THE FUNDAMENTAL PRIVATIZATION THEOREM: IDEOLOGY, EVOLUTION, PRACTICE

Alexander Radygin
Gaidar Institute for Economic Policy
Dean of the Department of Economics of the Russian Presidential Academy of National Economy and Public Administration (RANEPA)
E-mail; arad@rane.ru.

Revold Entov
Full Member of the RAS, Ye. T. Gaidar Institute for Economic Policy (5 Gazetny lane, Moscow, Russia 125993). E-mail: rentov@iet.ru.

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Abstract

The article focuses on the analysis of the evolution of contemporary theoretic approaches to the choice of an optimal form of ownership, and the corresponding estimation of privatization in the context of the advantages and disadvantages of the public and private sectors of the national economy. Various interpretations of the fundamental privatization theorem are considered: based on the principal-agent relationship; based on the comparison of the structure of information flows; the combination of ownership rights and contractual rights; consideration of sociopolitical factors, etc. The latest trends in Russia’s de-statization policy in 2010-2013 are analyzed in the context of ‘reluctant privatization’, with special emphasis on the asymmetry between the statization and privatization processes.

Keywords: privatization, government failures, state policy, public choice, allocational efficiency, information.

Jel codes: H82, K11, L32, L33
1. The Fundamental Privatization Theorem (the ‘Indifference Theorem’)

The modern theory of economics relies on the assumption that there exists no ‘universally applicable’ form of ownership, superior to any other forms of ownership in any country, in any branch or sector of a national economy, unchangingly and independently of any specific historic conditions. The choice itself of a form of ownership usually turns out to be less important than the specificity of the horizontal and vertical socio-economic ties that create a company’s environment. Various ideas have been put forth in this connection on many occasions, including in the framework of the discussion on government failures that has been going on for a few decades: a state company that sells its product in a competitive market (all other conditions being equal, of course) is faced with significantly fewer opportunities for inefficient economic performance than a state monopoly (see [Radygin, Entov, 2012]). This fact becomes even more obvious in the context of theoretical models designed to test privatization efficiency.

Some interesting aspects of that problem were first formulated by David E. M. Sappington and Joseph E. Stiglitz [Sappington, Stiglitz, 1987], who introduced a number of rather tough initial preconditions. Thus, the State always – both in its ‘production’ strategy and in its income distribution and redistribution policy – aims at ensuring maximum public welfare. At the same time, it may lack sufficient information on the production technologies relating to certain goods (or services); all private companies prepared to undertake such work possess identical information. It is supposed that, in actual practice, there are always at least two private firms interested in securing a government order. There is another precondition that appears to be no less significant: the market promotes the existence of a strictly competitive system of auction-based contracts. Given these preconditions (and also some additional ones), privatization may well prove to be unnecessary because the State, by ‘delegating’ via a competition-based auction the relevant powers assigned to a private firm that has offered the best possible terms (from a client’s point of view), may ensure efficient production of goods (or services).

In this case, competitive market mechanisms must play a decisive role. If necessary, such mechanisms may be further promoted by means of special additional government sanctions (indirect subsidies). In their formulation of the fundamental privatization theorem, Sappington and

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1 [Toxilus:] Well, go you off there at a distance out of sight; keep silence. When you see me talking to the Procurer, do you then make a row.
2 In the last century, the Parlement of Toulouse unanimously condemned Protestant Calas, later recognized to be innocent, to breaking on the wheel. Someone, trying to justify this error, cited the popular proverb that there was no good horse who had never shied. To which he got the following response: ‘It is all right for one horse - but a whole stable …’
Stiglitz emphasize the following point: that with the appropriately designed auction, the government, when performing its valuation function, attains all of its objectives (optimal income distribution) in an ideal setting, and so public production cannot improve upon private production, and direct presence of the State in the production sphere becomes superfluous. In order to produce a given good (or service), the government can ensure the ideal outcome via delegation of production.

These arguments bring us back to the issue as to the role of choice between different forms of ownership. The government usually resorts to public production in those situations when it believes it necessary to ensure the supply of certain public or private benefits. However, if producer firms are 'immersed' in a competitive market environment, the public and private forms of ownership may not only supplement, but replace one another.

Nevertheless, there exist numerous circumstances that can significantly modify this theoretic pattern. Thus, one may mention the factors of uncertainty and risk, and at the same time - the fact that private entrepreneurs display different attitudes to risk. So, the winner in a market auction may become an entrepreneur with a high risk propensity (the lowest reluctance to take risks), and not the firm producing a given product at a lowest cost. Besides, an analysis of optimality conditions implies a comparison between entrepreneurs and the government from the point of view of their risk propensity (and the required risk premiums).

The real problem, however, is that the concept of risk propensity, as applicable to government strategy, remains underdeveloped in the contemporary public choice theory. It is evident that even the definition of risk would be significantly different when applied to a private entrepreneur or the government. It will differ even for managers of private companies and their civil service counterparts. Moreover, the risks faced by the CEOs of public companies with their 'strong' political connections (and, consequently, their risk propensity) may also be markedly differ from those risks that the 'less protected' managers with a similar status in the private sector have to deal with. Besides, the routine practice of a political discussion seldom involves any serious consideration of potential risks.

As for the practical aspects of this issue, it should be noted that, whilst analyzing various risks, the government must also somehow take into account the corresponding market-based estimations (comparative risk premiums, potential changes in the solvency levels of certain participants, etc.). Meanwhile, so far even in the countries with best-developed financial markets, the continual emergence of new types of risks imposes constraints on the opportunities for creating competitive ('adequate') risk premiums. The most evident manifestations of 'failures' in that field could be observed in the course of the latest financial crisis [Gerardi, Lehnert, Sherlund, Willen, 2008].

Many problems also arise from the assumption as to the existence of competitive market auctioning mechanisms, in particular in the most oligopolistic sectors of the economy like the arms industry, as well as in the spheres dominated by natural monopolies. In such situations, as demonstrated by existing practical experience, the participants in bidding may coordinate their actions, thus securing additional incomes (rent).

A switchover to public production in such setting does not necessarily means an ultimate solution to the existing problem: the elimination of competitiveness also removes opportunities for strategically comparing different production technologies and managerial methods - that is, it

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3 Stiglitz himself recalls one of the episodes involved in the decision-making by the Clinton Administration: 'It was enormously difficult explaining the nature of the real risk faced by the government' [Stiglitz, 1998, p. 7].

4 The discussion of various aspects of this theme can be found, for example, in Fluck, Kose, Ravid, 2007; Hoppe, Schmitz, 2010; Bowles, Polania-Reyes, 2012; Gneezy, Meier, Rey-Biel, 2011; Fisman, Schulz, Vig, 2012; Bulow, Klepper, 2012; et al.]. Another sphere where, in actual practice, one may observe monopolist conspiracy and lack of proper information for the government acting in the capacity of a client is the outsourcing of contractual services by a core public company to its numerous subcontractors. The high level of subcontractor specialization per se may be in conflict with standard competitive procedures.
restricts the possibility to test different projects and select optimal decisions. In this connection, we may refer to the observations by Niskanen, who argued that bureaucrats tend to provide solutions to such problems by means of expanding the sphere governed by government regulations and further increasing the number of administrative and supervisory bodies (see [Niskanen, 1975; Niskanen, 2013]).

Another aspect of this issue is also noteworthy. Suppose that the government in interested in the appearance of a certain new product. In accordance with the logic described earlier, it will have to make a choice between placing a government order for bidding, on a competitive basis, by private firms or creating a new public company (or expanding an already existing one). In both cases, the authorities make a special contract in order to specify the amount of their payment. The research, development and implementation costs usually exceed the initially planned level. For understandable reasons, the government would then cover the resulting losses (and sometimes allocate funding to cover the operations with insufficient return) incurred by public companies, and not by private ones. It is the public form of ownership that, according to Sappington and Stiglitz, increases the probability of further government intervention - all other conditions being equal [Sappington, Stiglitz, 1987]. As a result, a public company finds itself, at least in part, beyond the realm governed by market discipline. The CEOs of such companies invest much less effort in order to lower their costs - and consequently, to manage their resources more cost-effectively. In the long run, the decisive role in this case will also belong to the overall structure of economic relations in which a given company is 'immersed'.

Suppose, for example, that a public company in possession of a unique new production technology in the course of its privatization has been turned into a private corporation\(^6\). Such a transformation will certainly entail certain changes in its behavior (say, the management will pay more attention to its profit-generating capacity and begin to invest in technologies oriented to less costly performance). However, a simple replacement of a state monopoly by a private monopoly is not going to eliminate the fundamental causes of production inefficiency and the lack of allocational efficiency\(^7\). Nevertheless, a private monopoly can (and, most probably, will) more energetically invest at least part of its increased income in the creation of new monopolistic barriers in order to prevent the entry of potential competitors in the relevant industry.

