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The Biggest Problem in Post-Communist Transition: The Privatization of Large Enterprises

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Abstract

Thirty years after the collapse of the Soviet Union, it is rather clear what transition policies have worked. Almost all the post-communist countries have become market economies and have achieved macroeconomic stability. Privatization was economically necessary, and its economic outcomes have been very positive. Alas, politically, these successes have often been unsustainable because of strong popular sentiments against the private ownership of big enterprises. Substantial renationalization has occurred. What went wrong? How could privatization be done better, or be defended? What should be done to defend private enterprise in the future? This paper argues that the nature of privatization is far less important than the establishment of good rule of law so that private property rights can be defended.

Introduction

After the collapse of communism around 1990, the introduction of a market economy and macroeconomic stability was widely accepted.[1] Small and medium-sized private enterprises were appreciated. The most difficult part of the transition from a state-dominated economy to a free-market economy was the privatization of large enterprises. No free-market economy or democracy can persist without predominant private ownership, but the privatization of large enterprises aroused popular resistance everywhere.

The outcome of the large-scale privatization has not been encouraging. The EBRD (2020) *Transition Report* for 2020-21 is appropriately called "The State Strikes Back." It contains three key observations. First, "45 per cent of people living in postcommunist economies...are now in favour of expanding government ownership of business and industry" (p. 8) to compare with 33 percent in advanced countries (EBRD 2020, 20). The second observation is that this is particularly true of big enterprises. Third, the renationalization of big enterprises is occurring in many post-communist countries.

The smaller a private enterprise is, the more respected its ownership is (EBRD 2020, 5). Throughout the post-communist world, the most successful development of new enterprises took place in the early transition in 1990-93, when state regulation was eased and state capacity to regulate (or harm) was temporarily reduced. This was particularly true of Poland, which carried out the most radical early liberalization of markets and enterprise (Balcerowicz 2014). The number of new enterprises has tended to be lower each year because of increased bureaucratization. It was vital to utilize the open window of the early liberalization for entrepreneurs (Johnson 1994). By and large, new enterprises, even when they have grown fast and become very large, have been accepted.

Conversely, the easiest privatization was of small shops and workshops; this was typically carried out by the local authorities. The original intention was to auction them off to the highest bidders, but in most places, they were acquired by the incumbent manager at a low price. Yet, it was more important that they were really privatized and not encumbered by harmful liens. The local authorities tended to be more responsive to

1 The author wants to thank Andrei Shleifer and Maxim Boycko for helpful comments. Any mistake that remains is my own.

pursue privatization if they obtained full responsibility for the privatization of small enterprises and received the revenues from their sale (Frydman et al. 1994).

Traditional private property, such as modest dwellings and household plots, was almost universally accepted. More surprisingly, restitution of residential houses and family farms has been honored in Central and Eastern Europe. All these countries, with the exception of Poland, adopted laws on restitution. Before these laws were adopted, restitution was intensely debated, but after their adoption this discussion abated, reflecting popular acceptance of restitution.

Wherever large-scale privatization took place, it led to a major improvement of both these privatized enterprises and the national economy. Politically, however, it was not very successful. Many did not respect their property rights but called for their renationalization. This is the focus of this paper. Why did that happen? What went wrong? What could have been done differently? Finally, what should governments do with large state-owned enterprises today?

1. The Aim of Privatization

All available empirical analyses suggest that the economic impact of large-scale privatization was highly beneficial (Djankov and Murrell 2000; Djankov 2002; Estrin et al. 2009). It was necessary for many reasons. The fundamental aim was to break the all-embracing state control of the economy – to depoliticize enterprises, as the leading Russian privatizers put it (Boycko, et al. 1995). It was vital for the creation of a market economy and democracy. Enterprise managers should be evaluated on the basis of their economic performance, not on their political or personal loyalty to superiors. The large state subsidies to enterprises had to be reduced. Enterprise restructuring, including the closure of failing enterprises, had to be facilitated. The market should be opened for new entrepreneurs and foreign investment should be facilitated. Ultimately, privatization was supposed to lead to a depoliticized and far more efficient economy.[2]

Privatization involved many aspects – justice, economics, politics, and law. Before privatization, people in all post-communist countries tended to support it. They liked the idea of a free market society, and most of them expected to obtain significant wealth as citizens, workers, or tenants. After the privatization had occurred, most became disappointed. They had received less than they had hoped for, and they reckoned that other people had obtained more than they deserved, and the positive impact of privatization took time. No privatization can be fair, so disappointment could not be avoided, though some governments were rightly blamed for having exaggerated people's expectations of swift enrichment.

