

Big Sale

The government announced a massive privatization. But will it be willing to sell the most attractive assets?

by Maxim Momot

Such notions as huge budget deficit, foreign loans, and the growth of national debt, along with the word ‘privatization’, defined as ‘structural’, were retrieved in the times of crisis. The head of the Ministry of Economic Development Elvira Nabiullina said that next year the government aims to sell about 20% of ‘Sovkomflot’ shares and 13.1% of ‘Rosgosstrakh’ shares. According to the Minister, they hope to raise 70 billion rubles in 2010 (10 times more than initially expected). Why did the government decide on such serious measures? Will it sell the most attractive assets after 2010? The government still does not want to sell ‘Rosneft’, ‘Sberbank’, VTB, RZhD (*Russian railways*) and ‘Aeroflot’. And the main question is – what is the government trying to achieve? To raise money for the depleting federal budget or to boost the country’s competitiveness through increasing the role of the private sector?

Roll up, it is cheaper

As a matter of fact, selling state property has not stopped, but it became very insignificant compared to 1990s. The question comes: how many noticed that the process still continues? Rosimuschestvo (*a federal agency that oversees privatization transactions*) traditionally reports on the unfulfilled privatization goals. Why does this decrease occur? First and foremost, due to the quality of “goods”. One can just go to the website of the agency where the list of all traded enterprises is published to make sure of the following: the government is ready to sell only the least attractive assets. But the management teams even of such enterprises are very often against privatization, “because state property is often used for personal gains”, as Alexey Kalinin, senior manager of the department of state consulting of ‘Development of Business Systems’ (auditing company) explains. Sergey Karykhalin, head of the analytical department of the managing company ‘Capital’, agrees with him. “Management of state enterprises sits on federal budget monies. Moreover, there are no sanctions against the bureaucrats who do not fulfill privatization plans’ – he says. Naturally, during the crisis the problems became worse. As ‘RBC magazine’ was informed in Rosimuschestvo, the following factors hinder privatization this year: contraction of demand on the market, declining preciseness of estimated values of property, an impulse to hold off sales until the macroeconomic situation stabilizes. As the agency reported, potential investors expressed their interest in auction sales only in 10% of cases (in the previous years the number went up to 30%).

Deepak Lal, a well-known American economist and a professor at the University of California Los Angeles named one more reason for privatization stagnation in his interview to RBC. According to him, the crisis affected the availability of loans, which might have driven the prices

even lower: investors are simply unable to get the necessary sums from the banks. “The problem is how to avoid selling state assets at such low prices, - underlines Georgiy Malginov, head of the laboratory of property and corporate governance issues at the Institute for the Economy in Transition. There is a certain contradiction: during the times of crisis the government is indeed tempted to get rid of its property, but they can only get good money for it in favorable economic environment’.

The graph shows the discrepancy between anticipated and actually raised money from privatization of federal property. The red line marks actual money and the blue line marks anticipated money. September 1, 2009. Source: government of Russia, Rosimuschestvo, Ministry of Economic Development and Federal Treasury.

The government realizes this problem. Elvira Nabiullina mentioned a possibility of holding off privatization transactions until 2011. But there is another opinion. ‘I don’t think that privatization should be put off because of the crisis, - thinks Sergey Karykhalin. – The worst phase of the crisis is gone and for good assets you now can get good money. If the decision to sell any companies has been made, they should be sold now”. The truth is that the crisis exacerbated the problem of inefficiency in the public sector.

Back to the past

The fact that government is turning to the idea of mass privatization is not surprising. “This is not so much a new wave of privatization, but the unfinished previous one, - points out Alexey Kalinin. – The structure of the federal property is not consistent with the functions the state does. The problem existed also in the early 2000s, reminds Mr Kalinin, but then due to some reasons, including big budget revenues, the issue of inefficient state enterprises did not interest anyone. But during the crisis one had to think about those enterprises. “According to the World Bank estimations, the share of state owned and municipal property is more than 75%, - says Alexander Varvarin, managing director for corporate relations and legal support of the Russian Union of Industrialists and Entrepreneurs. – At the same time foreign experience shows that in order for the market economy to function efficiently, the state should own not more than 20-25% of its property. This situation requires a mass privatization of state owned assets”.

