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Russian Railways' Privatization Gone Off Track

By Luka Oreskovic

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Russian Railways, the state-owned colossus that employs over 1.2 million workers on 85,200 kilometers of track and generates annual revenues of 1195 billion rubles, is the fourth-largest company in terms of revenues in Russia. In the privatization drive of 2012, President Vladimir Putin announced the government's intention to sell 25 minus one percent of the company, but plans have since gone somewhat off track.

Although Russian Railways continues its ambitious drive of internal expansion and international acquisitions, the government's dedication to privatizing the company seems adamant. Recently, the opposition to privatization plans became more vocal as various agendas conflicted over the government's privatization plans for 2013 that include Russian Railways.

The most vocal opponent has definitely been the company's president and President Vladimir Putin's close ally Vladimir Yakunin, who continues to argue in public against privatizing

Russian Railways as a strategic industry. In an October 2012 round table on the topic of government privatization plans, Yakunin argued that the company should not be included in the sweeping privatization plans as a specific distinction of Russian Railways RZD is that it is much more sensitive than other, non-strategic industries. Yakunin invoked China as an example of laudable state dedication to keeping strategic industries in government hands — a comparison that certainly points to a more statist approach to (or rather, against) economic reform that fully escapes the logic behind the privatization drive championed by Prime Minister Dmitry Medvedev. The standard Russian privatization recipe applies to the case of Russian Railways equally well — it is always more politics than economics.

The argument about the strategic importance of the railway industry to Russia is certainly a sound one, with the Russian commodities sector that dominates the economy profoundly dependent on Russian Railways as the monopoly owner and operator of an extensive network of rail infrastructure. Yakunin continued his case against privatization with examples about Russian Railways' competitive state of finances and the successful maintenance of its market-leader position against private competitors as a reference to traditional pro-privatization performance, efficiency and capital access enhancing arguments. A strong argument for the sound state of finances at Russian Railways is Yakunin's reminder that the company's 10-year eurobond placement in October of 2012 had a yield of 4.05 percent — compared to Russian 10-year eurobonds with a yield around 4.0 percent. Finally, the 10 percent margin the company maintains in its cargo business is a high one by European standards.

However, the primary reason for the privatization of Russian Railways is not raising efficiency or consolidating strained public finances — although both could use a push — but opening up and reducing the influence of the state in the economy. Russian Railways' investment plans and needs are beyond the capacity of the federal budget, but the central factor in the reasoning behind the push for the offering of a quarter of the company to private investors is not to finance its heavy investment needs (that the company could manage through debt placement) or to improve governance (although the company is accused of heavy nepotism, it is also true that audits and rating agencies conclude reviews with a weak positive).

The aim of Russian Railways' privatization, as well as that of Sberbank, VTB and others, is to enhance competition, spur economic activity, boost growth and liberalize the heavily statist economy. Yakunin's claims about "public sector strategic planning" yielding satisfactory results at Russian Railways that would not improve with the private sector's involvement are not essential to considerations on whether or not to privatize the company. Russian Railways' results would certainly benefit from increased oversight, improved governance and reduced corruption and nepotism. The central question is whether the Russian authorities should really want this — and this is in the most political, long-term and strategic sense of the industry and its importance for the national economy, ignoring medium-term financial considerations and challenges that will be great.

The dispute over Russian Railways' privatization extends to conflicting statements between government ministers and Prime Minister Medvedev himself. While Prime Minister Medvedev included Russian Railways in the 2013 privatization plans, Yakunin immediately described this as an unrealistic deadline. As The Moscow Times reported, another advocate of speeding up privatization is Economic Development Minister Andrei Belousov, who argued for going through with set privatization targets due to constraints in Russian Railways' finances as well as the federal budget. Furthermore, Belousov saw the company's social spending practices as problematic and in need of a private sector check on spending. Transport Minister Maxim Sokolov, in line with his sector's champion Russian Railways, argues against privatizing a quarter of the company, especially by the end of 2013, calling the deadline unrealistic. Still, a consensus might be in sight.

An initiative for a reduced float of 5 percent of Russian Railways was recently put forward, although it is unclear who receives the credits for this middle way solution.
The Transportation Ministry issued a statement that Russian Railways' privatization would amount to a 5 percent share issue planed for 2013. Economic Development Minister Andrei Belousov, in strong favor of privatizing a quarter of Russian Railways, also confirmed that a 5 percent share issue is being considered for 2013 as a pilot deal for the privatization of a quarter of the company. Those pushing for further privatization should consider leaving the share of the private sector in Russian Railways in the single digits, or at temporary consensus levels. Thus, the benefits of investor scrutiny over Russian Railways' governance, spending and transparency would be employed while control of a highly important strategic industry would remain in government hands. Finally, any listing on a foreign stock exchange would also contribute to the goals of reducing financing costs while an important reason currently driving investor confidence in Russian Railways securities — namely, strong government support — would remain a contributing factor for future debt financing.

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