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Privatization Alternatives From the Baltics: Part 2

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In the first article on "Baltic Lessons on Privatization Alternatives, part 1" we briefly discussed Lithuania's experience in choosing an alternative to state-owned enterprise (SOE) privatization for supporting its budget.

Reform principles of how the state manages its enterprises gave surprisingly quick and substantial results. In Russian context, an SOE dividend contribution of 150m EUR may not look as impressive, but it should be taken into account that Lithuania is a country of 3 million inhabitants. The importance of SOE dividend contribution should be understood within the following context. Exactly 150m EUR was necessary to raise pensions to pre-recession levels. Furthermore, a one-percent increase in value added tax would have produced the same revenue for the state budget. In Russia, the same one percent VAT increase would amount to $8.59 billion. It is of note that dividends paid to the budget were not paid at cost of important investment projects and did not hamper the growth of SOEs.

Still, the reform itself was not about extracting dividends. It aspired to change the whole ecosystem of policy makers and state owned enterprises. We saw important progress here.

The attitude towards SOEs has changed. An analysis of the political discourse some 5 years ago shows that there was a clear consensus in the left and right of the political spectrum that state owned commercial enterprises have only one solution — privatization. SOEs seemed to be doomed to inefficiency and corruption. When in power, social democrats initiated, and executed privatizations of a number of large state owned enterprises in Lithuania. However, just within two years of SOEs reform, a consensus was formed that there is a systematic way to manage SOEs efficiently and transparently. For most politicians, it was extremely satisfying as they think that the state needs to own certain enterprises for different reasons, be it national security or management of natural resources.

Not less importantly, the view that SOEs should act as commercial entities and not as public institutions is being slowly accepted by both politicians and the public.

The Lithuanian Ownership Guidelines now require that independent board members constitute at least one third of each board in largest state-owned companies. Representatives of government institutions must avoid conflicts of interests between private and public appointments, e.g. a person who is working in the postal market regulation should not be nominated to the board of the state-owned post company. They also need either financial or strategic planning expertise in the relevant sector.

Such changes should encourage more transparent and efficient management of SOEs and create the environment in which it will be harder for politicians or managers of SOEs to seek their private objectives at the cost of a company's performance.

With the tools created within the last two years, the government now has much more power and can make more informed decisions regarding SOEs. Of course, there is still much more to be done before best corporate governance practices become effective in Lithuanian SOEs.

The gap between SOEs and private sector returns remains large, and Lithuanian SOEs still generate significantly lower profits than their peers in other European countries such as Sweden and France.

It will be a challenge for the new government to continue the programme of SOE reform and implement the principles laid down in the Ownership Guidelines to ensure even better performance and management of SOEs. Still, the ice is already broken, and it would likely be too costly for any government to change the direction and go back to where the SOEs were just a few years ago. Recent negatively marked changes in Lithuanian SOE boards resulted in a resignation of the Minister of Economy in Lithuania, confirming, for now, that the direction of SOE reform is still in place.

Lithuania is not alone in trying to modernize management of SOEs. It is well known that Sweden undertook major SOE reforms in the period between 1999-2000 that revitalized state owned enterprises and made them globally competitive. Norway, Finland, Singapore and a number of other countries introduced corporate governance standards in management of SOEs, which yielded significant results.

So why is Lithuania important in this context of success examples?

When we analyze Scandinavian models of doing things we often hear that their examples cannot be transferred due to cultural mismatch. Scandinavian countries have a particularly high trust in public institutions, high business ethics, a society that generally obeys the law. Post soviet bloc countries do not have that luxury.

The Lithuanian example is important because it demonstrates the applicability of the model in a post-soviet country with all its societal flaws. It shows that the model of SOE management is highly applicable in very different environments and may yield fast and significant results.

Another conclusion is that policymakers of a "country in crisis" have at least one more option of extracting value from SOEs, besides the usual way of privatization. Circumstances may vary, but policymakers have to think twice whether the time of biggest economic slowdown is right for privatization of unreformed SOEs. Sometimes it may look more like a fire sale.

It is crucial to recognize that SOE management reform is not a rhetorical suggestion to manage enterprises better. This discipline has its concept, logic, and with political support, it can be implemented in a timespan of approximately 18-24 months.

Another important remark is that the government can easily ask for advice on the well-studied subject of privatization policy while SOE reform remains a subject with few resources to consult. While OECD material offers advice on how SOE management should work, guidelines on how to implement reforms are scarce. Therefore, a huge opportunity remains for academic research about SOE management reforms and its impact on competitiveness, business culture and the overall economy of a country. Meanwhile, decision makers should look to countries that succeeded in the field and consider how universal lessons as these apply to their local context. Countries like Russia, with an economy greatly dependent on SOE contributions, are well suited to start this reform process.

This article is the second in a two-part series on state-owned enterprise management co-authored with Rimantas Žylius, Lithuanian Minister of Economy (2011-2012) who previously served as Vice Minister and Advisor to the Prime Minister of Lithuania. He currently works as a public policy and management consultant.

The views expressed in opinion pieces do not necessarily reflect the position of The Moscow Times.