

**WORKER OWNERSHIP IN RUSSIA:  
A Possibility After the Command Economy**

**1992:4**

**John Logue and Dan Bell**

**Appeared in Dissent, Spring 1992 pp. 199-204**

John Logue and Dan Bell

## WORKER OWNERSHIP IN RUSSIA

A Possibility After the Command Economy

**I**t was raining when we pulled up in front of a low, nondescript factory in Tver, two hours' drive northeast of Moscow. The Tveris glass plant, built as a state enterprise, was celebrating its first anniversary of employee ownership.

Tveris Glass is one of some hundred firms that, by the time of our visit in July 1991, had opted out of the command economy through direct worker ownership. What "direct worker ownership" means varies from enterprise to enterprise, but the concept of worker ownership is an attractive alternative both to state ownership and to such other forms of privatization as sale to managers and government officials (the "propertization of the nomenklatura"); sale at auction to the Russians with the most rubles, the so-called black market mafia; or sale to foreign investors. "Employee ownership is the most socially acceptable form of privatization," economist Jacob N. Kermetsky told an audience of Soviet managers of employee-owned and -leased businesses in July. "because it avoids the class conflict inevitable in all the other types of privatization."

The Russian republic's government intends to convert its moribund command economy to a market economy. But who will own what is far from clear. A variety of ownership forms are compatible with the market, ranging from highly concentrated private ownership, through a Jeffersonian pattern of widely dispersed ownership in small businesses, family farms, and employee stock ownership, to state and municipal ownership within a market socialist structure. Each has its adherents among Russian reformers. Choosing *which* mix of

ownership forms is to replace monolithic state ownership is a crucial issue in the process of economic reform.

The purpose of our visit to employee-owned plants in the Moscow area in July 1991 was to discuss what Russian firms could learn from the American experience with employee ownership. Although that experience is mixed, some eleven thousand U.S. companies employing over 10 percent of the non-public sector work force have introduced some element of employee ownership through Employee Stock Ownership Plans (ESOPs) since 1974; more than two thousand of those employing more than one million people are estimated to be majority employee-owned. Studies demonstrate that firms that combine significant employee ownership with significant employee participation systematically outperform their conventional competitors. Good business and distributive justice can go hand in hand.

The passage of the Russian republic's privatization legislation in July 1991 lent a sense of urgency to understanding worker ownership, for the legislation gives employees preference in buying enterprises to be privatized. (Legislation calling for giving every citizen a voucher that could be exchanged for shares or real property was also passed. Implementation of the voucher system has, however, been postponed as inflationary.) The conservative opposition to the concept, epitomized by KGB chief Vladimir Kryuchkov's condemnation of direct worker ownership, was swept aside in the aftermath of the August putsch attempt. The July legislation is currently being amended. The government's position is to award 25 percent of shares to employees

## Worker Ownership in Russia

without charge and to sell an additional 10 percent to workers and 5 percent to management at preferential prices. Given Boris Yeltsin's announced aim of privatizing half or more of construction, food, light industry, and retail trade in 1992, the employee-owned sector could grow quickly.

Direct worker ownership remains terra incognita for most Russians. Leonid V. Leibov, the general director of a group of five furniture plants employing 2,500, put it succinctly: "When we started looking at introducing worker ownership at Mosfurniture, we had no more idea of how to carry it out than Gorbachev did when he started perestroika."

The first halting steps toward employee ownership were taken in the early days of Gorbachev's economic reforms. "Work collectives"—employees as a group—were permitted to lease state enterprises on an experimental basis. Employee leasing began on a small scale in the service sector of Estonia in 1985 and was adapted to industrial enterprises around Moscow in fall 1987 by Dr. Valery M. Rutgaizer, an economist then at the All-Union Institute for Public Opinion Research. Leased firms were able to retain their surplus and plow it back into the enterprise in the form of capital improvements, wage increases, and programs to improve the living conditions of the employees. By February 1990, employee-leased firms were estimated to number between 1,200 and 2,000 and to employ between one and two million. Such enterprises saw sharp increases in productivity and benefited from a more entrepreneurial management style.\*

While leasing contracts were initially negotiated on the basis of historical profitability, in December 1989 the USSR Supreme Soviet passed a law that changed the terms for setting the lease price to a formula based on a percentage of the firm's asset value. This raised lease fees sharply and diminished leasing's attraction. In January 1990, the Union's Council of Ministers offered an avenue permitting employees to buy industrial assets directly:

