

## Privatization as One of the Instruments for Modernizing Russian Economy: The Main Tasks and Solutions

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**Abstract:** The new phase of privatization in Russia envisages the transfer of certain enterprises into private ownership with the aim of modernizing the economy and making it more innovative. A number of measures have been elaborated by the government to facilitate this process and ensure a most effective outcome. Still, there exist some problems, which have to be tackled and hence the need for expert opinion and evaluation.

**Key words:** Privatization • Private owner • De-privatization • Investor • Modernization • Credit multiplier • innovative economy • Investment attractiveness • Competition • State sector • Joint-stock company • Forecast

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### INTRODUCTION

The return of the term “privatization” into the Russian political and economic vocabulary at first sight might seem unexpected, because only in 2008 subsided discussions on the revision of the results of previous privatization, whilst prerequisites of the new phase have already surfaced. At that time the government was getting rid of outdated and unprofitable assets of the Federal State Unitary Enterprises (FGUP), which were sold to private owners. These assets didn’t have much appeal for the buyers and the government’s decision was rather the evidence of de-privatization and of the growing government sector in the Russian economy. Notwithstanding, it was exactly in 2008, that new possibilities opened up for selling the airports and sea-ports to investors from Singapore and the countries of the Persian Gulf [1]. And in 2009 President Dmitry Medvedev issued an instruction to look for new objects for sale, which was followed by Igor Shuvalov’s statement on the possibility of privatizing “Rosneft” and a number of other infrastructural objects. By 2010 the government’s plans on the second round of privatization became public knowledge.

Further will be explored the objectives of this privatization, but it is obvious, that the Russian economy needs thorough modernization and privatization at this stage can become a vital tool.

The timing for launching the new stage in privatization is quite felicitous. According to forecasts, 2011 will not be different from the previous year-the economy is still on the rise after the crisis of 2008. The reduction of state expenses in euro-zone will somehow slow down economic growth, but it will be sufficient enough for compensational coverage of the market conjuncture in the event high prices for raw commodities are maintained because of the problems in China. Besides, the lending leverage is growing in Russia and the credit multiplier has begun to function.

This subject was studied worldwide for many years in works of scientists, [2-4]. Still this question is actual and is constantly discussed in popular scientific magazines and materials of conferences [5-7].

**The Aims and Tasks of New Privatization:** As Dmitry Medvedev said-“the main aim of privatization is to augment the efficacy of the privatized companies and to attract to Russian economy additional investments,

major investments at that and to use the revenues from privatization for the modernization of our economy” [8]. The present privatization is oriented towards the largest foreign and domestic investors and doesn’t intend the sale of small blocs of shares.

The new phase of privatization is supposed to facilitate transition to innovative and socially oriented development of economy. Should the privatization fail to deliver high revenues, at least, it may lead to reforms and improvement of investment attractiveness of Russia.

Participation of state bodies in the economic activities in Russia might be viewed as excessive, impeding competition in the market and leading to ungrounded price increases for the goods of low quality. It is virtually impossible to create correct stimuli for the managers of state companies producing consumer goods and providing services—they will always be tempted to use political influence for the restriction of competition and artificial stimulation of demand for their produce [9]. Hence, the main task of privatization is the creation of conditions for competition in the real market and not only in the political domain.

Step-by-step reduction of state’s participation in the management of property in competitive industries should be achieved via transparent and effective procedures based on the principles of market valuation, equal excess to assets and transparent activities of the state bodies [10].

The main aims of privatization might be briefly formulated as follows:

- Creation of conditions for attracting non-budget investments into the development of joint-stock companies on the basis of new technologies.
- Reduction of the state sector in the economy with the purpose of developing and stimulating innovative initiatives of private investors.
- Improvement of corporate governance through the attraction of strategic partners and sharing international experience in the management and application of the state-of-the-art technologies.
- Creation of conditions for healthy competition in the market of goods and services.
- Creation of conditions for the expansion of publicity of joint-stock companies.
- Forming up of integrated structures in strategic industries.
- Forming up of the revenues for the federal budget [11].

