

The Virtues of Privatization

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By Konstantin Sonin

Speaking last week at the Russia Forum 2011 in Moscow, presidential economic adviser Arkady Dvorkovich said the government needs to "completely, or almost completely privatize" VTB, the second-largest bank in Russia.

As with similar statements made by Dvorkovich's boss, President Dmitry Medvedev, the feasibility of his specific proposals remained unclear — although he is moving in the right direction.

There is nothing to be gained from the government's control over major segments of economic activity. It dampens market competition and ultimately forces consumers to pay higher prices for lower quality products.

What's more, it is practically impossible to create the right incentives for managers of state-owned companies that produce goods and services. They always want to use political influence to stifle competition and artificially stimulate demand for their products.

Not only economists support the idea of implementing a privatization program in the next several years. It might seem that Sberbank CEO German Gref would not want strong private rival banks to appear and would prefer state-owned banks to private ones in which the government controls only a blocking stake.

Nonetheless, as early as last year Gref spoke in favor of increasing the number of private shares in state banks. But keep in mind that Gref, who served as the economic development and trade minister and authored the government's economic program in 1999, is a long-time proponent of open markets and competition.

At the same time, however, we should not forget how strongly those with vested interests oppose competition. Of course, no politician would publicly take an "anti-competition" stance. But the status quo automatically works against free markets and competition simply because insiders always have more to lose from them, and the public is too fragmented to promote and defend them with a sufficiently united voice.

One week ago, the government ignored an offer by Alfa Bank to purchase Bank of Moscow. That's a shame, because it was the first opportunity to form a private bank with a serious shot at competing with Sberbank and VTB. Instead, Bank of Moscow shares will be given to one of the state-owned banks.

The main task of the new privatization program is to create conditions in which companies compete on the open market and not in the political arena. Achieving this would result in higher quality goods and services at lower prices than consumers now pay. Consumers will lose out if companies continue using political clout to gain monopolistic rights in a given market sector and to secure legislative and regulatory preferences.

At the same time, it is no simple task to strip privatized firms of their political influence without crippling them completely or to break up their share packets without spoiling incentives for top managers. But as difficult as those tasks might be, they will have to be met if Russia hopes to create a stronger and more market-oriented economy.

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