The privatizers, who were predominantly economists, thought mainly of economics. They aspired to enterprise restructuring, economic efficiency, responsible owners, decent corporate governance, a functioning stock market, and investment. People, however, often thought of privatization in terms of justice: I want my share, as a worker in a collective, as a collective peasant, as a resident of an apartment, or as a citizen. A more abstract view was political. Many called for the formation of a novel middle class of entrepreneurs for the building of democracy and the rule of law. A dispute raged whether property

2 The leading Russian privatization program was nicely published in a book by the key policy advisors (Boycko, Shleifer, and Vishny 1995). Their experiences were summed up in another book edited by Anatoly Chubais, Russia's privatization minister (Chubais 1999).

should be distributed or purchased. What was most important, state revenues or speed of privatization? The privatizers' ultimate aim was to render private property rights respected and stable, so that people dared to keep their assets in their country and invest.

2. How Large-Scale Privatization Was Done

The formerly socialist countries started with similar economic systems, though structural differences were significant, and the extent of late communist reforms varied greatly. Hungary had almost transitioned to a market economy, while many states remained completely Soviet. In Hungary, Poland, and the Soviet Union, market reforms had unleashed massive management privatization in the late 1980s. Managers "leased" the state enterprises they managed, effectively buying them gradually with the enterprises' profits. The reformers in these countries opposed the enrichment of the incumbent managers and called for a more just and effective privatization. Russia's President Boris Yeltsin (1991) concluded:

> For impermissibly long, we have discussed whether private property is necessary. In the meantime, the party-state elite has actively engaged in their personal privatization. The scale, the enterprises, and the hypocrisy are staggering. The privatization in Russia has gone on, but spontaneously, and often on a criminal basis. Today it is necessary to grasp the initiative, and we are intent on doing so.

Privatization was seen as a given. The question was who would be given the spoils and the command, insiders or outsiders? Yeltsin preferred outsiders.

Another issue was the capacity of the state administration. East Germany benefited from the well-functioning and solidly financed West German state. It set up its Treuhandanstalt, which sold every enterprise in an open sale (Brada 1996; Akerlof et al. 1991). In most post-communist countries, by contrast, the state administrations were dysfunctional and corrupt and sabotaged reforms. Hungary and Estonia stood out as exceptions with quite decent state administrations. Estonia, which was small and had few enterprises to sell and good state administration, adopted that strategy as well (Laar 2002; Nellis 1994). Also, Hungary went for sales of big enterprises, assuming that its state-owned companies worked decently (Kornai 1990). Enterprises were supposed to be sold at a market price, but market prices were deeply depressed, which advantaged those who had benefited from the old system or had earned money illicitly during the early transition.

Czechoslovakia pioneered voucher privatization designed to benefit all citizens (Klaus 2014). Russia and most other post-communist countries followed its example. In practice, however, a combination of insider privatization, voucher sales, and direct sales occurred. The Russian privatizers chose the Czech option of voucher privatization in favor of the people and a modern market economy against the old state managers and the old industrial ministries, while they intentionally ignored state revenues.

In August 1992, Yeltsin announced a program for voucher privatization that was quickly implemented. The Russian privatizers had many aims. They focused on economic efficiency. First of all, they wanted privatization to take place. Second, they insisted that enterprise management had to be depoliticized. Third, private property rights should be as clearly defined as possible. Fourth, a competitive market economy should be created. Fifth, the formation of a stock market was essential (Boycko et al. 1995). Equity and social justice were not high on their agenda. Restitution, which was common in Eastern Europe, was precluded since the Russian revolution occurred so long ago. Corporate governance was perceived as a premature topic to evolve out of the new ownership. A general idea was that the new owners would fight for their property rights and thus generate a decent judicial system. The Russian privatization attracted particular attention. It was the biggest and fastest privatization ever undertaken, and it was based on clearly formulated ideas. A key aim of Yeltsin and his privatization minister Anatoly Chubais was to stop management theft and instead distribute ownership to promote both modernization and justice (Chubais 1999; Åslund 1995, 226–232).

The Russian privatizers sought a balance between their ideas and the real political forces – state enterprise managers, employees, citizens, and capitalists, while they tried to exclude the old Soviet ministries, which wanted to persist as vast state holding companies. Their actual compromise amounted to one-fifth of the shares to the managers, two-fifths to the employees, and one-fifth to voucher privatizations, while the state kept the balance of about one-fifth of the shares. Although vouchers did not account for a large share of the ownership, they tipped the balance qualitatively from amorphous ownership to private ownership. Incredibly, in the course of two years, 1992-94, Russia privatized 16,500 large and medium-sized enterprises, each with more than 1,000 workers. This was the greatest privatization ever anywhere in the world. In 1995, Russia claimed 920,000 private enterprises (Blasi et al. 1997, 189, 192-93). A critical mass of private enterprise had been built.

