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Guest Post: Russia's privatisation drive is not enough, but it's a start

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The Russian government recently made two major announcements marking a dramatic shift in economic policy. In his speech in Saint Petersburg International Economic Forum, President Medvedev stated that Russian modernisation should be led by private business, not by state-owned companies.

This change is very welcome and much needed as privatisation is an important component of any plan to reform the economy of Russia.

Yet, we believe that in order to commit to reforms, the announced privatisation plans are not sufficient. To create demand for building pro-market institutions in Russia and to improve the efficiency of the largest Russian companies, the government has to let go the controlling stakes in the largest firms.

The list of "strategic enterprises" would be cut five-fold, freeing up hundreds of mid-size companies for privatization. On July 26, the Russian government announced the plans to privatise non-controlling stakes in the ten largest government-owned companies.

Russia will decrease its ownership of such giants as Rosneft, Transneft, Sberbank, VTB, and Russian Railroads to 51 per cent. These plans starkly contrast with the policies of the last seven years during which the Russian government consolidated control over an ever increasing share of the major companies.

Why does Russia need privatisation now? First, there is significant fiscal pressure. In recent years, the Russian government has dramatically increased spending. Unlike 3-4 years ago, when the Russian federal budget balanced at the oil price at the level of \$35-40 per barrel, Russia is now running a fiscal deficit even though the oil prices are relatively high (\$70-\$80 per barrel). The Finance Ministry's conservative estimate is that the announced sales will bring revenues of about \$30bn, or almost 3 per cent of annual GDP. This covers an annual budget deficit in 2012 and will dramatically reduce the need for government borrowing in the coming years.

Second, it has become obvious that the state-owned companies are not transparent and not efficient. This was not a problem during the "fat years" of continued oil price growth before the crisis. However, as the oil price is not likely to grow any further, state-owned companies are now a threat rather than a means of growth and popular support of the ruling elite.

The third, and most crucial, argument has already been proven by Russia's turbulent history over the last 20 years of economic reform. In order to catch up with OECD economies, Russia needs another decade of fast economic growth. This growth will depend on reform. Indeed, all easy sources of growth have already been exhausted. Unlike the 1999-2008 decade, Russia no longer has spare capital and labor. Oil prices are not likely to grow by 30 per cent a year (as it was the case before the crisis). Economists agree that the sustainable long-term growth relies on economic and political "institutions", most importantly on property rights and contract enforcement.

Russia has to create a better investment and business climate, fight corruption, improve its bureaucracy and courts, and open up to competition. The demand for such institutional reforms can

only come from the private sector. This is why reforms in the 1990s and early 2000s (when the Russian economy was privatised) slowed down and were reversed in the late 2000s - when the government re-established its dominance in the economy. Privatisation as a catalyst for economic reforms is an essential element of any sustainable growth strategy in Russia. This is why selling non-controlling stakes is not sufficient. Government domination over the economy's commanding heights will not be affected, and the demand for reforms will not be created.

If privatization happens, it is very likely to be far more successful and credible than the 1990s round. The market infrastructure is dramatically better than in 1990s. The Russian government now has sufficient experience in dealing with both local and foreign investment banks and investment funds.

This round of privatisation will be more palatable to the public. Commodity prices are reasonably high - assuring high prices for Russian assets and significant revenues for the Russian budget. Functioning markets and experienced management means that privatised companies will be run well (and certainly better than the current state appointed management). All of these factors will attract investment and raise productivity that Russia needs to embark on a sustainable growth path.

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