Moreover, the monopoly's potential for behavior oriented to low performance will increase even further if it secures a strategic place in the economy and may rely on the so-called soft budget constraints (the allocation of government subsidies in an event of financial troubles)\(^8\). Financial support received from the government may significantly exceed the 'simple' revenue generated by a monopoly. In that case, the optimal policy (from the point of view of private profitability) will be to demonstratively refuse to make any new investment and to bring its output volume down below the ceiling determined by a switchover from competitive to monopoly pricing mechanisms. As a result, government costs further increase, because now they are boosted not only by low production efficiency, but also by the financial burden of the new government subsidies.

In conclusion, it should be noted that the consequences of the switchover to private production as determined by the fundamental theorem (similar to other assumptions based on the analysis of Pareto optimality of a market economy and, in particular, the Arrow–Debreu general equilibrium theory) require a number of fixed initial preconditions. These include absence of externalities, fulfillment of all concluded contracts, efficient performance of a institutions, and primarily the situations where the ownership rights pertaining to the model are well-determined and securely protected by law and independent judicial instances.

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\(^6\) The possibility of a state monopoly being turned into a private corporation cannot be regarded as a purely theoretic assumption. Some authors who studied the privatization practices in West European counties specifically point to this trend and offer a detailed discussion of its economic consequences (see, for example Kay, Thompson, 1986; Caves, 1990).

\(^7\) However, this can be said only with some serious reservations. Thus, for example, one important argument of favor of nationalization for many years has been the presence of a natural monopoly, with its typical features (for more details concerning the theoretical model of a natural monopoly, see Mus-Colell, Whinston, Green, 1995).

\(^8\) For a detailed discussion of such a situation see, for example, Segal, 1998.
2. Privatization and Information Flows

The Sappington - Stiglitz analysis centered on the delegation of powers and the related aspects of the principal-agent relationship. Carl Shapiro and Robert D. Willig, however, chose another method for comparing public and private ownership [Shapiro, Willig, 1990], focusing their attention instead on the structures of information flows during the transition from the one to the other form.

The CEOs of private companies relate all the information on their economic activity to their owners who, in their turn, submit it to a certain agency that in one or other way regulates the company's activity (for example, the body empowered to supervise all companies belonging to a given industry). The information on received net income (profit) is of strategic importance. The regulator's status also enables it to estimate the public costs and benefits arising as a result of the operation of private companies. In this connection it is also assumed that the regulatory agency is also capable of monitoring the behavior of a private firm, and primarily its financial incentives, in such a way that can ensure a desirable ('optimal') production volume. The operation of public companies is fully controlled by a direct representative of the government ('minister'). This representative has direct access to all the available information on the profitability of a given public company, and besides, his high 'ministerial' position enable him to estimate the external effects ('externalities') created by that company's activity. On the basis of all that information the minister can make relevant decisions concerning investment in the company's fixed assets and its output volume.

Contemporary theory of economics cannot ignore the existence of private benefits available to government officials – cars, airplanes, country villas and other 'accessories' (practically at their complete disposal). So, the target function that the bureaucrats (ministers and regulators alike) will want to maximize may appear as follows:

$$V = W + \gamma (z_s)$$

where W describes the level of public welfare ensured by a given company's operation; z is its physical production volume; \( \gamma \) is the variable describing the external effects created by its operation; \( \gamma \) is the coefficient that describes the existing potential for the 'bureaucrats' (ministers and regulators) to derive private benefits from the company's operation.

The assumption is that the more efficiently a given political system can control the behavior of 'bureaucrats', the more limited are the opportunities for deriving political rent.

Now we can proceed to the discussion of differences in the structure of information flows, порождаемых choice of the form of ownership. In case of public ownership, all information concerning a company's activity is held by government representatives (a minister and other 'bureaucrats'), while in case of private ownership – by the CEOs of a private company. Any barriers in the way of the information flows from a private company to the government inevitably gives rise to the principal–agent problem (similarly to the Sappington - Stiglitz model). Due to this information asymmetry, the government can identify the unfavorable (for public welfare) effects.

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9 The discussions as to the necessity to nationalize certain operations or introduce government price control in the case of a natural monopoly, see West, 2004. However, lately some significant changes have been noted in that sphere - not only in economic theory, but also in economic practice; in some public utilities sectors, the distribution of product (or services) is subject to centralized regulation, while competitive relations are maintained in the phase of production.

10 From the very structure of the model it follows that the notion of 'minister' encompasses many public officials – from the CEOs of a given company to members of the government. Meanwhile, the existing real experience of the functioning of public companies in different counties testifies to the fact that, as a rule, the reports submitted by such companies are incomplete, and in some cases - even unreliable. The lack of transparency in the economic activity of these companies (which remain non-transparent even for many government agencies) is usually justified and further increased by the considerations that strategic information must be kept secret, and so on.

11 Thus the assumption of a benevolent government (applied in both the Stiglitz–Sappington and Shapiro-Willig models), whose activity aims exclusively at increasing public welfare, is somewhat weakened. So, the model may become, as a result, more realistic.
of the private company's activity only post factum, although the necessary 'corrective' measures ought to have been envisaged by the regulatory body in advance, before the private company had adopted the relevant decision and made the necessary investment.

The paramount importance of the prevailing mechanisms of economic regulation and coordination may be illustrated on the basis of the Shapiro-Willig model. If the regulator can promptly access the information on a private company's profitability level, while at the same time being deprived of opportunities for deriving private benefits from it, the mere fact of privatization or nationalization, in the final analysis (as follows from the model assumptions), has no influence on the level of public welfare (neutrality of the form of ownership).

Moreover, if the existing political system is far from perfect and offers a broad range of opportunities for 'bureaucrats' to enjoy private benefits (in particular in presence of systemic corruption, when the value of coefficient \( \gamma \) (as in the formula above) is especially high, the best results can evidently be obtained by a switchover from public to private ownership. In this connection it should be noted that it is the competitive market mechanisms that represent one of the most effective forces capable of revealing the relevant private information, including information (or at least some signals) that can help determine the profitability of certain companies\(^\text{12}\).

Thus, in presence of certain theoretic preconditions, the choice made by the government between public and private companies when it wants to place an order for private benefits, cannot be based on the assumption of a comparatively better economic performance that can be achieved by a public company. In an ideal setting, as it is called by Sappington - Stiglitz, one can once again observe a similar 'difference': a changeover to 'government entrepreneurship' cannot result in a higher efficiency of public production.

In contemporary economic analysis, special importance is ascribed to the movement of information flows. In the most well-known theoretical models it is usually assumed that only a company's owner possesses full information on all aspects of its economic activity. Consequently, the authorities have at their disposal practically the entire information on the operations carried on by public companies, while the necessary information on the profitability of private companies is lacking. So, the differences between the public and private forms of ownership turn out to be insignificant from the point of view of production efficiency if, say, the government may get timely and full access to all information on the profitability level of a private company (information symmetry).

Such theoretical considerations are, undoubtedly, of some interest and mark an important phase in the development of the theory of privatization. At the same time, as also noted by the authors of these models, such 'ideal' preconditions (including the idea of a benevolent government striving for maximum public welfare) can hardly be taken as a realistic assumption. The problem of information accessibility can also be viewed from a different angle. 'Purely technological' information can probably interest only a company's competitors (the form of ownership being, most likely, irrelevant). As for important financial and economic data, the situation may really become paradoxical: sometimes the government through its tax, supervisory and other agencies manages to collect more information on the operations of private companies than on the activity of public ones, with their 'autonomy' and lack of transparency.

There is also another point that seems to be of especial importance. In the majority of studies aiming at a comparative analysis of the entrepreneurial activity of public and private companies, 'government vs. private entrepreneurship' is treated only as a choice between two alternatives. However, such an approach appears to be grossly oversimplified, to say the least. In fact, in the current phase of economic development, it is difficult to imagine any state-owned entities where the State could be simply 'pushed away' from the sphere of economic relations.

\(^{12}\) By the way, the methods and forms of revealing such information are actually described by one of the authors in another work (Willig, 1985); similar conclusions are made by John Vickers and George Yarrow in their study on the theory of privatization (1989), which later became very well known, and also by Yifu Lin, Fang Cai, Zhou Li (1998).
Besides, in those cases when it is considered feasible to use more extensively the market regulation mechanisms, it is the State that initiates and organizes such a transition, and then exercises practical control over compliance with all the rules of the competitive market 'game'. In other words, no matter what form of entrepreneurship - public or private, government supervisory and regulating bodies must always properly perform their functions. What really matters is the optimal choice of form whereby the contemporary State performs its functions, which are vitally important for society.