Russia stands out as the poster boy of an economically successful but politically disappointing privatization of big enterprises. The main political conundrum was the so-called loans-for-shares privatization in 1995, which many called the original sin of the Russian reforms. That is paradoxical since most reforms had ended in 1993. Chubais as a lone reformer remained privatization minister in an anti-reform government, but he insisted on privatization. At this time, it was politically impossible to sell large enterprises to foreigners, while the government was desperate for cash. The reformers wanted to tie the new businessmen to reform and Yeltsin (Freeland 2000). In fact, only 12 companies participated in the loans-for-shares privatization, and merely three changed principal owners, but they were important – the Yukos Oil Company, the Sibneft Oil company, and Norilsk Nickel, which were sold to young outside financial specialists. These three companies were economically extraordinarily successful (Shleifer and Treisman 2004).

But their great economic success led to the conspicuous enrichment of their young outside owners, which Russian society could not stomach. In the oil companies Lukoil and Surgut, the dominant owners just consolidated their ownership. Russia established vibrant stock exchanges early on, but they have deteriorated since 2008 because of poor corporate governance, caused by excessive state interference and poor rule of law.[3] Yukos was confiscated by the Russian state from 2003-5 in an irregular court process. Sibneft was bought by the Russian state company Gazprom at a price that was considered too high in 2005, while Norilsk Nickel remains private.

The Russian privatizers had feared that the old industrial ministries would take over the companies, privatize them to insiders, and establish monopolies, as was done with Gazprom. Gazprom is the outstanding example of insider privatization, carried out by Viktor Chernomyrdin, Prime Minister from 1992-1998. Its management used vouchers for their privileged privatization of 40 percent of the company for about $100 million, while its market capitalization peaked at $369 billion in May 2008. This was by far the biggest giveaway in the Russian privatization (Klebnikov 2000, 134-135; Åslund 2019a, 109–110).

Most other post-Soviet countries pursued privatizations similar to Russia's, but more slowly so. They carried out some mass privatization, but big enterprises tended to be sold in insider deals to members of the ruling elite. Contrary to anticipation, the quality of privatization did not necessarily improve over time. It did so in Central Europe, because the rule of law improved in the EU candidate countries, while it tended to deteriorate in the former Soviet Union (Gans-Morse 2017; Pomeranz 2019). By and large, the economic results of privatization were positive in nearly all regards however privatization was undertaken. Yet, the public has been dissatisfied with large-scale privatization in most countries, which has led to a trend to renationalization.

3 Chrystia Freeland describes how the loans-for-shares privatization took place (Freeland 2000). Andrei Shleifer and Daniel Treisman assess the great success of these enterprises (Shleifer and Treisman 2004), while Stephen Fortescue (2006) and Kokh (1998) offer an overall positive economic perspective.

3. What Happened after the Large Privatization?

Today, people have largely forgotten how awful communist enterprises were. Everything was wrong. The typical Soviet-type enterprises suffered from underinvestment and technical obsolescence. They were heavily overstaffed and poorly managed (Kornai 1992). The communist world had too many mid-sized factories, but far too few small enterprises and the large companies were too small. They were all autarkic and national. The management lacked knowledge of foreign countries and their languages, and rarely knew how to export (Brown et al. 1993).

At present, most old state companies are sad ruins for good reasons. They represent the desired creative destruction. Meanwhile, a few companies have become modernized and consolidated into much larger companies and are highly successful big companies. This was the desired restructuring. In a 1999 report, McKinsey Global Institute (1999) argued with great foresight that Russia could reach a long-term economic growth of 8 percent a year, if it only pursued the right economic policies. The physical and human capital was sufficient, but production of steel, for example, had to be concentrated to the best facilities. The crucial hurdle to success was to close down the many small and obsolete steel mills that were value detracting. Over the next decade, half a dozen of successful Russian steel companies had done so.

In their excellent book, *Starting Over in Eastern Europe*, Simon Johnson and Gary Loveman (1995) elaborated on how mastodon a change was needed to turn large Soviet-style enterprises in Poland into viable capitalist enterprises. Their properties, which had been no concern of a socialist state, had to be defined. A new owner had to possess considerable political leverage to claim the relevant assets. A big state enterprise usually had substantial social and local responsibilities, which needed to be evaluated and constrained, which could hardly be done without privatization. In an important 1993 article, Brian Pinto, Marek Belka, and Stefan Krajewski (1993) established that state-owned enterprises also carried out substantial restructuring, but the EBRD (1999) concluded that state-owned enterprises cut costs reasonably well, but they did not show entrepreneurship.

The situation was even worse in the former Soviet Union because of the far-reaching criminalization of the economy in the early 1990s (Klebnikov 2000). When a Russian or

Ukrainian outside owner took over an old Soviet enterprise, the new owner had to secure physical control of the company, which often meant sending in private security forces. Next, the new owner needed to stop the stealing by the staff, which was characteristic of Soviet enterprises. This was particularly true for the transportation and construction departments, the whole staff of which were typically sacked. The ensuing step was to take control over the finances with the assistance of an international auditing company, while bookkeeping was usually in good order, since money had not been important under socialism. The engineers and workers were usually quite competent and decent. The new owner tended to invite a Western management consulting company, such as McKinsey, to improve the efficiency of production. Often, a Soviet-style company suffered from a few bottlenecks that small investments could cure.