President Medvedev’s intention to engage major foreign investors in the privatization process can be explained by objective needs. In experts’ assessment the Russian market is currently the most undervalued among other BRIC countries [12]. In view of UBS analysts, the shares of many Russian companies are traded with a discount in regard to similar shares in the emerging markets, despite excellent growth perspectives. The privatization program might serve as a good reason to carry out re-rating.

Timely privatization may become for a number of companies an excellent exit from the crisis and become a financial resource for reorganization and upgrading, particularly in the regions with insufficient budgeting. Situation with the “Stavropol” international airport may serve as an illustration, where the agreement with the “anchor” air company, as well as the privatization of the airport and the sale thereof to a private carrier interested in boosting passenger flow, might be an excellent solution to the problem [13]. “The anchor company will be in a position to develop new types of business, including the technical servicing of its own and other companies’ airplanes. Besides, thanks to its “own” tariffs it can cut down the prices for air travel, competing on short-distance routes with the railways and land transportation”. On the other hand, “Kavminvodyavia”, over which “Aeroflot” will take control, will hardly be able to do the same. It’s not intention of “Aeroflot” to invest in airports located in close vicinity to Moscow—it makes no sense for the company [14]. Therefore, the privatization instrument cannot be viewed as a panacea, the effectiveness in many respects depends on rationality of application and clear vision of how it has to be implemented.

**Essence of Privatization Program:** Initially, the privatization program was worked out with the aim of simplifying and optimizing the process of privatization for all federal unitary enterprises and joint-stock companies (apart from strategic ones), as well as for land plots, which are fully or partially state property [10]. Besides, the revision of the list and number of strategic enterprises is also envisaged, as well as the setting up of an open database for providing information on objects of privatization and on the course of privatization of federal property [15].

By the beginning of 2009 Russia kept on its balance 3,765 federal state unitary enterprises, as well as the shares of 3,337 joint-stock companies [16]. The selling of these enterprises envisages a long procedure of joint-

stockization and should this process not fit into the time-limit, the privatization will have to be included into next year's plan, which creates additional difficulties. This problem is resolved by a three-year planning, which allows to transfer automatically the unused assets without additional coordination. Besides, the three-year period allows investors to get prepared for the new transaction better and to obtain the required financial resources.

Enterprises, earmarked for privatization, are mostly those of the agricultural sector, science and non-production sphere. On the one hand, it's explained by the desire to retain state control over the strategically important units, on the other hand, it demonstrates that the authorities are not ready to part with the most attractive companies in the spheres of oil industry, medicine, precious metals and stones.

A similar situation is shaping up in the case of distribution by industries included in the program. Absolute leadership is for the companies of agro-industrial complex and in the event of involvement of major investors it may become an effective measure to make domestic agriculture healthier. Enterprises in construction, power engineering and commerce are also quite lucrative and have a big potential. Nevertheless, forecasting is not easy-it's not yet known whether the buyers will get interested in all proposed joint-stock companies in the spheres of polygraphy, science and road infrastructure.

Among large privatization objects for 2011-2013 may be mentioned the blocs of shares in open joint-stock companies, such as: "Apatit", "Prosvesheniye" Publishing House, "Sibir" airlines, "Archangelsky Tralovy" fleet, "Ulyanovsky Moto-car" works, "Murmansky Rybny" port, "Vostochny", port, "Almazny Mir". Also are listed for sale in 2011-2013 the shares in the biggest joint-stock companies: "NK "Rosneft" (25%-1 share), "RusGidro" (7.97%-1 share), "FSK EES" (4.11%-1 share), "Sovkomflot" (50%-1 share), "Savings Bank of Russia" (7.58%-1 share), "VTB Bank" (35.5%-1 share), "Joint Grain Company" (100% prior to 2012), "Rosagroleasing" (50%-1share, not before 3013), "Russian Railways" (25%-1 share, not before 2013). The above examples highlight serious intentions of the Government in this respect.

In regard to separate companies, the reduction of government's participation in the authorized capital might be implemented before 2015 ("RusGidro" OJSC, "Sovkomflot" OJSC, "Rosselkhozbank" OJSC (up to 75%).

The concrete dates and modes of sale of the above companies shall be determined with the account of market situation, coordination of sales with other privatization processes in relevant industries, as well as with the account of leading investment consultants.