3. The Functions of the Public Sector and the Delegation of Powers under Incomplete Contracts

First of all, we are going to address the issue of economic incentives and the role of individual initiatives of managers or rank-and-file employees. In case of private entrepreneurship and competitive environment, labor relations are primarily regulated by the demands of market discipline. A private corporation, if it sticks to outdated technologies and/or inefficient methods of production organization, is usually doomed to bankruptcy (or takeover), with the resulting mass-scale dismissals of personnel. It is clear that competition - including rivalry on the labor market - under certain conditions may create incentives for the administrative personnel to strengthen the competitive capacity of their company. Moreover, long before the appearance of the first signs of impending bankruptcy, the information coming from financial markets (for example, a stable decline of demand for a given company's stocks) may serve as an unequivocal piece of evidence pointing to a lack of competent managerial decision-making.

Other criteria are usually applied when it is necessary to choose an appropriate economic project to be implemented by a public company: the project must be primarily orientated to increasing the level of public welfare, and in many cases its goal is to provide solutions to those problems that cannot be solved in the framework of private entrepreneurship (in this connection, the assumption concerning 'benevolent' government agencies is still regarded as a relevant one). In this case, even long-standing consequences of inefficient performance do not always serve as sufficient grounds for rejecting the planned project and liquidating the public company (such is the effect of soft budget constraints). If 'unplanned' losses begin to increase in the course of performing important tasks, public companies always rely on additional government subsidies\(^{13}\). For them, there is no threat of a forcible takeover (or seizure), either. At the same time, acting in the capacity of a principal towards the staff of a public company, the government may behave like a private owner. Thus, a comparative analysis of the number of personnel recruited by different companies can testify to the fact that, all other conditions being equal, the number of employees in public companies are usually higher than in their private counterparts\(^{14}\). Thus, the administrative personnel of a public company not only feel that they are better protected from the threat of mass-scale dismissal - they may also spend comparatively less effort on sustaining the abstract notion of their company's 'competitive capacity', in particular the orientation towards lower production costs. These considerations are also true - and even more so - for the planning of long-term investment projects. As proved by experience, these are usually oriented towards satisfying the requirements to the quality of products supplied to the State that are set by the relevant government agencies.

However, for the aforesaid reasons (and for some other reasons as well), these efforts to improve product quality seldom result in any breakthrough discoveries and promising innovations. So, it is not by chance that the industries selected for nationalization must answer the following

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\(^{13}\) Empirical studies in this field prove rather convincingly that in transition economies and well-developed market economies alike, public companies are usually granted much higher government subsidies by comparison with private companies.

\(^{14}\) Some significant differences can also be observed in the relations of public company with its private suppliers. As demonstrated by numerous observations of the behavior of such companies, when they act as clients, they often do not object to the suppliers' policies aimed at raising their selling prices.
requirement: their functioning must have a very low dependence on the success of their innovation activity.\(^\text{15}\)

The history of government entrepreneurship points to its limited ability to ensure scientific and technological breakthroughs and increase a given industry's competitive capacity by introducing measures designed to artificially isolate that industry (or an enterprise) from the effects of competitive mechanisms existing in its economic environment.\(^\text{16}\) It is not by chance that a vast majority of successful businesses operating in developed countries, whose names are the epitomes of success in the hi-tech field, grew and gained their strength outside of the public sector.

In contemporary economies, the innovation activity and high productivity in the strategic industries, as demonstrated by the results of numerous empirical studies, depend on the presence of (private) initiative and a sufficiently intense competition. William J. Baumol chose this title for his book published in 2002: *The Free-Market Innovation Machine: Analyzing the Growth Miracle of Capitalism* [Princeton University Press, 2002.]. Thomas J. Holmes and James A. Schmitz, Jr., on the basis of their in-depth review of scholarly works, describe their results as follows: ‘Nearly all the studies found that increases in competition led to increases in industry productivity. Plants that survived these increases in competition were typically found to have large productivity gains, and these gains often accounted for the majority of overall industry gains.’ [Holmes, Schmitz, 2010, P. 639]. Thus internal conflicts can be revealed, which are associated with nationalization of some of the industries (or companies) that occupy strategic positions in the contemporary economy. On the one hand, the broader opportunities open for public companies arise from the fact that they can operate beyond the limits imposed by the narrower, purely commercial considerations that govern private companies.

On the other hand, such an activity inevitably implies that these exists a certain system of incentives, control and performance regulation, which functions with the same level of efficiency as the system of commercial incentives and market discipline mechanisms; otherwise the operation of public companies will be fraught with increasing losses and the resulting burden on society. This latter factor, as proved by the experiences of economic development in the USSR in the 1960–1980s, becomes especially prominent when the authority, with the advantages offered by the public form of ownership, launches ambitious projects in conditions of a comparatively low labor productivity and capital gains.

The analysis of ownership rights and the choice between different forms of ownership in a market economy is inseparable from the issue of compatibility of ownership rights and contractual rights.\(^\text{17}\) Recently, the comparison of the performance of public and private companies in Western economic theory has been increasingly linked to the concept of incomplete contracts put forth by Sanford J. Grossman and Oliver D. Hart [Grossman, Hart, 1986]. In their paper dedicated to the 25th anniversary of the publication of Grossman and Hart's, Philippe Aghion and Richard Holden specifically point to the connection of the theory of incomplete contracts with the choice of private or public ownership of a firm (see Aghion, Holden, 2011, p. 188–189).\(^\text{18}\) If the relations between

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\(^{15}\)&#x2003; This, of course, does not eliminate the vital need of private innovation-oriented businesses, especially those operating in the hi-tech sectors, for comprehensive support by the government - including financial support.

\(^{16}\)&#x2003; Most sources point to the fact that government-initiated innovation in the past was usually fragmentary and unsustainable, implemented at a relatively low pace. See G. Mulgan, 2011, p. 259.

\(^{17}\)&#x2003; In a post-socialist economy, the transition to economic relations formalized as contractual agreements has specific socio-economic importance. Under a 'socialist' government system based on specific authority-ownership relations, it was necessary to copy the most basic human rights, including many rights of citizens stipulated in the law or official agreements. This situation was by no means the manifestation of failures of the (democratic) state, but one of the necessary conditions of the 'normal' functioning of a totalitarian state. The transition to democratic society and market relations was followed by narrowing of sphere governed by the universal centralized regulation and control system. That is why, in a transition economy, it appears to be of especial importance to create mechanisms for civilized enforcement of the property rights and contractual rights of each participant in the economic process.

\(^{18}\)&#x2003; For the discussion of the relationship between property rights and contractual rights in a Russian source, see Radygin, Entov, 2001.
a public company and its employees are regulated by a long-term contract, the standard theoretical model of property rights, according to Hart, may become useless (see Hart, 2003).

Thus, when contracts are inevitably incomplete, the theoretical model described by the Sappington - Stiglitz fundamental privatization theorem needs to be significantly adjusted. Following the model's logic, when at least some of the operating private entrepreneurs can ensure better results (lower costs, higher product quality), the State can identify these companies by means of an auction, and then contract them for the production of some good (or the rendering of some service). However, it becomes obvious that such a contract will inevitably be incomplete.

At the moment when a contract is concluded (ex ante), both parties simply do not possess all the necessary information. So they cannot come to an agreement and enter into the contract the information concerning, for example, the scale of optimal investment (from the government point of view) in technologies capable of lowering production costs and/or improve product quality, as well as the optimal distribution of powers between the participant in the production process, etc. Consequently, those private entrepreneurs who have won in an auction, will have well-justified concerns that the additional efforts and expenditures needed, say, for improving the quality of products, may well remain uncompensated (the difficulties involved in the estimation of quality of most types of goods (or services) only strengthen such concerns).

The concept of incomplete contracts also helped to analyze the ratio of optimal to real relationship-specific investment. This issue can be illustrated by the contracts that companies usually make with their administrative personnel. In most cases, managers are required to have the qualification level enabling them to provide (best) solutions to any technological or organizational problem arising in their sphere of governance over the period of their contract. In order to comply with these requirements, the applicant for a relevant post can, in advance, make 'special' investment – that is, invest in human capital. That human capital will become the future manager's property. It is a well-known fact that the role of such 'specific' knowledge and skill may become of especial importance.

However, the relevant requirements and rights cannot be properly stipulated in a contract, they are non-contractible. And the applicant for a managerial position naturally has doubts as to whether the material means and efforts representing his 'special' investment, i.e. knowledge and experience fully applicable only for this particular type of production, can indeed be compensated by an adequate income. As noted by Jean-Jacques Laffont and Jean Tirole, such doubts are especially appropriate when one applied for a managerial position in a public company, because it displays more bureaucratic features and far less flexibility in promoting timely professional reactions on the part of managers [Laffont, Tirole, 1991]. As a result, at least part of the managerial personnel refuse to make such 'special' investment, which has a negative effect on the governance of public companies.