Soviet enterprises endured chronic overstaffing, and usually most of the employees needed to be laid off, which involved disputes with workers, trade unions, and local authorities. National owners were better suited for such battles than foreigners with little comprehension of local social and political demands. Soviet companies often comprised company towns with plenty of non-core assets to be sold off. Since Soviet enterprises did not scrap equipment, enterprises were cluttered with obsolete paraphernalia. New national owners had little capital, so they used the viable existing Soviet equipment, while foreign owners usually scrapped it all and invested in new machinery, which was more expensive. In Russia in the early 1990s, it was said that no foreign company should purchase a company with more than 1,500 employees, because such a company was unmanageable. In all these matters, locals tended to be superior to foreign owners (Åslund 2013, 206–211).

To accomplish a successful enterprise restructuring, a new owner needed great powers. Given the absence of the rule of law and good corporate governance, such powers required concentrated ownership. This is one of the least understood aspects of the restructuring of big post-communist enterprises. Since the new owners had exhausted most of their funds by purchasing assets in the early 1990s, they were unable to carry out real investment for several years. Most companies had minority shareholders, often foreigners, who had participated in the voucher auctions. The minority shareholders wanted good corporate governance to achieve a fair value of their investments, whereas the new post-Soviet owners preferred to dilute their shares, which prompted foreign investors to sue the new majority owners.

By the end of the 1990s, the contesting parties settled their conflicts, all far richer than in 1995. The new owners had consolidated their ownership. Given the great economies of scale in resource industries, the big companies won out. Since concentrated ownership was highly desirable to overcome the poor rule of law, the new owners swiftly became multi-billionaires. This was true of energy, metallurgical, and mining companies in Russia, Ukraine, and Kazakhstan.

By 1999, the new Russian owners turned around, opting for transparency, good corporate governance, and initial public offerings on international stock markets, usually the London Stock Exchange, because they wanted to boost their share prices. Yukos and Sibneft were stellar examples of success. But they had misjudged the process politically. Transparency exposed them to public criticism. Unfortunately, this process of legalization came to an abrupt end in 2004, because the Russian rulers had abandoned its proclaimed project of developing the rule of law and instead focused on concentrating their own power and wealth (Åslund 2019a).

Sergei Guriev and Andrei Rachinsky (2005, 148) noted, “Oligarchs seem to run their empires more efficiently than other Russian owners [but] a majority of the Russian population deems their property rights illegitimate, which creates a fundamental problem for building a democratic and prosperous Russia.” They concluded presciently, “An unpleasant implication of this analysis is that the development of democracy in Russia may take a long time.” They were all too right.

4. What Went Wrong?

The short answer to the question what went wrong is "the oligarchs." The very concept arose in Russia and Ukraine around 1994. Previously, Russians spoke of "New Russians," meaning newly wealthy businessmen, who indulged in conspicuous consumption. The problem was not their economics but their politics and lifestyle.[4] Allegedly, they did not pay taxes, but the crucial complaint was that they had bought the state – courts, governments, parliaments, and media – and that they promoted corruption and indulged in corporate raiding (EBRD 1999).

When you ask so-called oligarchs, you hear a very different story. They complain that predatory state agencies do not obey the laws. Only the strongest, that is, the oligarchs, survive the attacks by lawless law enforcement agencies – courts, prosecutors, tax authorities, and security services.[5] Both stories are true, but what is the hen and what is the egg? How is it possible to break the vicious circle? What was the main problem? Was it the privatization method, the oligarchs, or the predatory state agencies?

The fundamental shortcoming was that the rule of law was not built in the former Soviet Union, where only Georgia has some elements of the rule of law and thus property rights. The post-communist EU states, by contrast, have comparatively good rule of law (Transparency International 2021). Notably, Poland and Hungary already had functioning commercial law for their private enterprises – significant early reforms were pursued and then came the EU with its *acquis communautaire* forcing all EU candidates to adopt plenty of sound laws and legal practices, with the European Court of Justice as the ultimate arbiter.

Many observers of the post-communist transition have argued that the reformers should have started by building the rule of law, but that was not a realistic option, because the necessary reform capacity was absent. Almost all reformers were economists with little knowledge of law. The communist world had many lawyers, but most of them were servants of the state, while others were commercial lawyers, focusing on making money. Very few post-Soviet lawyers were reformers, and no reform is possible without competent domestic reform leaders.

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4 The best account of the Russian oligarchs is Freeland (2000). Another excellent account is Hoffman (2002).