\* For an account of the leasing system and early steps toward direct worker ownership, see Jacob Keremetsky and John Logue, *Perestroika, Privatization, and Worker Ownership in the USSR* (Kent: Kent Popular Press, 1991).

it created BUTEC People's Concern as an economic experiment combining collective worker ownership of enterprises and market relations. State-owned enterprises that joined BUTEC were permitted to withdraw from the state plan when their work collectives purchased the enterprises' assets. The Law on Property, which took effect on July 1, 1990, provided a more permanent legal basis for this form of ownership.

In BUTEC's first eighteen months, work collectives of some sixty-six state enterprises in light industry, construction, and services—70 percent of them in the Moscow area—took advantage of the BUTEC model to buy their assets. (As of July 1991, BUTEC members also included four hundred new businesses. About eighty state enterprises in sectors where privatization was not permitted were associated members.) Together they employ about twenty-six thousand people; the median employment is about three hundred, small by Soviet standards. While other experiments have been undertaken on an ad hoc basis in individual firms, such as the truck producer Kamaz, the BUTEC model prescribed a systematic framework governing the purchase, operation, and distribution of member enterprises' profits. Although the new privatization law will lead to mass privatization outside BUTEC, the BUTEC experiment provides most of the Russian experience with direct worker ownership.

Work collectives joining BUTEC received the right to purchase the business at the "residual asset value" as determined by a local commission. Although prices have varied with the skill of the negotiators, they have typically been low—encouraging experimentation—since "residual value" permitted deducting imputed payments on the assets' acquisition price through employee labor during the years of state ownership. Funds for purchasing assets were derived from the profits of the enterprise, employee savings, and state bank credits. At the state's discretion, outdated fixed assets could be given to the employees. Purchase payments were divided between the union government and the local government in proportion to the share each had previously received of the profits of the enterprise.

Once the enterprise was purchased, the

## Worker Ownership in Russia

BUTEC model permitted its value to be divided among the employees individually "according to their personal labor contribution." How an individual's labor contribution was determined was left to the discretion of the enterprise. However, the law specified that the value of the enterprise for individual distribution was set at the initial amount paid plus any portion of the acquisition loan that had been repaid. Any value that has not been paid for, because it was credited to employees for past labor or was a simple grant from the state, would not be distributed among the workers individually though it belonged to them collectively. An employee leaving the enterprise would be entitled to compensation for his individual share.

BUTEC enterprises were permitted to determine their own plans for production, obtain their own sales, deal directly with suppliers, issue securities, hire skilled labor, set wages, and establish their own prices within legal limits "under the guidance of the market," as the regulations implementing the Council of Ministers' decree stated. BUTEC member firms were also entitled to engage directly in foreign trade and to set up a commercial bank to provide credit to the enterprises and to individual employees and to handle foreign currencies. Thus BUTEC enterprises represented a nascent market system, building market relationships from below, though they also could continue to buy from and sell to state enterprises covered by the plan. Their profits belonged to the enterprise (and hence the employees); their direct relation to the state was limited to paying taxes. Rates vary with use: retained earnings used for capital improvements and social development (such as housing) were taxed at 8 percent; remaining income was taxed at 17 percent. What was left could be allocated among employees in bonuses and dividends.

Motivations for joining the BUTEC experiment varied. "We were all idealists," says Valery N. Varvarov, BUTEC's personnel director. But idealism was tempered with economic incentives. For the managers we talked to, a crucial motivation was escaping the straitjacket of the state plan. As one put it, in the old system "The art of the manager was to

neutralize the bureaucracy and to keep it from hindering your work." In the new, they could escape the command system entirely.

In enterprises like Tveris the legal framework for worker ownership is being fleshed out. "Our principles are empirical," says BUTEC's Varvarov. "We are designing a new ownership and managerial system through our practice." So let us look at two cases.

The Tveris plant, which produces consumer glassware and art glass, was built from scratch by its employees a quarter of a century ago. On July 1, 1990, employees bought the firm's two glass plants and auxiliary enterprises (a machine shop, power plant, and hog farm) for six million rubles. This is a modest price for a firm that does thirty million rubles in sales, employs one thousand people, and has an operating income of ten million rubles. Igor Semionov, its director, estimated the firm's real value to be at least fifteen million rubles. The purchase price was calculated as the residual asset value of the plant's 1972 asset inventory. Of the six million ruble purchase price, two million came from cash on hand; the remainder was a three-year bank loan with a 10 percent fixed-interest rate.