In those cases when there is a significant difference between the interests of principal and agent, the classical theory usually recommends the so called incentive contracts, based on a system of strong incentives. However, as shown in a number of studies (see, for example, Wilson, 1989; Dewatripont, Jewitt, Tirole, 1999), it is in the public sector that the attempts to apply effective incentive schemes result in a conflict, for the following reasons:

- the comparatively narrower range of powers granted the majority of officials;19
- the essentially non-market services delivered by public entities;
- lack of necessary information and the difficulties inevitably involved in the estimation of the performance level of public employees;

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19 The range of powers granted to CEOs employed in the private sector of the US economy is far broader than that granted to their counterparts in civil service (see, for example, Zeckhauser, Horn, 1989).
the comparatively weak incentives for public CEOs to monitor the activity of their staff due to absence of market discipline, or its insufficiently strong effects (for more details, see Lott, 1987)\textsuperscript{20};

- the opportunities for deriving political rent.

Among the other factors caused by the specificity of contractual relations that can be added to this list, we shall point out only the frequently observed cases when the government fails to fulfill its contractual obligations to public employees (the State, responsible for enforcing contractual discipline, may itself turn out to be non-contractible).

The system of incentives itself turn out to be very specific. The criteria applied to identify the instances of successful performance of public employees only rarely include the initiatives aimed at frugal spending of the expenditures earmarked for the delivery of some or other services. Incomplete 'implementation' of budget resources is more often treated by politicians as a sign of inadequate performance of government departments.

So we have been discussing the methods of remuneration - 'positive' incentives for the best-performing public employees. However, it is sometimes even more difficult to estimate the practical use of sanctions against the worst-performing ones. The consequences of poor economic performance in conditions of a competitive market are usually pretty obvious, while the disciplinary sanctions are by no means always properly and inevitably imposed on a poorly performing employee in a government apparatus\textsuperscript{21}, and even the dismissal of an employee (or another form of administrative punishment) cannot always be regarded as a consequence of poor performance.

Due to the impact of all these factors, the production performance level of public companies in actual practice, as a rule, is found to be lower than that of private corporations. The more general issue of allocational efficiency is somewhat more complicated, because it involves a number of additional considerations; the amount of created consumer surplus may be influenced, for example, by the specific pricing policies of private and public companies. This, in the presence of some evident sighs of the danger of escalating inflation, the government may for a certain period of time suppress the growth of tariffs for the products of some state monopolies. However, in those cases when public companies declare their high losses, the government, as noted earlier, may allocate to them special subsidies, thus effectively providing them with additional funding set against the corresponding amount of tax revenues withdrawn from the income of the population and private companies.

Throughout our discussion so far we have relied on the assumption of a benevolent government, which focuses all its efforts on achieving the goal of maximum public welfare. It is a well-known fact, however, that contemporary political theory treats such assumptions with considerable skepticism (see, for example: [Theory and Methods in Political Science, 2010]). Besides, it should be borne in mind that the notion of what exactly public welfare is (and so, what it means exactly to maximize it) turns out to be simply non-operational when applied in actual practice\textsuperscript{22}. This circumstance significantly weakens the position of standard utilitarian models\textsuperscript{23}.

\textsuperscript{20} Besides, these CEOs must pay comparatively more attention to 'sensational' events (the worst instances of deceit and power misuse) instead of their daily routine duties (estimation of the ex ante system of rules for governing an organization) (see Vining, Weimer, 1990, p. 15).

\textsuperscript{21} Thus, RF Minister of Finance Anton Siluanov noted in one of his interviews: 'For example, today there exist federal targeted programs (FTPs), but none of the officials responsible for the implementation of a FTP has been dismissed for failure to properly implement it, or failure to achieve the specific results stipulated in the FTP. They have not been properly scolded, or issued a reprimand'. (Izvestia [The News], 2012, 7 March).

\textsuperscript{22} This has to do, in particular, with the problems of how to measure (and compare) aggregate welfare, the choice of criteria to estimate its growth, the justness of revenue (wealth) distribution, etc. It appears an even more complicated task to reveal the interrelations between the economic and non-economic factors of welfare. Suffice to remember in this context the ongoing active theoretical discussion of the Easterlin Paradox (Stevenson, Wolfers, 2008).

\textsuperscript{23} For these reasons, utilitarianism no longer offers a certain finite set of measures, to be applied in government politics because it is distinctly superior to all other approaches. Modern utilitarianism, notwithstanding its radical legacy, no longer represents a well-defined political standpoint. See Kymlicka, 2010, P. 77].
It must be added that contemporary economic theory is increasingly focusing on the self-serving acts of 'bureaucrats' and/or 'politicians', which may significantly modify the general policy of any government (see Niskanen, 1971; Acemoglu, 2007; Alesina, Tabellini, 2008, etc.). Thus, it is rather easy to demonstrate that in a situation when one has to deal with a malevolent, not benevolent, government, privatization may result in more benefits for society. In particular, this is even more true in those situations when public companies get involved in costly projects which are very profitable for their CEOs, and/or when the activity of such companies is shaped under the influence of certain interest groups. In such cases, genuine involvement of public companies in the system of relations governed by market competition can boost both their production and allocational efficiency.

The general postulate of a benevolent government usually implies the presence of many other 'ideal' preconditions. This, in the theoretical model described earlier, is usually assumed that the State (that is, the government), when considering the list of potential candidates to the top managerial positions in a public company, is always governed by purely business goals, and so selects only the most competent, gifted and diligent workers.

In actual practice, however, their personnel recruitment policy may be strikingly different from such 'elegant' theoretical structures. In reality, the government officials ('bureaucrats'), as well as their relatives and friends assigned 'places of honor' in the higher echelons of power inside public corporations (similarly to top managers with some access to the levels of state power), are focused first of all on strengthening the monopolistic position of a given public corporation and increasing its income. Elimination of competition and creation of an oligopolistic (or monopolistic) structure, in its turn, further weakens both production and allocational efficiency.

All these considerations, of course, do not imply that the presence of strong external effects cannot give rise to serious arguments in favor of nationalization (at least temporary) of some big companies occupying strategic positions in the national economy. This switchover to public ownership must not be accompanied, however, by dismantlement of currently existing competition mechanisms. Besides, all the operations carried on by the newly created public companies must probably be made absolutely transparent for official public control.

The experiences of some West European countries have demonstrated that temporary nationalization in certain sectors can help in accomplishing their organizational restructuring and technological modernization. At the same time, in the current phase of development, the existence of a powerful public sector cannot really be regarded as an indispensable attribute of the production sphere in any country.

4. 'Government Failure': the Role of Socio-political Factors

To view the specific features of the public sector's functioning and the associated failures separately from the effects of the multiple political factors that shape up the everyday activity of the government would have meant to grossly oversimplify things. So, here we are going to discuss the influence of some of the existing socio-political forces on the general character and forms of government participation in the economic life of a given country.

Among the works that rather schematically present the influence of political factors on the functioning of the public sector in a national economy, we may point to the article by Bruno Biais

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24 A typical example of this phenomenon can be found in the 'classical' work of Laffont and Tirole (1993). Thus, in some instances it is the government itself that exerts pressure on public military-industrial companies, discouraging them from entering in any form of competition with private corporations manufacturing civilian products, although the production capacities of public enterprises may be at that time strongly underused, and besides the production costs of civilian products manufactures by them could be much lower.

25 One example will suffice. In early 2012, The Economist (UK) published a special report, The Rise of State Capitalism, addressing the public sector issues in the post-socialist and some developing economies. State-owned companies, as noted in the report, provide comfortable berths for leading politicians and their children and hangers-on. Institutions that are nominally owned by the people have been taken over by ruling elites...' (State Capitalism // The Economist, 2012, 21 January, P. 15).
and Enrico Perotti (Biais, Perotti, 2002). For simplicity's sake, the authors subdivide the entire population of a country into three 'classes': the rich, the middle class, and the poor. In this connection it is assumed that in the country under consideration there are two political parties – the rightist and the leftist; the rightist party's entire activity is aimed at protecting the interests of the rich, while the leftist party aims at maximization of a certain aggregate target function of the poor class. The analysis centers around the question as to how the political rivalry between these parties may influence the size of the public sector and the specificity of its functioning.

Assume that, as a result of certain choices, the rightist party's representatives come to power. Then, in order to protect the interests of society's richest strata, the party will certainly reject all the nationalization projects. This rejection will be caused not only by the fact that, to buy out big stakes in the companies earmarked for nationalization, the government would need to approve substantial budget allocations (because the bulk of stocks will have to be bought out from their rich owners at a high price). The subsequent less-than-perfect economic performance of the newly created public companies would have required the allocation of further government subsidies. The attitude of the rightist parties to the idea of government ownership of businesses is especially hostile in those countries where income tax is steeply progressive, and so rich families have to shoulder a substantial share of taxes. At the same time, the rightist party will be striving to restrict the scale of income redistribution in favor of the poorest strata.