5 Based on many personal conversations with Russian and Ukrainian big businessmen over the years.

Boycko et al. (1995, 150-151) offered a fundamental argument: “Privatization has created a substantial class of property owners who are increasingly demanding reforms that assure protection of property and contract enforcement. The most important of these reforms is the creation of commercial laws covering a whole range of market transactions.” Unfortunately, the new enterprise owners in the former Soviet Union stopped half way. They promoted the adoption of modern commercial legislation, such as joint stock company laws and commercial codes, but they did not fight for their property rights and thus the promotion of the rule of law at home.

Konstantin Sonin (2003) put it most succinctly. Instead of lobbying for better rule of law, the new rich can easily afford their own protection, including by bribing officials to protect them from competitors (Havrylyshyn 2020, 194). Unlike the American robber barons, they benefitted from the services of offshore havens. Many new entrepreneurs made great fortunes, but since they did not trust their property rights at home, they transferred their surplus cash to offshore havens with sound rule of law, limiting their domestic investment.

With a keen understanding of the political and legal realities, post-Soviet businessmen started talking about the “redistribution of property.” They expected that new rulers would seize their assets, and so they did. In authoritarian countries, the ruler and his family indulged in corporate raiding and extorted an increasing share of the profits of others. In semi-democratic countries, the corporate raiders were businessmen who had bought courts and politicians.

The turning point for the whole region occurred in 2003, when Putin had Russia’s richest man, Mikhail Khodorkovsky, arrested in order to confiscate his oil company. Other post-Soviet countries followed suit, and big businessmen learned the lesson. Either they nurtured a close relationship with the ruler and paid their due, or they accepted to sell their companies to the state or to the ruler’s friends at modest prices and then emigrated.

This is not only a Russian or Putin problem, but it is generally true of the post-Soviet countries, while the EU members have maintained much stronger judiciaries and thus property rights. Political governance and property rights move in parallel. Not one of the post-Soviet countries is recognized as a democracy by the authoritative Freedom House (2020). It categorizes seven countries (Azerbaijan, Belarus, Kazakhstan, Russia, Tajikistan, Turkmenistan, and Uzbekistan) as “not free,” while the other five post-Soviet countries (Armenia, Georgia, Kyrgyzstan, Moldova, and Ukraine) are labeled as “partly free.” This distinction is significant. The seven unfree countries are consolidated dictatorships, or authoritarian kleptocracies, where the ruling family controls all property and focuses on the interests of a narrow elite (Åslund 2019a; Belton 2020). The five partly free countries may be called oligarchic. None of them are fully democratic, but elections matter. They are open and politically unstable with frequent regime changes. None of their rulers have managed to consolidate power for a significant period.

Among the countries that were part of the Soviet Union, two countries are exceptions with regard to judicial reform and property rights, Estonia from 1991, and Georgia under Mikheil Saakashvili from 2003. In both countries, earnest reformist lawyers executed truly radical judicial reforms from the top down. They abolished the old prosecutors' offices and courts and laid everybody off, building up new agencies and employing outsiders. No lustration was needed. Given the small numbers of judges and prosecutors required, this was feasible by attracting lawyers from the private sector and newly trained lawyers (Laar 2002; Bendukidze and Saakashvili 2014; Åslund 2015, 138-146). The international support was minimal, and it tended to focus on commercial issues, not on the judicial system itself (Pistor et al. 2000).

This failure to pursue judicial reform was not necessary. Estonia and Georgia have shown that sound judicial reform is possible in the region and how it should be done. Estonia has persistently topped the Transparency International Corruption Perception Index (2021) among post-communist countries and Georgia among post-Soviet countries. Lithuania and Latvia have followed Estonia's stellar example and have successfully reinforced property rights (Baltic Ways...2011). We know how to establish strong property rights. Unfortunately, many rulers prefer the absence of the rule of law because it gives them more political and financial power.

Property rights need to be established through judicial reforms started by insightful lawyers from the top of the state. There must be a clear design and strict execution. Such reforms do not evolve through trial and error. No good reform has been done unless led by a top reformer who knows what he is doing and really wants to succeed. The conclusion is as simple as shocking: You succeed with what you know, believe in, and focus on, but you have to fight.[6] In the early Yeltsin years, judicial insights and competence were missing. As we now know, Putin aspired to absolute power and opposed the rule of law (Åslund 2019a, 50-52). The situation was similar in other post-Soviet countries.