Registered initially as a "People's Concern" within BUTEC, Tveris restructured itself as a shareholding society in May 1991, issuing 6,500 shares valued at 1,000 rubles each. Two thousand shares, representing the initial two million ruble payment, were allocated on the basis of seniority and salary to individual employees; some 70 percent of the employees qualified for these shares on the basis of their service records. An additional five hundred shares were made available for direct purchase by employees who could buy them on credit; this represented new equity, and was also distributed to individuals. The remaining four thousand shares are held by the shareholding society collectively; some or all of this bloc may be sold in the future. The firm will initiate an internal market in 1992, which will permit employees to buy and sell shares to each other.

In its first year of employee ownership, Tveris did well. It increased both wages and wage differentials from a range of two hundred

foreign companies. Two more apartment buildings for Stroipolymer workers are on the drawing board and sixty detached cottages are planned.

In addition to recognizing the need to educate the workers about ownership, Stroipolymer's Makharinov has been focusing on what he calls *psychological privatization*: getting workers to take ownership and responsibility for their work through decentralization and team decision making. His greatest success has been a group of eight employees involved in producing polymer stabilizers who now run their department as a separate subsidiary. They produced eighteen tons of stabilizers the previous year; now they produce eighteen tons a month.

In theory direct employee ownership of enterprises is an ideal solution to the problem of privatization. It can be carried out quickly, provides powerful incentives for workers to increase production and reinvestment, and its labor-based formula for allocating capital fits both ideological and cultural norms.

**B**ut will it work in practice? What we saw at Tveris, Stroipolymer, and the four other plants we visited was an impressive demonstration of managerial initiative, improvements in productivity and compensation (in real terms, at least through July 1991), a significant expansion of existing production capacity, and the development of new products, businesses, and joint ventures. Production is up, wages are higher, and employees are beginning to accumulate substantial capital.

Yet even in these innovative enterprises, significant technical and cultural problems remain. The purchase price of the companies we visited was being allocated to currently employed workers as "shares" with a fixed value, more like bonds than shares. (Moreover, in the BUTEC model, the portion of the value of the business not paid for in cash belongs to the employees collectively but not individually.) Thus the individual worker's shares do not appreciate when the business does well, although current dividends can be increased. Nor do prices and the liability to pay off departing owners decline when the business

does badly. In the current inflationary environment, of course, the shares will depreciate in real value.

While the enterprises comprising BUTEC were sold at low prices, mass privatization requires establishing a fair market value for the sale of state enterprises, if only to be fair to pensioners, public-sector employees, and those working in sectors where privatization will not occur. That will not be easy. "Residual asset value," the basis for previous purchases, is obviously too low a price. Yet setting a price through an auction-style competitive bidding process, as envisioned in the July 1991 privatization act, is also problematic: it assumes both a pool of buyers and a means to evaluate future earnings potential independent of the historical numbers derived from the irrational pricing system of the command economy.

Perhaps the most intractable immediate problem for employee ownership is the lack of a culture of ownership among Russian workers. When we asked at works council meetings at Tveris and Ordynka (a Moscow-based freight broker with 343 employees), "What proportion of employees understand ownership?" only two of nineteen works council members thought that as many as half the employees understood ownership; the median guess was that only 10 percent understood.

While the example of Stroipolymer suggests that information and education may create a sense of ownership over time, given the current level of understanding of stock ownership among Russian workers, there is a substantial likelihood that individually held employee stock will be resold as soon as the law permits and ownership will rapidly become concentrated. Some Russian economists consider this desirable, and they treat employee ownership as only a transitional phase.

By contrast, the "collective private property" that BUTEC has promoted ties capital ownership to labor input. Although it can be (and is) combined with joint ventures with foreign firms and investors, its underlying premise has been that privatization should spread productive wealth broadly. BUTEC's combination of individual property rights with a collective structure will require some techni-

## Worker Ownership in Russia

to six hundred rubles a month to a range of three hundred to twelve hundred. (The average industrial wage in July 1991 was about 250 rubles per month.) The firm undertook a number of major projects including building a new plant and four and a half million rubles worth of new housing construction for employees. In an effort to insulate Tveris against what Semionov called "the complete anarchy in supply," a small commercial bank and several trading firms were founded to serve as an alternative to state supply and distribution channels.