The representatives of the rightist party, once in power, are more inclined to undertake privatization - at least with regard to some comparatively unsuccessfully performing public companies. In such instances, the change in the form of ownership displays a more decisive character, because right-wing governments seldom desire to secure at least partial control over the companies being privatized (for example, by leaving a certain amount of stocks in public ownership, or introducing to the golden share rule). In addition, right-wing governments more often resort to privatization as an important instrument of boosting current economic activity.

If the leftist party wins in the election, the course of events would be different. Then, the government consisting of representatives of that party (with their (as a rule) comparatively narrower planning horizon) will, most likely, support the projects aiming at nationalization of private corporations. At the same time, they will be insisting on setting a low asset buyout price, because the poorest strata usually hold a comparatively small amount of stocks.

The less-than-perfect economic performance of the newly created public companies that the government will have to somehow deal with later on is by no means an important consideration in the eyes of leftist politicians. It is usually supposed that the insufficient revenues (or losses) will be set off primarily against the high taxes levied on the incomes of rich families. In the event of undertaking privatization programs, the left-wing government insists on selling public property at comparatively higher prices. By doing this, they can get more money that can then be redistributed in favor of the poor.

The pre-election political struggle between the rival parties gives rise to strategies aiming at attracting the middle class to their side. Thus, the rightist party may suggest, for example, that some of the existing public companies should be transferred to private owners; in this connection it is planned that the bulk of stocks will be sold at an attractive (for the buyers) price to rich families and the middle class. So, privatization coupled with easy access to stocks for families with medium income may prove an important tool for winning middle class votes for the rightist party.

Need it be specifically added that such political maneuvering is motivated only by the desire to get better of one's political rivals, and not by any lofty goals of increasing public welfare? A change in the form ownership, similarly to the choice between the most urgent expenditures needed for public development, and pork barrel expenditures (government spending intended to benefit constituents of a politician in return for their political support), in this case is the upshot of the election campaign maneuvers of political parties. These quid pro quos within the afore-said

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26 For an overview of empirical studies in this field see, for example, Bortolotti, Milella, 2008.
27 The policy of low tariffs on housing and utilities, public healthcare, public education and other government-funded services pursued by a left-wing government may exacerbate the financial problems faced by the public sector.
political and economic structures may evidently be classified as an illustration of long-term government regulation failures.

One of the first theoretical models of the interaction between politicians and private companies was developed by Andrei Shleifer and Robert W. Vishny [Shleifer, Vishny, 1994]. The authors present many examples of public and private companies, but also 'mixed' forms of ownership by the State ('treasury') and private shareholders. On the basis of their own observations and the results of a number of empirical studies, the authors put forth their core thesis that one of the main causes of low performance of state-owned enterprises is the presence of redundant workforce. Their privately owned counterparts employ noticeably less labor resources.

The higher demand for workforce displayed by public companies helps bring down the unemployment level and ease social conflicts. By allowing this, the political party in power may effectively increase its share of the popular vote.

To avoid the extra problems associated with the delegation of powers, the authors assume that the owners of private companies also act as their managers. Their demand for labor is regulated by the constraints imposed by market discipline. However, by offering progressively beneficial financial conditions (increasingly high subsidies), politicians may create incentives for private companies to keep on their redundant personnel.

The upshot is a sort of game where both parties – the politicians and the companies – are trying to derive highest benefits. It is easy to notice that the structure of this theoretical model strongly resembles the famous Coase models. But in the Shleifer -Vishny model, the role of side payments is played by 'corruption money' (bribes), freely changing the participants' hands. By means of such payments, one party may urge the other to change the number of personnel hired by a private or public company and/or to grant (or terminate) additional subsidies.

The game is organized in such a way that its participants can achieve the Nash equilibrium. It turns out that at the point of equilibrium the allocation of resources and aggregate employment level essentially do not depend on whether the redundant workers are employed by public or private enterprises. In conditions of achieved equilibrium one can observe the already mentioned indifference relations: in presence of these assumptions, the issues of ownership become of secondary importance, and a change in the form of ownership per se cannot remove the existing misbalances and ensure a more efficient use of the available production factors.

Thus, the analysis of the relations between politicians and companies in the framework of the Shleifer-Vishny model proves that the role of the form of ownership may become secondary not only in conditions of competitive markets, but also when economic activity is regulated by corruption mechanisms (extension of commercial incentives and payments to the areas where these are not allowed by the rules of game). It should be noted, however, that when the corruption methods are applied, the resulting equilibrium is not Pareto efficient. Most frequently, it is associated with inefficient allocation of resources.

It is easy to see that the methods employed in the enforcement of these informal obligations may be gradually perfected by the practices of the corrupt bureaucratic apparatus. In a transition economy, the 'policy' planning horizons can be particularly narrow, and the public control mechanisms very far from perfect; thus, many components of the continuing centralized regulation will inevitably fail.

When formulating their general privatization theory, Shleifer and Vishny (in collaboration with Maxim Boycko), as in their previous works, specifically emphasize the desire of political activists to capture the majority of public vote by making public enterprises keep their redundant workforce. Evidently, when enterprises are privatized, representatives of these political parties must create incentives for their private owners (the CEOs of privatized companies in the theoretical models described earlier) to shoulder the excessive labor costs.

So the authors assume that even after privatization is completed, the government may continue to heavily subsidize from the budget those private companies that continue to keep the redundant workforce on their payroll. A prompt switchover of privatized enterprises to the system of hard budget constraints should be conducive to a more efficient distribution of resources. At the
same time, it is obvious that politicians and 'bureaucrats' would be reluctant to let go of their right to dispose of the revenue flows. All these considerations (in conjunction with other corruption-related factors) may urge them to resort to various forms of 'nomenclature privatization' [Boycko, Shleifer, Vishny, 1996, p. 313–314].

In such a context, one more example for the application of the aforesaid principle of indifference with regard to forms of ownership: the government, being interested in maintaining a higher employment level ('redundant' employment), may introduce some additional indirect allocations to make private companies to stick to their old technologies based on higher labor input. As a result of 'understanding' achieved between CEOs of private companies and politicians, the continuing inefficiency will become fully internalized. ‘… The same level of extra employment is reached regardless of whom has ownership and control rights over the firm’. [Bortolotti, Siniscalco, 2004, p. 9].

The thesis of workforce redundancy being a typical feature of public enterprises can hardly be regarded as absolutely far-fetched. At certain stages of development in post-socialist transition economies this problem may increase to a critical scale. One illustrative example is the so-called transformational slump in the Russian economy.

So, the rapid production decline over the first half of the 1990s revealed the presence of an impressive number of 'redundant' workers, whom the directors of big state-owned enterprises tries to keep employed, and were allocated for this purpose huge financial subsidies from the federal budget. Suffice it to say that in some years, nearly quarter of all the workers registered as employed by Russia's big and medium-sized public enterprises, in actual practice were put on compulsory (so-called) 'administrative leave', or worked on a part-time basis.

The essence of the problem, however, is that these processes are inevitably imbalanced. Moreover, all other conditions being equal, it is privatization that specifically results in a more efficient use of available labor resources. Insider privatization, of course, made it convenient for the former CEOs of public enterprises (red directors) to keep the bulk of redundant workforce at the newly created privatized enterprises, but the results of all these efforts were short-lived. The effects of the emerging market forces made private entrepreneurs to gradually adopt other, more efficient forms of labor process organization.

To keep the redundant workforce employed in the public sector of the national economy and soften the problem of part-time employment is by no means the only method whereby politicians can capture the majority vote. In some countries, a substantial proportion of seats in elected legislative bodies is still held by deputies from the communist parties (or other leftist parties), whose program documents are continuing to call for 'direct government management' of the national economy and various other forms of nationwide planning, which rely on a prominent presence of the State in the economy. Not only the representatives of leftist political forces, but also the proponents of different 'patriotic' movements are often inclined (especially when faced by industrial slump and increasingly acute financial problems) to impose constraints on the 'alien' market forces in order to make the national economy 'more easily manageable', and the role of the so-called 'manual regulation' - more prominent.

Due to all these circumstances, now and then politicians begin campaigning for increasing the role of the State in the economic sphere. During such periods, new public companies can be created and endowed with a very broad range of powers. In some cases, there may emerge a trend towards nationalization of an entire industry (or several industries). The advantages perceived in the creation of big public companies are associated with their easier 'manageability', which makes it possible for the government to 'prevent the evolvement of a crisis' in the relevant industry, with its subsequent technological restructuring.

However, there also arises one very serious problem - the very low transparency of all the aspects of economic activity of such companies. The occasional audits invariably revealed instances of large-scale embezzlement and misappropriation of budget allocations. In many cases, all the considerations of production targets and allocational efficiency appeared to be of little importance to the management.
At the same time, in a number of studies addressing the issues of the public sector's functioning and privatization it is emphasized that for the politicians who have put forth the initiatives aimed at 'statization' of entrepreneurial activity, any losses resulting from inefficient management and squandering of allocated funds only serve as yet another argument in justification of still more budget allocations. The desire for statization of the economic activity and centralization of the decision-making mechanisms is usually manifest of hopes for achieving 'better manageability' of economic processes. Meanwhile, two decades have already passed since Stiglitz came forth with his observation that while everybody is convinced in the necessity of diversifying the market asset portfolio, the diversification of the decision-making processes is quite a different matter altogether [Stiglitz, 1991, p. 31–32].