Since 2003, the Kremlin has pursued a policy of renationalization, promoting the idea that big companies, especially resource companies, should be owned by the state. According to opinion polls, the public has responded positively to this message. Roughly half of the Russian economy remains under state control. Private companies grow faster, but the state catches up through nationalizations (Radygin et al. 2018; Di Bella et al. 2019; EBRD 2020). Yet, the distinction between state ownership and the ownership of cronies is becoming blurred, as the Putin regime has transferred a substantial share of major state companies to close friends of the presidents (Nemtsov and Milov 2008; Dawisha 2014; Åslund 2019a). The concentration of ownership to the state, Putin's friends, and aging oligarchs with little interest in economic

6 The same is true of democracy building. No post-Soviet reformer had a clue about democracy building, so how could it possibly succeed? (McFaul 2001; Åslund 2013).

growth is an important cause of Russia's economy having been nearly stagnant since 2009 and completely stagnant since 2014.

Throughout the post-Soviet world, the remaining state companies are major sources of corruption. No economic crime in the Russian economy appears greater than Gazprom. In a fine study, opposition analysts Boris Nemtsov and Vladimir Milov (2008) established that Putin's cronies extracted $60 billion from Gazprom in 2004-8 through overpriced no-bid procurement contracts and asset stripping. The looting by Putin and his friends has continued unmitigated. Nemtsov was shot dead outside of the Kremlin in February 2015 and Milov recently fled to Lithuania. In 2018, two Sberbank CIB analysts concluded: "Gazprom's investment program can best be understood as a way to employ the company's entrenched contractors at the expense of shareholders" (Fak and Kotelnikova 2018). They were immediately sacked.

As the EBRD *Transition Report* for 2020 points out, renationalization is a general phenomenon embracing most post-communist countries. The fundamental problem is that politically influential wealthy businessmen and top government officials have an interest in undermining the rule of law and property rights in order to be able to enrich themselves as much as possible. This concept has become known as *Sistema*, that is, the system (Lough 2021).

5. Why Big Companies Have Been Renationalized?

The patterns of renationalization are clear. The key industries are what the Bolsheviks used to call the commanding heights of the economy – banks, energy, transportation, and communication. The state is coming back with a vengeance. Yet, the state share of GDP remains rather stable. The explanation is that while the state takes over more enterprises, it has a preference for the old, shrinking economy, and it manages its companies poorly.

In the early 1990s, as inflation was brought under control, bank crises occurred in almost every country, with the exception of Poland. The biggest crash took place in Russia in August 1998, when half of the private banks went under. Millions of depositors lost their money, and it took years for the government to establish deposit insurance. In Russia, only the old state savings bank, Sberbank, safeguarded deposits. People flocked to remaining state banks, granting state banks cheaper funding than private banks. When necessary, the state bailed them out. The capital market understood, so private funds happily bought state bank bonds (Vernikov 2012).

Bank crises were even more frequent than in the West, and the state usually took over failed banks. Ukraine is an illustrative example. Traditionally, it had two state banks, the savings bank (Oschadbank) and the export-import bank (Ukreximbank). Each was run by loyalists of the rulers, and they bailed out influential companies when requested. In return, the government recapitalized them repeatedly. After the two financial crises of 2008-9 and 2014-15, 100 private banks went under, so the state bank share rose to nearly two-thirds of all banking assets (Åslund 2015).

In similar developments in Russia, Sberbank has grown to the biggest bank, followed by VTB, which used to be the foreign trade bank. As a monopolist, Sberbank is making huge profits, while the next three big state banks – VTB, Gazprombank, and Rosselkhozbank (the agricultural bank) – are patently loss-making, but the Russian government recapitalizes them when required. From 2014-18, some 500 private banks collapsed in Russia. The managers of some big private banks had opted for excessive risks, not least because of the unfair competition with the big state banks. When they went bankrupt, the state took them over (Åslund 2019b).

In the early 1990s and after the Russian crash of 1998, private banks took over throughout the reformist former communist countries. In Central and Eastern Europe, the old state banks were privatized in an orderly fashion, often through purchases by West European banks. In the former Soviet Union, unregulated new private banks mushroomed. From 2005-08, Western banks bought good local private banks in Russia and Ukraine. State banks stayed dominant only in the most conservative communist countries. After 2008, however, West European banks have wanted to get out if possible. All but three significant foreign banks have departed from Russia, finding the business environment too unfriendly and the economy stagnant.

Since the Russian state banks are big, they pay little attention to small and medium-sized enterprises but concentrate their credits on big state enterprises, and the government often requests them to subsidize loss-making state companies. The big expansion of the state sector in Russia occurred in 2009 as a result of a government bailout of the 200 biggest companies (Radygin et al. 2018). State banks tend to accumulate large non-performing loans, more than 40 percent in Ukraine. State banks in Russia have frequently been accused of having been involved in corporate raiding by unexpectedly pulling credits early (Åslund 2019b). The three countries where state banks dominate – Russia, Ukraine, and Belarus – stand out for having had no growth since 2014. Clearly, the unfortunate allocation of credits by state banks and their unreliability hamper economic growth.