Semionov first became general director in 1988 in the brief period when directors were directly elected by the workers. Today he is selected by and responsible to a seven-member management board elected by a fifteen-member shareholders' council, which, in turn, is elected by the employee shareholders. The council includes the local trade-union leader. The relative roles of management and council have not been clarified. The council represents the owners and has a right to democratize management. Yet management requires expertise. Semionov has tried to educate his staff on finance, so far with little success.

Despite the innovations in ownership and the computer on Semionov's desk, Lenin's collected works still fill his shelf. "Which of Lenin's articles would you recommend that I read to understand what's happening?" I inquired. "All of them, John. All of them," he replied.

**B**y contrast, the portrait of Lenin that had hung over the desk of Stroipolymer's general director, Boris N. Makharinov, had been removed by February 1990. The awards for exceeding the plan still held their accustomed place of honor, but the new buildings and new products drove home the point that independence from the plan had obvious advantages.

Stroipolymer, located in Golitsyno, about thirty miles outside Moscow, manufactures laminated polymer construction products, including linoleum, wall paper, and vinyl wall coverings. In April 1988, it was one of the first plants in the Moscow region to be leased by employees. It did very well; the average wage

increased from 220 rubles in April 1988 to 360 in February 1990 for its 700 employees, while the enterprise also constructed sixty apartments and built a clinic. In August 1990 employees bought the plant for twenty million rubles; 5.7 million was deducted from the purchase price for capital improvements made while leasing, one million was paid in cash and 13.3 million was borrowed from the state bank with an eight-year term and an interest rate of initially 5.5 percent. Since employees bought the plant, the average wage had doubled to 700 rubles in July 1991, while employment had been cut to 610. Sales for 1991 were expected to hit between sixty and seventy million rubles with an after-tax profit of about twelve million rubles.

Stroipolymer had the lowest ratio of shareholders to employees that we encountered: only 290 of 610. To be included, one needed two years seniority and a good evaluation of job performance. Share allocation was then based on seniority and wages; the 290 employees who qualified will receive about 70,000 rubles each in shares. To justify the allocation of shares on which the loan has not yet been repaid, workers sign individual contracts agreeing to pay for their shares by pledging the future dividends from these shares.

Stroipolymer has sought to promote a culture of ownership since employees leased the plant in 1988. This effort has met with some success. Employees interviewed at random seemed knowledgeable. For example, Anatoly Aleshinkov, a manual worker with thirty years of seniority and ninety thousand rubles in shares, explained to us in some detail how the dividends on his shares, which came out of Stroipolymer's profits, were actually paying for his shares. "But," we asked, "has ownership affected your daily job?" "Previously we were on fixed wages," responded Aleshinkov. "Now when we get greater production, we benefit directly. So now we always try to implement good ideas. That often requires buying new equipment," he added.

Stroipolymer has embarked on a two hundred million ruble capital improvement project that will more than double existing production capacity, add additional products, and increase the firm's participation in joint ventures with

## **Worker Ownership in Russia**

---

cal adjustments to work over the longer term—for instance, it does not make adequate provision for including new employees—but in these technical areas, some aspects of American Employee Stock Ownership Plans (including the trust structure, allocation formulas, vesting and distribution schedules, the company's obligation to repurchase the stock, and the employee's obligation to give the company the first right of refusal to buy the stock) can be adapted to Russian circumstances to keep the ownership of capital decentralized.

So far the efforts to create a market economy in Russia have yielded much pain and few results. Shelves are empty and prices are rising. Existing enterprises are structured as monop-

lies, which makes any market system—no matter who owns the enterprises—an easy victim of price fixing. For too many Russians the free market has meant no more than the disappearance of goods from the inexpensive state sector and their reappearance at a much higher price in the private market—for the profit of those carrying out the diversion.

The experiments with employee ownership offer some relief in this bleak picture. In the midst of the general Russian economic debacle, the evidence is overwhelming that employee-owned and -leased enterprises have worked on a small scale. Whether they will work on the continental scale now required remains to be seen. □