5. 'Reluctant Privatization'

An important role in 'nurturing' this trend may also belong to the specifically rent-oriented behaviors of politicians and government officials. Greater presence of the State in the economy opens up more opportunities for deriving private benefits of all sorts, which may result in the emergence of a certain seemingly 'technical' asymmetry in the government's behavior. Thus, any proposals concerning the possibility of 'de-statization' of big public enterprises inevitably give rise to lengthy discussions based on cumbersome organizational and coordination procedures and requiring thorough preparations. Prior to their implementation, privatization projects usually have to overcome many obstacles. At the same time it often happens so that relevant decisions as to the creation of new 'close-ended' public companies or aggressive cartel enforcement in the strategic industries under the aegis of major public enterprises are often adopted quietly, as part of everyday routine. Usually this takes place without any special reference to the legislative bodies.

If we compare the history of nationalization and privatization processes over the past few decades, their asymmetry will become obvious. Giant public companies or conglomerates are usually created at the stroke of a pen or, in any case, very rapidly, without any preliminary public discussions. As for privatization, the situation is fundamentally different. The potential advantages resulting from privatization, including those in the fiscal sphere, have been discussed for years (and the discussion is still underway). The plans for 'partial privatization' of some of the existing public companies have been repeatedly postponed for various reasons over the years, and further adjusted, and sometimes there were unequivocal signs of the policy's reversal.

The presence of such asymmetry is a clear indication of the traditional preference for administrative methods, while at the same time this phenomenon may reflect the already noted reluctance of the ruling elites to let go of their well-tried power levers and sources of income. In the theoretical literature on the subject, an appropriate term was created at the turn of this century – reluctant privatization [Bortolotti, Facio, 2004].

The specific features of this particular type of privatization have been identified by the authors on the basis of their data collected in Italy. Over several recent decades, the Italian government has been energetically pursuing a privatization policy based on formal criteria. By the amount of revenue generated as a result of privatization since 1993, Italy comes third in the world. However, the government still retains a leading position in many of the 'privatized' companies.

Thus, by late 2000, the government held the biggest stakes in approximately 30% of all 'privatized' companies. By late 1996, the government has secured the so-called golden share in 62.5% of all privatized entities. As a result, by late 2000, the government had retained control over more than 60% of all privatized companies. Moreover, the companies where the government had

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28 See, for example, Afonso, Fuceri, 2010; Baland, Moene, Robinson, 2010; Besley, 2011; Figlio, Kenny, 2009; Klomp, De Haan, 2009; Simmons, 2011; et al. For the description of the model in which it is the political risks associated with the operation of public companies that act as the factor urging the government to allocate additional subsidies to them, see, for example, Sheshinski, Lopez-Calva, 2003.

secured a leading position, as a rule, belonged to the category of biggest corporations, with the highest market capitalization index. Among the potential advantages available to the companies thus 'privatized', the authors mention, in particular, loans granted on preferential conditions, guaranteed contracts, more lax regulation system, etc.

The phenomenon of reluctant privatization per se is fully compatible with the signs of inertia associated with the increased presence of the State. We should like to add in this connection only one point. Sometimes the already mentioned 'short-sightedness effect' can be observed. This happens because the negative consequences of a switchover to market strategies may soon become distinctly visible: the number of unemployed increases, while the salaries of part of the employed personnel may be subject to cuts.

Of course, all these developments may instantly weaken the political position of ruling political group. Meanwhile, production reorganization and improved economic performance are much more lengthy processes that evolve over a longer period and can be masked by other 'background' trends. Besides, the government usually prefers not to encourage a broad public discussion of the issue of feasibility of keeping so-called strategic companies in public ownership30.

Many of the projects envisaging sale of strategic blocks of shares in public companies, also stipulate that the golden share should remain in the hands of the government. In a majority of cases, the actual powers retained by the State are not properly outlined, while any arising disputable cases are usually interpreted by judicial bodies in favor of the executive authorities. So, once again, government officials are granted broad opportunities for enforcing their own managerial decisions (or imposing constraints). As demonstrated by the results of some studies (Borisova, Brockman, Salas, Zagorchev, 2012), if a golden share in 'mixed-ownership' companies remains in the government's possession, the quality of corporate governance becomes very low.

And this happens not only because these features of reluctant privatization predetermine its purely formal nature. How efficient is the performance of those companies where the State largely retains its prevailing (or significant) share in ownership and overall control? Empirical studies point to the fact that, if the State remains a majority shareholder, the performance of companies after such 'reluctant privatization' improves only slightly [Boubakri, Cosset, 1998; Boubakri, Cosset, Guedhami, 2004]. Typical signs of 'reluctant privatization' can most often be observed in the developing economies, where the governments, for understandable reasons, are particularly wary of the effects of market forces, which determine capital inflow and outflow.

It is easy to notice that a similar situation is also typical of Russia. In 2011–2013, alterations in the sphere of government privatization policy were going on as before, at a rather high pace. One may point out some relevant innovations in legislation (Federal Law of 31 May 2010, No 106-FZ 'On Introducing Alterations in the Federal Law 'On Privatization of State and Municipal Property'), new political declarations aimed at speeding up the privatization process, new applied technologies for electronic bidding, the development of strategies for federal state unitary enterprises (FSUE), withdrawal of top government officials from boards of directors, expansion of the existing methods applied in the transformation of state unitary enterprises, etc.

Over the period 2012–2013, active discussions were under way with regard to some new strategic documents: The Concept of Federal Property Management for the Period until 2018, which was to replace The Concept of Public Property Management and Privatization in the Russian Federation adopted in 1999, and the Government Program Federal Property Management for the period 2013–2018 (approved by Regulation of the RF Government of 16 February 2013, No 191-r). So, the task of elaborating and implementing Russia's 'new' privatization policy in the period 2009–2013 was one of the government's priorities.

30 'I find it surprising that privatization advisers or international development agencies often do not challenge or question governments when they classify a long list of companies as strategic and plan to keep them in state ownership.' [Robert E. Anderson, Just Get Out of the Way: How Government Can Help Business in Poor Countries. Washington, DC: Cato Institute, 2004. P. 102].
But simultaneously, the existing program documents reflect prospects for expanding the government's participation in the economy. In *The Concept of Long-term Socio-economic Development of the Russian Federation for the Period until 2020* (approved in 2008), it is noted that the public sector is a natural component of Russia's economy, and that the role of government entrepreneurship is traditionally prominent. Nevertheless, as far as public property management (the management of some property categories) is concerned, this document is geared in the main to the same approaches as were stipulated in the previously adopted government programs of the 2000s. The latest *Concept*'s distinctive feature, however, is the requirement that the composition of public property be compatible not only with the powers and functions of the government, but also with the structural changes taking place in some or other sectors of the national economy.

The proposals aiming at proper regulation of the public sector's expansion and making it a top economic policy priority\(^{31}\) were reflected, in the form of declarations, in the program documents adopted over the period of 2011–2013; at the same time, these proposals, with the exception of those relating to privatization, have remained outside the domain of legislative norms. Nevertheless, adequate solutions are still needed to the following issues: the feasibility of subdivision of big state-owned conglomerates into smaller entities (creation of separate sub-holding companies); withdrawal of assets unrelated to companies' core activities; the imposition of legislative constraints on the formation, in the future, of state-owned integrated structures; the acquisition of new assets by public companies and their dependent structures, in particular their participation in privatization in the capacity of buyers. Simultaneously, due to the very vaguely defined role of the public sector, since the mid-2000s another process has been underway - that of creation of public corporations and other development institutions. The current strategy's vagueness ('from general institutional environment to effective projects' - or, *vice versa*, 'to each project - its own institution') has determined the choice of a seemingly easier way. One of the 'applied' problems arising in this connection is how to transform such structures, later on, into some organizational-legal forms that would be better understandable and more transparent for the market.

As far as the plans for privatization of biggest companies in Russia are concerned, the 'safest' variant (from the point of view of administrative management) that has been already discussed for a long period of time, is as follows: a certain amount of shares in the 'privatized' companies is sold to private owners, while the majority of ordinary shares (or votes) is left in the hands of the State. In other words, the right to receive dividends (and in some cases, also the foreign exchange gains) it treated strictly separately from the right to manage and control the company's operations, which is retained by the State. In this connection, the data shown in Table 1 are quite illustrative.