In Poland and Hungary, the causes of renationalization have been quite different. During the global financial crisis, foreign-owned banks in these countries were accused of not expanding credits to support these economies, though none of them withdrew at that time. The foreign-owned banks had provided a substantial volume of housing mortgages in Swiss francs and euros, which became much more expensive as the Hungarian forint and the Polish zloty were devalued. Hungary imposed special taxes on foreign banks and Hungary and Poland legislated reductions in the cost of mortgages in foreign currency. Realizing that the business environment was no longer propitious, foreign banks have gradually sold their assets in Hungary and Poland. Today, hardly any West European bank seems interested in buying any bank in Eastern Europe, while state banks have expanded (EBRD 2020, 68-85).

Another industry that has seen substantial renationalization is energy. The outstanding examples are the big Russian oil companies – Yukos, Sibneft, TNK-BP, and Bashneft. These four companies were thoroughly restructured and modernized by Russian outside investors and produced stellar performances before their renationalization. The state oil company Rosneft captured them because of its political clout. Rosneft's successes are due to its seizure of these more efficient companies (Gustafson 2012).

In Poland, the main state oil company PKN Orlen was never privatized because of national security concerns. The electricity companies have been renationalized, partly because

West European owners were not allowed to set profitable tariffs and partly because the Polish government desired "national champions," meaning large state-owned companies. Yet, unlike in Russia, these state purchases were voluntary, and the state paid. These nationalizations were driven by populism, national security, and politics, not by economics.

The Polish coal mines have stayed state-owned because the government failed to overcome the political impediments to privatization. As a result, the Polish coal industry has seen a steady decline, with decreasing production and steady losses. The Russian coal industry, by contrast, was privatized in 1999, which led to its expansion and profitability, and it has stayed owned by wealthy oligarchs (Åslund 2013, 110-112). The substantial Czech coal industry looks more like Russia than Poland. The big Czech coal companies were privatized by domestic businesspeople, who were commercially highly successful, but when global coal prices plummeted in 2016, one of the biggest coal companies went bankrupt and was renationalized (Lazarova 2018).

This brief review of some major renationalizations offers a rather clear picture. In the banking sector, many domestic private banks went under, often because of embezzlement. No foreign bank in the region went bankrupt, but criticism mounted that they exposed their creditors to excessive risks, while not providing sufficient credits in the global recession. The governments have chased them out with regulations, taxation, and rhetoric. After the state had taken over banks, it was difficult to sell them, given that too many foreign banks had suffered bad experiences, and EU demands for more bank capital made West European banks reluctant to commit to Eastern Europe. State banks have typically benefited from cheaper funding and implicit state guarantees, while they have concentrated their credits to not very profitable big state-owned companies, seriously harming economic development. Today, American private equity funds appear to buy banks in Eastern Europe.

The energy and mining sectors offer a different picture. Privatization led to highly successful enterprise restructuring in coal and oil, but these fortunes went to outside investors with little political support. Neither domestic oligarchs nor foreign companies could defend their property against the popular emotions exploited by populist governments, so they were forced to sell to the state. The government wanted to obtain the fruits of their successful restructuring, investment, and modernization.

None of these renationalizations appear to have been beneficial to the national economy of the country in question, though several bank nationalizations appear to have been necessary to counter destabilizing fraud.

6. What Could Have Been Done Differently? Forget Privatization!

In hindsight, it appears obvious that the development of the rule of law should have been at the top of the agenda in the early transition, but at the time, few lawyers promoted the development of the rule of law. The pioneers were the Germans, who imposed the West German legal system in East Germany. Estonia followed suit with radical judicial reform, but hardly anybody paid attention. The dominant Western view in the early 1990s was that the socialist world had a respectable judicial system, so judicial reform was not deemed essential (Pistor et al. 2000).

In a conversation in Kyiv in 1995, Daniel Kaufmann, the resident representative of the World Bank in Ukraine, told me that as a Latin American he found it strange that Ukrainian judges were not very corrupt, given how much money they could make. He rightly predicted that soon they would be. In the former Soviet Union, courts have become hearths of corruption.

The fundamental insight is that the defense of property rights is not connected with the mode of privatization but with judicial reform. Regardless of how privatization was carried out in the EU countries, property rights and thus privatization were much more easily ccepted there because they had much better rule of law than the post-Soviet countries. Businessmen and commercial lawyers promoted plenty of sound commercial legislation, but the defense of property rights required profound judicial reform, which was beyond their pale.

Another key observation is that the economic success brought about by privatization has not rendered the private ownership of a company acceptable. Few privatizations have been as economically successful as the privatizations of Yukos, Sibneft, and TNK-BP (Shleifer and Treisman 2004). Therefore, the Russian state took them over. In hindsight, Lukoil seems to have been wise. Its owners did not try to maximize their profits but political security (Alekperov 2011).