The problem of inefficient stated-owned property is not limited to stated-owned enterprises. It is not by accident that Vice-premier Igor Shuvalov mentioned earlier a possibility of privatization of ‘Rosneft’. State ownership of the largest oil corporation, as well as of ‘Gazprom’ decreases efficiency of natural resources use. ‘These companies do not invest enough in exploration of new oil/gas fields, and they, compared to western companies, do not use already existing fields efficiently”, - thinks Director of the Institute for Strategy and Competitiveness of Harvard Business School Michael Porter. In his opinion, Russian state-owned raw oil and gas manufacturers focus on buying assets and use their position for short-term goals. Indeed, at the beginning of October the media discussed an intention of “Gaztorgpromstroi, a subsidiary of ‘Gazprom’, to open a chain of supermarkets and fast food restaurants. Moreover, - points out Mr

Porter, - such companies interfere in the relations of Russia with the neighboring countries which makes realization of long-term goals of Russia with regard to those countries more difficult.

The government underlines that structural change of the economy and increase of the private sector role in it is the main goal of privatization. But they clarify: it is necessary to also “enhance” the federal budget. “The first goal is long-term and strategic, - insists a representative of Igor Shuvalov’s secretariat. – State and municipalities own too many enterprises which can be managed by the private sector. In case of privatization, management of such enterprises will become more transparent, because private sector is more efficient. Moreover, unnecessary state functions will be decreased”.

Prospects

So, is the state ready to make a decisive step forward and sell really interesting assets? So far officials refrained from any specific statements, only limiting themselves to general words. As a representative of Igor Shuvalov’s secretariat told RBC, the work at the privatization plan of 2010 is still in progress. It should be finalized by the end of the year. However, as a member of the academic council of Moscow Carnegie Center Andrey Ryabov told RBC, success of privatization will depend on how it will be implemented. “It is hard to guess from the statements of Vladimir Putin and Igor Shuvalov, - says the experts. Will the option of “clannish capitalism” be implemented when property goes to close friends of bureaucrats? or will the mechanisms be modern and will allow for the efficient entrepreneurs to get control of the enterprises?”

The scale of privatization will be influenced by the political environment. “Of course, the government will retain control over “Gazprom” and “Rosneft”. Hypothetically speaking, loss of this control would lead to a more pluralistic political system in Russia. But at the beginning, pluralism will only be allowed on the top”. According to his estimations, the situation could be similar to the one in 1990s, or maybe go even further. “In this case, broader public could influence the process of political decision-making” – forecasts Mr Ryabov. Current Russian officials are hardly interested in this outcome. And because of that privatization and its expected positive consequences will apparently be quite limited.

Calling of the Varangians

Will foreigners be allowed to the upcoming privatization? “From economic and fiscal perspectives, this decision would be right”, - thinks the head of the analytical department of managing company ‘Capital’ Sergey Karykhalin. “There will be many foreign investors because they are the ones who have the money now”, - he says. Attracting these investors will make management of the enterprises more efficient”. The main point is that the privatized companies should be ready to compete, - says a representative of Harvard Business School Christian Ketels. According to him, although privatization was done in a bad way and has an ill fame, the

companies which became private then, are now much more efficient than the state-owned. An employee of Barry College School of Business (USA) Paulina *Inglis* (?) in her comment to RBC magazine said that lack of managing capabilities of Russian business people is the main obstacle to the development of Russian economy. In her opinion, some of the issues are resolved in an incompetent way: for example, how big salaries should be and who should make decisions in a company. As long as this situation sustains, it is not surprising that privatization does not meet expectations. Knut Richter, professor of European University Viadrina (Germany) agrees with Mrs Inglis. “Judging by the experience of transition to market economy in East Germany, selling state assets to private companies often looks like a preferred option, – he points out. – Both public and private sectors in Russia need organization innovations”. According to Christian Ketels, there is another advantage in western companies participating in Russian privatization: foreign experts who provide their services in the privatization process can be put on trial in their respective countries if they are suspected of corruption. In Russia fighting corruption is problematic. However, there is another point of view. “One could talk about low quality management in Russian companies only at the initial stage of privatization. Now many Russian managers have enough qualifications without yielding to their foreign colleagues, - underlines Alexander Varvarin from the Russian Union and Industrials and Entrepreneurs. – Giving access to key assets to foreign companies which have bigger financial resources and newest technologies could create a big barrier towards development of national entrepreneurship. Some are ready to trust only the most problematic assets to foreigners. “Because the government has to support national businesses, I think that some limitations on the right of foreigners to participate in privatization of strategically important enterprises are reasonable. For example, mining belongs to such spheres, - said First Deputy Head of the Committee on Property of the Russian Duma Dmitry Sablin. – At same time we can favor participation of foreign capital in auto industry, where foreign investors could bring modern technology”. How actively the government will attract foreign investors remains unclear. Rosimuschstvo underlines there are no legal barriers to bidding by foreign companies. This issue remain political, - summarizes senior manager of the department of state consulting of auditing company “Development of business system” Alexey Kalinin.