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**Table 1. The Evolution of Privatization Plans for Russia's Biggest Companies, 2010–2013**

<table>
<thead>
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<tbody>
<tr>
<td></td>
<td>initial version</td>
<td>as amended by Regulation of the RF Government of 20 June 2012, No 1035-р</td>
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<tr>
<td></td>
<td>stake size</td>
<td>timelines</td>
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<tr>
<td><strong>Rosneft</strong></td>
<td>25% minus 1 share</td>
<td>2011–2013</td>
</tr>
<tr>
<td><strong>RusHydro</strong></td>
<td>7.97% minus</td>
<td>2011–2013 (or 2016)</td>
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</tbody>
</table>

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\(^{31}\) See, for example: [Strategy 2020, 2013, Book 2, Chapter 20, pp. 187–215].
<table>
<thead>
<tr>
<th>Company Name</th>
<th>Initial Ownership</th>
<th>Required Percentage</th>
<th>Required Action</th>
<th>Date Range</th>
<th>Final Ownership</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Grid Company of Unified Energy System (FGC UES)</td>
<td>4.11% minus 1 share</td>
<td>reduction of government stake to 75% plus 1 share</td>
<td>2011–2013 (or until 2105)</td>
<td>until 2016</td>
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<tr>
<td>Sovcomflot</td>
<td>50% minus 1 share</td>
<td>reduction of government stake to 25% plus 1 share</td>
<td>2011–2013</td>
<td>until 2016</td>
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<tr>
<td>Sberbank of Russia OJSC</td>
<td>7.58% minus 1 share</td>
<td>reduction of government stake to 75% plus 1 share</td>
<td>2011–2013</td>
<td>until 2016</td>
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<tr>
<td>VTB Bank</td>
<td>35.5% minus 1 share</td>
<td>reduction of government stake to 50% plus 1 share</td>
<td>2011–2013</td>
<td>until 2016</td>
<td></td>
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<tr>
<td>Rosagroleasing</td>
<td>50% minus 1 share</td>
<td>no earlier than 2013</td>
<td>49.9% minus 1 share</td>
<td>2012–2013 rr.</td>
<td></td>
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<tr>
<td>Russian Railways (RZD)</td>
<td>25% minus 1 share</td>
<td>no earlier than 2013</td>
<td>25% minus 1 share</td>
<td>2012–2013 rr.</td>
<td></td>
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<tr>
<td>Russian Agricultural Bank (RusAg)</td>
<td>reduction of government stake to 75%</td>
<td>complete withdrawal from capital</td>
<td>until 2015</td>
<td>until 2016</td>
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<tr>
<td>Zarubezhneft</td>
<td></td>
<td>complete withdrawal from capital **</td>
<td>until 2016</td>
<td>reduction of government stake to 90%</td>
<td>until 2016</td>
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<tr>
<td>INTER RAO UES</td>
<td></td>
<td>complete withdrawal from capital</td>
<td>until 2016</td>
<td>reduction of government stake to 0% plus 9 shares</td>
<td>until 2016</td>
</tr>
<tr>
<td>Sheremetyevo International Airport</td>
<td></td>
<td>complete withdrawal from capital ***</td>
<td>until 2016</td>
<td></td>
<td>2014–2016</td>
</tr>
<tr>
<td>Aerofoil</td>
<td></td>
<td>complete withdrawal from capital **</td>
<td>until 2016</td>
<td>reduction of government stake to 25% plus 1 share</td>
<td>until 2016</td>
</tr>
<tr>
<td>ALROSA JSC</td>
<td></td>
<td>complete withdrawal from capital **</td>
<td>until 2016</td>
<td>reduction of government stake to 25% plus 1 share</td>
<td>until 2016</td>
</tr>
<tr>
<td>Transneft</td>
<td></td>
<td>reduction of government stake to 75% plus 1 share</td>
<td>2016</td>
<td>reduction of government stake to 75% plus 1 share</td>
<td>until 2016</td>
</tr>
<tr>
<td>OJSC Research and Production Corporation UralVagonZavod</td>
<td></td>
<td>reduction of government stake to 75% plus 1 share</td>
<td>2016</td>
<td>reduction of government stake to 75% plus 1 share</td>
<td>until 2016</td>
</tr>
<tr>
<td>Company Name</td>
<td>Year</td>
<td>Reduction of Government Stake</td>
<td>Year until</td>
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<tr>
<td>United Aircraft Corporation (UAC)</td>
<td></td>
<td>reduction of government stake to 50% plus 1 share</td>
<td>2016</td>
<td></td>
<td></td>
</tr>
<tr>
<td>United Shipbuilding Corporation (USC)</td>
<td></td>
<td>reduction of government stake to 50% plus 1 share</td>
<td>2016</td>
<td></td>
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<tr>
<td>RUSNANO</td>
<td></td>
<td>reduction of government stake to 90% (additional issue)</td>
<td>2016</td>
<td></td>
<td></td>
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<tr>
<td>Rossspirprom</td>
<td></td>
<td>complete withdrawal from capital</td>
<td>2014–2016</td>
<td></td>
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<td>Rostelecom</td>
<td></td>
<td>complete withdrawal from capital **</td>
<td>2014–2016</td>
<td></td>
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<tr>
<td>Vnukovo Airport</td>
<td></td>
<td>complete withdrawal from capital ***</td>
<td>2014–2016</td>
<td></td>
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<tr>
<td>Vnukovo International Airport</td>
<td></td>
<td>complete withdrawal from capital ***</td>
<td>2014–2016</td>
<td></td>
<td></td>
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<tr>
<td>State Transport Leasing Company</td>
<td></td>
<td>reduction of government stake to 75% plus 1 share</td>
<td>until 2016</td>
<td></td>
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</table>

* – Rosneftaz is allowed to act as investor in the course of privatization of fuel and energy producer companies until early 2015, on condition that it submits the relevant financing programs envisaging the use of dividends on shares in the companies owned by it;

** – it is possible to apply the special right of the Russian Federation to participate in the management of joint-stock companies (golden share);

*** – with due regard for the decisions issued by the RF President and the RF Government concerning the strategic development of the Moscow Aviation Cluster, it is possible to apply the special right of the Russian Federation to participate in the management of joint-stock companies (golden share).

Source: data are prepared by G. N. Malginov on the basis of analysis of projects and approved forecast plans (programs) of privatization for relevant years.

An important distinctive feature of the privatization program for the period of 2011–2013 (adopted in November 2010) was the selection of a group of biggest companies of nationwide importance, in respect of which certain acts could be undertaken only if allowed by special decisions of the RF President and the RF Government (and investment consultants had to be invited to participate in organizing the sale of such a company). In the initial program, ten companies of this type were included: Rosneft, RusHydro, the Federal Grid Company of the Unified Energy System (FGC UES), Sovcomflot, Russian Railways (RZD), the United Grain Company (OZK), Rosagroleasing, VTB Bank, Sberbank of Russia OJSC, and the Russian Agricultural Bank (RusAg). This was to be the sale, in the main, of blocking and minority stakes. The only amendment introduced in 2011 was a more precise definition of the format whereby the government stakes in RusHydro and the United Grain Company (OZK) were to be reduced, the remaining controlling stake amounting to 50% plus 1 share. The year 2012, however, saw a much more radical revision of the privatization plans of biggest companies. The category of biggest companies was now to include United Grain Company (OZK) (with termination of the government's participation in its charter capital), Sovcomflot (50% minus 1 share), Rosagroleasing (49.9% minus 1 share), VTB Bank (25.5% minus 1 share), Russian Railways (RZD) (25% minus 1 share), and Sberbank of Russia (7.58% minus 1 share), with the prospect of terminating the government's participation in their charter capital in the period until 2016 (with the exception of Sberbank of Russia and Russian Railways). The introduction, in the future, of a similar measure has been declared with regard to many other companies (Zarubezhneft, RusHydro, Inter RAO UES, the Sheremetyevo International Airport, Aeroflot, the Russian Agricultural Bank, and ALROSA JSC). In some companies, the size of the government stake will be reduced (Transneft, FGC UES, the Research and Production Corporation UralVagonZavod (up to 75% plus 1 share), the United Shipbuilding Corporation (USC), and the United Aircraft Corporation (UAC) (up to 50% plus 1 share).
share). Besides, in 2012 it was planned to reduce the government stake in the charter capital of RUSNANO OJSC to 90% by means of launching additional issues of shares to be placed on the market, and from 2013 onwards - to gradually alienate the shares in Rosneft, so that by 2016 OJSC Rosneftgaz would completely withdraw from its charter capital. In 2013, the privatization plans involving biggest companies were once again significantly altered, but this time in the other direction. The list of assets earmarked for privatization, however, remained essentially unchanged.