In general, private ownership of large enterprises in authoritarian or semi-authoritarian states is only accepted if the owners serve and pay the ruler personally. Needless to say, this is unrelated to the privatization of a specific company or its economic performance. The better a company performs economically, the more likely the owner is to become overconfident and challenge the ruler, which is usually his death sentence. Moreover, the more authoritarian a state is, the more likely is renationalization, which seems to be borne out by the greater renationalization in the most autocratic post-Soviet states (EBRD 2020).

7. The Way Forward

What should be done with the many remaining large state-owned enterprises? Many problems have been resolved. The properties of most enterprises and their actual owners have been defined. Asset prices have reached a reasonable market level, rendering stock sales less controversial. Many state enterprises have died and represent only real estate value. Other state enterprises have carried out major cost cutting.

But new problems have arisen. The blatant authoritarian kleptocracies – Azerbaijan, Belarus, Kazakhstan, Russia, Tajikistan, Turkmenistan, and Uzbekistan – do not aspire to any rule of law or property rights. Their rulers will persist as long as they stay in power. International financial institutions should abandon these countries and let their rulers stew in their juices.

Before renewed large-scale privatization can become meaningful, elementary rule of law needs to be established, because unless private property rights can be secured, the current political redistribution of property will continue. Judicial reform does not occur in small steps or from below, it has to start from the top with full support of the government. Piecemeal judicial reform does not work. The West should become much firmer in its demand for the rule of law, and it should establish an international organization for the building of the rule of law in parallel with the IMF.

Yet, small and medium-sized state enterprises can be auctioned off on open markets before a judicial reform. The extent of state ownership is mind-boggling. Extensive public ownership leaves vast territories in ruins. Around 2000, one-third of the territory of the Kyrgyz capital of Bishkek consisted of the ruins of state enterprises.[7] Andriy Boytsun, a leading specialist on corporate governance in Ukraine, assesses that "Ukraine's central government owns 3,500 businesses, with another 12,000-15,000 owned by regional or municipal governments. But nobody knows for sure" (Bonner 2021). Most of these assets have only real estate value and should be sold off as fast as possible. It does not really matter for how much they are being sold, while it is vital that the state relieves itself from claims on subsidies and corruption.

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7 Information from my time as advisor to President Askar Akaev.

The greatest intricacy is how to handle the large state enterprises in energy, infrastructure, transportation, communication, and banking, because they possess substantial value. Several of these companies need to stay state-owned for national security reasons or because they are national monopolies, such as rails, electrical grids, and perhaps pipelines. Still, they all need to go through the restructuring typical of a big Soviet enterprise: their finances need to be cleaned up; the customary petty theft needs to be stopped; non-core assets should be sold off; the overstaffing has to end; tariffs should be adjusted to markets and costs; and substantial investments are needed in key activities – and they require financing.[8]

They present an unsolvable conundrum. If they stay state-owned, they will be inefficient and corrupt, possibly buying the state as the national oil and gas companies have done in post-Soviet states. If they are privatized to individuals, they are likely to do much better economically, but their owners may buy the state, and popular pressure for their renationalization will rise. The sale of major state enterprises to foreigners is rarely accepted politically.

Short-cuts, such as voucher privatization or direct sales, are no longer possible or desirable. The state enterprises have to go through the long, hard slog of corporatization, the introduction of serious corporate governance, and gradual privatization on the market through initial public offering. Each country "should have fewer yet better-governed state enterprises" (Bonner 2021).

In the early 1990s, reformers rightly dismissed the British privatization in the 1980s as too slow and cumbersome, but preconditions have changed. Importantly, the main improvements of old British state companies took place when they were being prepared for privatization.

Ukraine has introduced independent supervisory boards with a majority of independent directors at nine state companies and four state banks, which has been a great achievement. This has led to an extraordinary reduction in the state subsidies of state companies of 8 percent of GDP. However, corporate governance has come under severe criticism by President Volodymyr Zelensky, who in a populist fashion has complained about foreigners on supervisory boards earning too much and working too little. Rather than supporting independent directors, the current Ukrainian government tries to marginalize them and limit their influence, eliminating most of the positive effects. Neither the state enterprise managers nor foreign investors believe that the supervisory boards have any real power, since the government appoints management and approves financial and strategic plans (OECD 2021). Then, corporate governance cannot do much to improve management or efficiency at state companies. Sound corporate governance with strong supervisory

8 These are my experiences from two and a half years on the supervisory bord of Ukrzalisnytsia, the Ukrainian state railways.

boards dominated by independent directors has to be reinforced to promote transparency, efficiency, and productivity in line with OECD standards.[9]

By and large, the post-communist countries have failed to develop sound stock markets. The only real success is Poland. Russia still has a big stock market, but its market capitalization in dollar terms is about half of its value in May 2008. For many countries, this means that an IPO should take place either in Warsaw or at a Western stock market.

9 I served as an independent director on the supervisory board of the Ukrainian State Railways from June 2018 until September 2020.

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