The list of open joint-stock companies, which are on the balance of federal authorities, will be supplemented taking into account the outcome of optimization of the state's property structure. Arkady Dvorkovich, President's assistant, said that it was necessary to increase the share of companies for sale and in this way "to make the state pay more attention to the protection of private property, instead of keeping a defense for state assets".<sup>1</sup> The companies, which are operating in competitive environment and have no direct strategic importance should be passed over to private owners without retention for the state of the controlling stake. Oleg Vyugin, a former head of the Federal Service for Financial Markets, is of a similar opinion: "It will be the third stage in the redistribution of property, which will strengthen competitiveness of the Russian business"[17].

It is planned to privatize in 2011-2013 the shares of 35 joint-stock companies, shares in 10 companies with limited liability, as well as 73 objects of other property owned by the Russian Treasury, including objects of real estate, maritime and river vessels [10].

By minimal estimates the revenues from the sale of federal property during 2011-2013 may amount to one trillion rubles [10]. This sum considerably exceeds the entire income from privatization for the whole period starting from the 90-s.

Apart from that, the Russian Government considers the possibility of privatizing in 2011 part of state bloc of shares through "exchange bonds"-a low yield state bonds which can be converted into blocs of shares by which they are secured. The main advantage of "exchange bonds" is the possibility to quickly privatize blocs of shares in joint-stock companies, while the state reserves the right to vote with the blocs of "pledged" shares. In this way xbonds, in fact, represent a postponed privatization. It's also profitable for the Finance Ministry that the yield of such securities is extremely low and makes up 0.5-1% per annum, while the option for the conversion offers, apart from sovereign, additional guarantees for the shares' holders. Such practices are wide spread abroad-xbonds are used in private transactions in the USA and in privatization transactions in the EU, e.g.: privatization of Deutsche Telecom and

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Deutsche Post in Germany from 1996 to 2009, Eni in Italy, France Telecom in France. This experience should be taken into account during privatization in Russia. Notwithstanding, currently xbonds are viewed only as a supplementing tool in privatization: the ultimate volume of such securities for the shares of the Savings Bank is valued at 2.8% of the company's capitalization, in VTB bank-2.9%, "Rosneft" and FSK-2.7%, "RusGidro"-3.3%. Given the current capitalization of the issuers, the placement of xbonds will bring to the Russian government not more than six billion USD in profit-i.e. 20% of monetary indicators for 2011-2013 privatization plan.

Another burning issue concerns privatization of mass-media. President's words regarding the need to privatize media owned by state authorities in his address to the Federal Assembly were commented by his aid Arkady Dvorkovich as follows: "Nowadays it's a useless waste of money. They are for sale, but the timing has not yet been fixed." In our view, this orientation in privatization can hardly get a priority at the moment. On one hand, it's not feasible to gain substantial profit from selling small regional media outlets. On the other hand, transfer of the same print media to private ownership will not change the content and orientation, in all the likelihood it's going to be a formal re-selling of these outlets to businesses which are friendly to authorities.

President's edict on privatization in this part was most resonant with the regional authorities. Oleg Grachev, Chelyabinsky region first vice-governor says: "Media, publishing official information, are directly related to the activities of the power bodies. Such media cannot appear on an empty place-they have heir specific tasks." Further commented Vadim Dubichev, deputy head of Sverdlovsky governor's administration: "The federal law allows the authorities to be media owners, should it be changed, we'll certainly relinquish them. But I don't think it's expedient right now-official mass media depend on budget injections only partially-the rest of the money they have to earn themselves" [18]. In the opinion of Alexei Glazyrin, President of the Russian PR Association, "although the authorities view official media as a good resource for propaganda of their activities, the majority of state media are non-efficient from the point of PR."

### **CONCLUSIONS**

At the present stage of economic development privatization can be an efficient tool in the modernization of Russian economy. No matter how long it might take to

fully implement the program, even if carried out only by a third of its volume, it may considerably change the investment climate in Russia and augment the attractiveness of domestic companies for foreign investors.

Many problems arising in the course of contemporary privatization can be circumvented, if leading economists and analysts become more actively involved in monitoring and assessment of the ongoing process. Their expert opinion may help identify in due time bottlenecks and challenges accompanying such large programs and maximize revenues for the state.

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