygon – they stopped the production and started to rent out the premises.” The respondent also noted:

The meat industry, in contrast to the defense industry, was almost independent from the central authorities. A cow would come from a local village, a local meat factory would turn it into sausage, this sausage would be consumed locally as well. Thus, food and food processing industries are industries with considerable revenues. Besides, these revenues quick to gain. They could not but succeed because we must eat even under the economic transitional circumstances. Radio-electronic industry was created from above. It was the part of the federal defense program. They all, with rare exceptions, worked for the defense ministry. So, when there was no federal program, they could not get restructured. Because any restructuring in this industry would demand huge investments. There were almost no investments.

The managers of the defense enterprises and other state-dependent industries were less inclined to become owners. One of the most vivid examples of this pattern of behavior is the case of one of the Novgorod defense factories that produced equipment for the defense ministry. The director general of this factory has occupied this position for 18 years. At the beginning of the 90s, his factory was privatized. In the course of the decade after the privatization, the number of the factory workers fell from 2,000 to 150 employees, 100 of which are administrative staff (sales department, accounting, etc). Some employees left of their own accord; some were fired due to the insurmountable economic hardships. One of the factory’s workers declared that it was a decision of the management to downsize, in contrast to what the director said about his desire

to make the enterprise profitable and keep the people at all costs through selling the equipment and land. It is hard to say who is right, the worker or the factory director, the facts are, however, that the director enjoys a lucrative salary and is going to retire in a short period of time, the factory is, however, at the brink of bankruptcy. Some of the justifications of economic inefficiency brought by the director are valid:

Under the Soviet regime the defense enterprises enjoyed tax cuts. After 1998 all tax cuts (tax on land, premises, etc.) were abolished. The defense enterprises found themselves in a difficult position. On the one hand, they had to survive, but the state-controlled system of guaranteed market for their products collapsed, on the other hand, these factories possessed huge patches of land that they had to pay a tax for.

The factory director thinks that the fiscal burden placed on his and other enterprises was unbearable. In general, the position of the factory director is that due to their dependence on the state in the Soviet times, these factories were not able to survive on their own, without the state support, when the economic reform took place. Furthermore, some technological innovations developed in the Soviet times were lost forever due to insufficient funding. The whole military machinery was left unattended. Therefore, in his opinion, privatization of the defense industry was a huge mistake.

This factory was privatized and turned into a joint-stock company at the beginning of the 90s. Now there are about 20 organizations that possess its shares and 250 individuals. The factory chose the first option of privatization - the control packet of shares belongs to the employees. The question is, however, since the number of employees at the beginning of the privatization process was about 2,000, how did the number of shareholders become decreased up to 250 individuals? Since the shares did not produce dividends, people were getting rid of them, or, as one of the workers noted, some people in senior positions and close to the director were buying the shares from the employees to have some control over the enterprise. The current

shareholders regularly reappoint the director general at the shareholders' meetings by the majority of votes and he continues to receive his high salary probably on the basis of his successful dealings with the factory's land. He argues, however, that it is the state that should be blamed for the meager existence of the enterprises like his. He was looking for markets outside Russia, but encountered barriers in the form of competition, certification standards, and the need for investment. Thus, he blames external forces in the form of the state abandoning him or market competition for the failure of his enterprise.

One of the respondents argued that privatization was a spontaneous endeavor fulfilled without a proper cost-benefit analysis. Certain powers were unleashed and defense factories were sinking one after another like Titanic. The managers of these enterprises selected a unique strategy of survival – they would not become owners due to obvious non-profitability of the factories, but would stay to extricate as much as possible from the “dying relative.” The continuity of top management, however, was maintained circumstantially, not necessarily as a conscious effort by the elites.

Conclusions

Privatization was one of the avenues that the Soviet elite took to allocate even more resources after the collapse of the Soviet system. The continuity of elites is probably the major characteristic of the transition process in Russia. Power and resources did not change hands. The circumstances surrounding the transition were beneficial for the so-called “red directors”, the Soviet managers who “migrated” into the new Russian elite. Corporatization, the policy to provide opportunities for Soviet managers to become owners, was part of the privatization process.

Therefore, as the case study of the privatization process in Veliky Novgorod demonstrated, if an enterprise was economically viable the top management tended to allocate the shares and become an owner. When they became owners they could either sell an enterprise or continue to own it. The extent of success as an owner depended, however, on the personal credentials of the managers. The most successful obtained additional education, attracted investment, and expanded their business.

In the case of the less viable enterprises the former Soviet managers, like in the defense industry in Veliky Novgorod, drove an enterprise to the brink of bankruptcy or stayed in the management position if the enterprise was privatized. Then they usually would manage the property of the enterprise as if it was their property but in a clandestine manner: they would steal, rent out the equipment, premises, and land. The general pattern for the managers was to suck all juices out of an enterprise, drive it to the brink of bankruptcy, and then leave the boat.

However, this paper does not emphasize the moral aspect of the elite transition. Presumably it was the only way to address a complete economic, political, and social devastation that Russia experienced after the collapse of the Soviet Union. This paper emphasizes the importance of elite continuity as a characteristic feature of the Russian economic transition. This paper also stresses the necessity to look at the process of elite transition in a specific context. That is why a case study as a research tool was selected to demonstrate how the former Soviet managers used privatization as a tool of resource allotment in Veliky Novgorod.

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Appendix

The 16 interviews that were used for the purposes of this research were conducted between June and August of summer 2004 in Veliky Novgorod, Russia. The interviews were recorded, transcribed and translated from Russian into English. The list of respondents' affiliation institutions includes:

1. Novgorod TV and Radio Broadcast Company "Slaviia"
2. Novgorod Region Duma (Parliament)
3. Meat factory "Miasnoj Dvor"
4. Foreign Relations Department, Veliky Novgorod City Administration.
5. External Economic Relations Department, Veliky Novgorod City Administration.
6. Novgorod municipal energy enterprise "Novgorodteploenergo"
7. Municipal enterprise that organizes children sports, development, educational, and leisure activities "Alye Parusa"
8. Electronic factory "Kondensatornyj zavod"
9. A private taxi company
10. Center for the Entrepreneurship Development at the Novgorod Regional Administration
11. Center of Political Analysis "Dialogue"
12. New Novgorod Newspaper
13. Novgorod Region Administration
14. Spirit factory "Alkon"
15. City Administration of Veliky Novgorod
16. A private firm dealing with alarm systems