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Let’s Get Privatization Right This Time Around

By Anders Aslund

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At a conference in Cambridge, Massachusetts, in February 1992, I and a few other advisers to Russia’s young reform government discussed how to pursue privatization in the country.

The main goal of privatization was to build a market economy, and the destructive asset stripping by state enterprise managers had to be stopped. Privatization had to be simple, fast and have popular appeal to beat them. Because of a “leasing” program introduced by former Soviet leader Mikhail Gorbachev, managers could buy the state companies for themselves. If this isn’t a conflict of interest, I don’t know what is.

Since the managers were not sure of their property rights, they gradually transferred assets of their state enterprises to “cooperatives” in their own names, established on the basis of Gorbachev’s Law on Cooperatives of May 1988. They were robbing the country empty, shifting assets from thousands of state companies to their private firms.

We were led by Harvard University professor Andrei Shleifer, one of the world's most authoritative economists and specialists on privatization. The leading Russians were Dmitry Vasiliyev and Maxim Boiko, a top adviser to Anatoly Chubais, who headed Russia's privatization program.

My role was marginal, but I insisted on voucher privatization to balance the state managers and get the privatization going fast before the reaction had mobilized and the companies had been destroyed by their masters. Chubais accepted our common judgment. In August 1992, President Boris Yeltsin presented voucher privatization in his speech on the anniversary of the August 1991 coup.

In the end, Chubais had to compromise with the state managers. Effectively, he allowed them to seize one-fifth of the shares of the big state companies, while employees obtained some 40 percent, and only 22 percent of the shares of 16,000 large corporations were sold at voucher auctions. Nonetheless, the final voucher sale made all the difference. Privatization was done. Suddenly, ambitious entrepreneurs knew that they could carry out hostile takeovers, and they did. The old managers could cut costs, but only new owners could think strategically and build anew.

Privatization was key to Russia's successful construction of capitalism that delivered an average annual growth of 7 percent from 1999 to 2008. Only slightly simplified, Russia's market reform has been privatization. Government revenue was never an aim of the early privatization.

In some big companies, the old managers were too well-connected or too criminal to be beaten. Their mismanaged enterprises could not be salvaged without privatization. This was one of the motivations of the loans-for-shares privatization in late 1995, which privatized 12 big companies, including half the oil industry. Economically, this was the most successful privatization, but because outsiders took over, the old insiders complained loudly and, as it turned out, political acceptance was more important.

As a result of the loans-for-shares privatization, the country's oil production surged by 50 percent from 1999 to 2004, which came as a complete surprise. Previously, the general judgment was that Russia's "brown fields" had reached their limit, but the oligarchs who took control made the correct decision by inviting international service companies to enhance production and rationalize finances and production. AvtoVAZ, by contrast, remained controlled by its old state manager for years and stayed dysfunctional and criminalized.

Since 2004, Russia's oil production has leveled out because of the Yukos confiscation and Gazprom's purchase of Sibneft. Rosneft and Gazprom are blatant examples of expropriation and stagnation, whose only beneficiaries are their managers and perhaps high-ranked bureaucrats.

Although state corporations have expanded again, this has been accomplished through state raiding, not free-market mechanisms. As usual with state companies, they have reduced economic efficiency. Russia's state corporations have again been exploited to enrich the corrupt and powerful insiders. As a result, the country's economic growth rate has fallen sharply.

Only Venezuela's self-obsessed President Hugo Chavez has carried out an equally disastrous policy. He is, of course, a good friend of Prime Minister Vladimir Putin and Deputy Prime Minister Igor Sechin, the most destructive forces in the Russian government. Venezuela has experienced a sharp economic decline over the past 10 years, having reduced its oil production from 3.2 million barrels per day in 2000 to 2.4 million bpd in 2009, despite eminent resources. It is very disturbing to think that Putin and Sechin view Chavez's economic model as something worth emulating.

Therefore, Russia needs a new large-scale privatization. The main goal is not to reap state revenues, but to reduce the size and influence of state companies, which might comprise as much as half of Russia's corporate sector today. The overriding goal should be to make Russia's economy more efficient. Moreover, privatization should reduce corruption by decreasing the power of the state managers. But this won't be accomplished by selling minority stakes in 11 Russian state corporations worth $29 billion, as Finance Minister Alexei Kudrin announced several weeks ago.

Other forms of privatization would be more useful. Obviously, the time of voucher privatization and loans-for-shares has passed. The primary goal of privatization must be to change ownership of the state companies, not to give them more resources. They must become truly private and subsequently oust their blatantly incompetent managers, who are undertaking massive "insider privatization" at state corporations. Often it is difficult to know whether large "state companies" like Gazprombank are state-owned or insider-privatized. Opposition leaders Boris Nemtsov and Vladimir Milov have documented this well in their book "Putin and Gazprom." The current insider privatizations are reminiscent of the Gorbachev period, and we all know how that ended.

The best solutions are perhaps a combination of two methods: initial public offerings of a majority of the shares and open auctions of individual companies or assets. While it is difficult to avoid some corruption in privatization in a country where corruption is so pervasive, an increase in private enterprise and a decrease in state enterprises can at least make a dent in the country's level of corruption.

Privatization should break up monopolistic state corporations, oust their managers, enhance transparency and improve corporate management. State revenues remain secondary.

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