

Privatization and Nationalization in the Post-Soviet Region: How Changes in State Ownership Affect Domestic Politics and Regime Stability

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Executive Summary

Informed by Title VIII fieldwork in 2012, this brief addresses two questions: When and why do non-democratic countries choose to either privatize state-owned enterprises or nationalize existing private firms? What effects do such changes in state ownership have on regime stability? Concerns over winning elections and curbing regional opponents significantly affect how post-Soviet states manage economic assets. Large-scale privatization can dramatically weaken non-democratic governments, but only when private businesses are secure enough economically to challenge ruling elites. U.S. policymakers should adopt ‘apolitical’ positions to help protect the rights of owners of privatized firms, which in turn may create indirect openings for further democratization.

The Return of State-Owned Enterprises

Over the last 10 years, the number and size of state-owned enterprises (SOE’s) has grown tremendously around the world. In fact, three-quarters of natural resource wealth is owned by national governments.¹ Often these ‘national champions’ are an important part of foreign and domestic policy through their ability to make large foreign investments, use contracts and prices to apply international pressure, and conduct trade with embargoed or sanctioned states. Domestically, when the government is simultaneously the owner and regulator of large firms, both market-based capitalism and democratization struggle to take hold.

The post-Soviet region is replete with examples of SOEs’ dominating economic and political life. For example, Gazprom, Russia’s only gas exporter and largest taxpayer, has recently been shielded by its government from having to cooperate with EU officials over complaints of pricing manipulation and monopolistic behavior. Of great interest to U.S. policymakers is when and how these states will sell off huge stakes in strategic sectors.

Looking to the Past Decade to Predict the Future

Contrary to popular perceptions that Putin-era Russia only nationalized firms, significant privatization has also been conducted. Over the period of 2000-2012, the Russian government sold off nearly \$2 trillion worth of assets (author’s calculation), affecting 5% of the total workforce. These dynamics offer insight into how Russian policymakers manage economic enterprises, as well as clues to their future behavior regarding such state-owned giants as Sberbank, Rosneft, and Aeroflot.

First, the electoral calendar matters greatly for privatization and nationalization activity. Russian officials prefer not to nationalize large, unprofitable firms in pre-electoral periods, federal and regional, for fear of massive layoffs possibly leading to social unrest. Alternately, following

electoral victories at both levels, bureaucrats are keen to sell off profitable enterprises as a reward to previous supporters of the regime, often at non-market prices. State-owned enterprises are thus a powerful tool for maintaining political stability.

Secondly, the last ten years have shown that Russian officials manage auctions to ensure that their preferred buyer wins. Whereas large firms operating at a loss are more likely to be swallowed up by one of Russia's large 'state corporations,' officials have shown no reluctance to sell unprofitable brownfield assets to foreign firms and independent businessmen. If workers are laid off or unhappy later on, officials can then blame these investors. On the other hand, profitable state corporations, especially those in the natural resources, have a curious way of landing in the hands of regime insiders.

Consequences for Regime Durability

Beyond the logic of the individual sales, reducing the overall share of state ownership in an economy can have profound effects on the ability of a regime like Russia's to stay in power. Privatizing firms can hurt a regime at the polls because the government can no longer force workers at SOEs to vote for the ruling party; the government has less leverage over private firms. Wealthy businessmen also have the resources to support an opposition. Research suggests that past authoritarian governments in Egypt, Mexico, and Ukraine were substantially weakened after having undergone privatization.

Yet not all non-democratic states that have privatized are prone to collapse; Malaysia and Vietnam are two prominent exceptions. What matters most for regime stability after privatization is how strongly a regime can threaten to take back what it just sold off. When investors or businessmen fear the loss of their property, they back off from joining the opposition. The case against Yukos CEO Mikhail Khodorkovsky exemplifies this kind of threat that leaders can make. By signaling to investors that their businesses are under threat, governments can deter businessmen from defections.

Policy Recommendations

Russia's recent accession and Kazakhstan's strong application to the WTO have opened up opportunities for further engagement with the West. Alongside these opportunities come uncertainty and risk about investing in and purchasing state-owned assets. Policymakers should be aware of the political factors influencing the security of property rights as well as be able to respond quickly to societal changes that may occur as a result of large-scale privatization.

Some initiatives to assist investors and reduce the politicization of economic activity might include:

- Supporting programs that help build corporate governance by increasing transparency and limiting interference by officials
- Promoting international solutions (arbitration courts, etc.) to protect investors who have taken stakes in state-owned enterprises or privatized firms

- Taking steps to increase economic engagement, trade openness, and interdependency between the U.S. and post-Soviet countries. Greater interconnectedness may offer a peace and stability dividendⁱⁱ.

ⁱ Ian Bremmer. 2010. *The End of the Free Market: Who Wins the War Between States and Corporations?* New York: Portfolio.

ⁱⁱ Eric Gartske. 2007. "The Capitalist Peace," *American Journal of Political Science*, 51:166-191