The new list no longer included Rosagroleasing, the Russian Agricultural Bank and FGC UES, but it was augmented by RUSNANO, Rosspirtprom, Rostelecom and the State Transport Leasing Company, as well as two Moscow airports. Nevertheless, in contrast to what was planned in the framework of the privatization program for 2011–2013, the reduction of the stakes held by the Russian Federation in the charter capitals of many biggest companies will involve retaining the right of corporate control, or at least the right to influence the corporate governance procedures by means of holding a blocking stake (25% plus 1 share). The previously existing privatization program had envisaged termination, in the period until 2016, of government participation in the charter capital of all the companies included in the list, while allowing the possibility of applying the special right of the Russian Federation to participate in the management of Zarubezhneft, RusHydro, Aeroflot and ALROSA JSC (that is, to hold the 'golden share'). As for the possibility of reducing the government stake in VTB Bank OJSC to less than 50% plus 1 share, the program stipulates that this will be done in coordination with the measures aiming at reducing the government stake in Sberbank of Russia as well, although the new head of the RF Central Bank has recommended that the stipulations concerning the possibility of altering the relevant stake sizes after 2016 should be removed from the text of the forecast plan, adding that the RF Central Bank has no intention of reducing the size of the stake held by the Russian Federation in Sberbank of Russia's charter capital 32. In this connection, it will be worthwhile to briefly discuss the issue of optimization of the control procedures established for the economic subjects operating in the public sectora. If it is not intended to revise the plan whereby a company's strategic core is to remain, in the long run, in government ownership, the most feasible option will probably be to lower the majority control ceiling for all big companies to the level of 50% + 1 share. The currently applied principle – to maintain the level of 75% + 1 share for 'infrastructure' companies – has no sense from the point of view of either economic or administrative benefits, because in this case their shares can be required only for short-term speculations, they offer no incentives for strategic investors, while minority shareholders can be involved in the governance procedures only on condition of infringement of their shareholder rights. Equally senseless would be any minority participation on the part of the government (including in the form of 'trading' budget investment for a minority stake in an event of an additional issue of shares): the level of influence would be insufficient, the amount of dividends transferred to the budget - too small, and the level of responsibility of the government bodies - too low.

The available estimations concerning the use of the special right (the golden share) are also controversial.33 On the one hand, the golden share is a more preferable instrument than a minority stake: golden shares represent in many ways a perfect solution to the set of political problems faced by the government, because they make it possible for the government to accomplish privatization of public enterprises, abstain from getting involved in the daily corporate governance routine, while at the same time being able to protect the country's national interests. On the other

32 Over the period 2011–2013, three privatization deals took place, which involved Russia's biggest companies (not counting the acquisition, by BP, of 12.84% in Rosneft in the framework of the purchase of TNK-BP): the sale, in September 2012, of 7.58% of shares in Sberbank of Russia OJSC formerly owned by the RF Central Bank, worth Rb 159bn; the sale by the federal government, in February 2011, of 10% of its shares in VTB Bank OJSC, worth Rb 95.68bn; the purchase by Summa Group, in 2012, of a stake in the United Grain Company (OZK) (50% –1 share) in the form of an additional issue of shares placed by way of a closed subscription, worth Rb 5,951bn.

33 For example, in the EC the use of golden shares has been subject to restrictions since 2002. Moreover, there are known precedents of rulings issued by the Court of Justice of the European Union whereby it is recognized that the right to hold a golden share practiced in some counties was contrary to the EU laws. In actual practice, the permission to issue a golden share is limited to those cases when there is an evident threat to the interests of national security.
hand, the time and scope constraints on the use of this special right must be strictly defined, otherwise the very fact of the existence of such a right may be used by the buyers as a grounds for insisting of a significant discount. Later on, the legislation on privatization will need to be amended in order to altogether abolish this special right, because its presence complicates corporate relations and makes them less predictable.

Moreover, there also exists a broad spectrum of other mechanisms for securing the degree of government control that is not directly proportional to the stake actually owned by the government: from direct government control over the activity of corporate CEOs to the introduction of measures designed to strengthen control, similar to the measures practiced by private companies. In the framework of contractual obligations, it can be possible to introduce (at the stage when the procedure of privatization is already completed) some special (more rigid) regulatory rules, or to conclude special long-term agreements prior to privatization. In some OECD countries, there exist the laws whereby the government is endowed with the right to veto the corporate decisions made by the management of the already privatized companies (outside of the 'golden share' mechanism). In order to retain control over partially privatized companies, the State may even apply certain instruments whereby shareholders can separate the right of ownership from their voting rights: double voting shares, ceilings imposed on the number of shares and votes, the qualified majority mechanism, pyramid-structured holding companies, etc.\(^{34}\)

No doubt, here we can observe not only the phenomenon of reluctant privatization, at least in the case of biggest companies, but also - over the past decade - the distinctly visible asymmetry between the processes of statization and privatization. Here, without going into many details about the entire set of comprehensive factors and motives that lie behind this asymmetry, we would like to point out those risks that were still relevant in 2011–2013 - that is, after the issuance of a number of official declarations, legislative initiatives and new long-term programs aimed at speeding up the privatization processes:\(^{35}\):

\(^{34}\) For more details see, for example, Megginson, 2005; Bortolotti, Faccio, 2007; OECD Guidelines, 2005.

\(^{35}\) For more details see, for example, Radygin, Simachev, Entov, 2011; Malginov, Radygin, 2013.
result in strengthening of the government's informal influence on such companies. Due to lack of proper regulation in some sectors, which previously was 'compensated' by the government's direct participation in the management of some big companies, the fact of the government's withdrawal from the management sphere will make it necessary to apply some other instruments for accomplishing important public tasks. The essence of the problem in this case will be the even greater lack of transparency in such companies from the point of view of public interests, the emergence of opportunities for replacing public interests by the narrow departmental or private special interests of particular interest groups - as opposed to the situation characterized by direct government participation - when the government holds a stake in the charter capital of a company. Besides, the inevitable delay in the introduction of 'external' measures needed to improve the investment climate may even further diminish the positive structural effect of privatization;

– the incompatibility of the ambitious privatization plans with the existing organizational opportunities and the available sources of financing. In this connection, the vaguely defined conditions and criteria to be applied in the process of privatization of big companies and the criteria for attracting investment needed for their development, the probability of conflict between the expectations of the government and the owners of such companies as to their mutual responsibilities may increase the mutual pressure exerted in one or other form by the parties involved in the deal, and create additional opportunities for politicians to appeal to those strata of society which traditionally complain of the 'unfairness' and 'cheapness' of privatization;

- the special role of political decisions, the periodic pattern of increasing (or weakening) influence of the existing groups of interests on the process of decision-making in the sphere of privatization; the consequences of such rivalry will be the adoption of decisions based on compromise, incompleteness and controversial character of the implemented measures, the predominantly the secretive nature of lobbying for group interests in the framework of privatization, greater opportunities for individualistic decisions in view of the vaguely defined normative legal framework, lack of well-developed official argumentation to support the adopted decisions;

- the quality of the instruments available to the government in the sphere of public property management (that is, unitary enterprises and stakes in joint-stock companies) probably cannot be improved any further, for quite objective reasons. So, the risk of conservation of the existing governance model, in spite of the current high level of activity and the initiatives put forth by the RF Federal Agency for State Property Management (Rosimushchestvo) over recent years, remains very real, and so any further measures aimed at de-statization may prove to be only palliative and inefficient.

By way of summing up, let us once again recall the fundamental privatization theorem (the indifference theorem) and its various interpretations suggested earlier. There exist no decisive arguments against its key thesis, – all other conditions being equal, the reasonability of an actual choice in favor of privatization or nationalization, government or private entrepreneurship is by no means always evident. However, when we start to discuss the applied tasks in the framework of long-term economic policy, the proviso, 'all other things being equal' (‘ceteris paribus’), acquires crucial importance because the ‘things’ in question are the ‘benevolent’ government striving to maximize public welfare, the immersion of producer companies in a competitive market environment, the absence of external factors, comprehensive and timely access of the government (the owner) to information flows (information symmetry), the completeness of all concluded contracts, efficient institutional performance, well-defined and securely protected (by the law and independent judicial instances) ownership rights, and the impossibility to derive private benefits in the framework of a given political system (and even more so - in an event of systemic corruption). Need we in this connection discuss, again and again, the feasibility of a consistent and rather tough policy of deep de-statization (privatization) in Russia in a situation, when the reverse processes are beginning to gain speed? Dicit sāpientī sat est.
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“Fundamental” Privatization Theorem: the Ideology, Evolution, Practice

The article analyzes the evolution of modern theoretical approaches to selecting of the optimal form of property and related assessment of privatization in the context of the strengths and weaknesses of the public and private sectors. The different interpretations of the "fundamental" privatization theorem are discussed - through "principal-agent" approach, a comparison of the structure of information flows, the combination of property and contract rights, taking into account the socio-political factors, etc. The authors analyze recent policy trends of privatization in Russia for 2010-2013 in the context of the "reluctant privatization" and the asymmetry of the processes of nationalization and privatization.

Keywords: privatization, government failures, public policy, public choice, allocative efficiency, information

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