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How Russia Is Being Nationalized

In 2004, [Kommersant](#) Publishing House began the >B>Who Owns Russia project, which researched the large private property holdings in Russia that formed as a result of privatization. Today we are talking about the opposite process – the formation of a powerful government sector in the Russian economy. In our new project, How Russia Is Being Nationalized, we discuss how that is happening and what it means for the country and its citizens.*

The Subject Matter

Nationalization is defined differently by different economists and politicians. That is natural, of course, since it is the most radical method of strengthening the state's role in the economy. To avoid lengthy discussion, we will take the simplest working definition of the word, in our view. Nationalization is the transfer of control of any asset from a private structure to the state. State control may be direct or indirect, but it must be based on legitimate property rights. That is to say that, when the police confiscate a knife from a criminal, it is not nationalization, any more than the expropriations the revolutionary masses made from the expropriators were in 1917.

Nationalization has been the most notable process in the Russian economy for more than four years and it is not too early to ask about intermediary results. Has it lead to radical changes in the economy? Are racing toward a planned economy? In our view, the answer to those questions so far is “no.” The state sector is growing rapidly but, for the main part, businesses and companies continue to live by market rules. That includes those that have become government property. The point of no return is still far ahead.

Knowing that our view may seem excessively rosy, we will provide one argument for it. We were only able to count five large private businesses that left there historical arenas as a result of processes of nationalization. Those companies are [YUKOS](#), [Sibneft](#), [Irkut](#), Power Machines and the Industrial-Construction Bank of St. Petersburg. For the same reason, two state companies, [Sukhoi](#) and [MiG](#), ceased to exist. They, along with Irkut, become the core of the United Aviation Construction Corp. There were four large state businesses created. Those are UACC, the recently founded Helicopters of Russia helicopter-construction holding and the United Shipbuilding Corp. And then, of course, there is [Rosneft](#), which was undeniable a different company before its acquisition of YUKOS. We will discuss [Gazprom's](#) bloating in the next article in the series, but for now we will note that it has not become a different company. Those shifts, though noteworthy, do not constitute a cardinal change in the market.

Beginnings and Endings

The official start of nationalization was in December 2004 with the sale of Yuganskneftegaz to Rosneft. But we can start from two years earlier than that. In 2002, Gazprom set about to regain its straying assets. Through the efforts of the management and well-known metals businessman (and [Kommersant](#) owner) Alisher Usmanov, head of Gazprominvestholding, [SIBUR](#), Stroitransgaz and the main gas-producing assets of [Itera](#) returned to Gazprom. Since

Gazprom transferred other of its holding to private ownership at the same time (it sold share packages in the Oskol Electrometallurgical Plant and the Lebedinsky Mining and Dressing Plant to Usmanov and the [National Reserve Bank](#) to Alexander Lebedev), those actions were perceived as state-supported optimization of the corporate structure. At that time, privatization processes were still dominate at the state level. INAKO oil company was sold in 2002, and [Slavneft](#) at the end of 2002. The establishment of the [TNK-BP](#) company, with approval from high places, in the first half of 2003 put an end to any fears of nationalization. Only the most foresighted person could have seen at that time that the arrest of YUKOS co-owner Platon Lebedev would lead to a change in government policy toward private business.

Today, the number of large nationalized businesses and banks is approaching twenty. That many more are on the horizon. Pending court decisions may take Russneft (the most notable assets of which are oil producer Varyeganneft and Varyeganneftekhim), Bashneft and Bashneftekhim. Atomenergoprom is being formed to united civil assets in atomic energy under state control.

Rosoboronexport is continually establishing holdings in various industries. The latest of them is Russian Special Steel (It is already known that the Red October plant in Volgograd and Stupino Metallurgical Production Association are to be incorporated into it.) and Russian Composites (about which the general public knows nothing but the name). Rosoboronexport is in a good position to set such goals and achieve them. It created the Helicopters of Russia holding and it manages carmaker [AvtoVAZ](#).

Other state monopolies have ambitions as well. [Russian Railways](#) intends to buy a blocking package in its main equipment supplier Transmashholding, and Gazprom will acquire a significant share in the thermal electric industry and in SUEK, the main producer of coal for power generation. It will also take under control of all the natural gas assets in the eastern part of the country under exclusive conditions. If all of those plans are realized, the question of the extent Russia has a market economy will have to be reexamined.

Doing the Same Thing for Different Reasons

It is obvious to us that the authorities did not have a nationalization plan, do not have one, and are not expected to make one. (That is not to say that there are not a certain number of papers with titles of that sort, written on orders from above, or not.) There are specific actions taken for various reasons. We have succeeded in identifying six such reasons.

The first is industrial, that is, the conscious decision that state domination should be guaranteed in various sectors. At the moment, that is the oil industry (because it is the most profitable) and the atomic industry (because it is the most sensitive). There is no need to mention gas because the state has always controlled it. There is a definite logic to such an approach, but no one said that it cannot be applied to other sectors, and an unlimited number of them.

Second, there is the elementary profit motive in state monopolies. That motivation clearly drives Gazprom to invest in Sakhalin 2 and the Kovykta deposit, and impels Rosoboronexport to buy the VSMPO-Avisma titanium holding. Russian Railway's plans to buy a blocking package in Transmashholding look the same. The explanation that a major supplier has to be controlled is not convincing. It is better for market structures to buy equipment on a competitive basis and not from a dependent company.

Third is national security. Or at least speculation on it. Someone has declared several industries or parts of them critical for the country, and in connection with that, the need for complete state control is found. Rosoboronexport head Sergey Chemezov has a particular knack for it.

Fourth is an honest attempt by the government to take on the role of anticrisis manager in a branch of industry that really needs it. That was the case with AvtoVAZ. Rosoboronexport managers took over the management of a tired, unprofitable enterprise with an extremely confused ownership structure and cooperative ties. If it has any noticeable success with it at all, it will deserve a monument for it. The same is true of UACC. By combining successful military aviation enterprises and unsuccessful civil ones, the state is trying to pull the entire industry up, using money from the federal budget, state resources, and the best managers from the private sector. The chances here, we think, are definitely high. The creators of United Shipbuilding had similar motives, but it

encompasses only state-owned wharfs so far.

Fifth is mutual desire for nationalization. That is when the owner of a certain asset wants to leave the business and is able to convince the government of the appropriateness of buying it. A wide range of experts say that that is what happened with Sibneft and the Industrial-Construction Bank, which were bought by Gazprom and [Vneshtorgbank](#), respectively. Former owner of the Industrial-Construction Bank Vladimir Kogan changed careers and is now deputy head of Rosstroj.

Last is what we would call "no reason." Here we lump together actions that were situational or lacked clear motivation. For example, no one wanted to buy or sell [Guta Bank](#). But it was in a difficult position and many depositors could have suffered, so the state, in the form of VTB, had to intervene. Guta Bank was bought for the symbolic price of 1 million rubles and renamed and reorganized as VTB Retail Services (VTB-24). Along with Guta Bank, VTB received shares in the Perm Motor Complex, that were completely useless to it and that have reportedly been resold to AFK Sistema. [Gazprombank](#) similarly received Uralsmash along with Power Machines, which was nationalized for the sake of the atomic industry. One peculiarity of that deal was that the main seller was Power Machines founder Kakha Bendukidze, who was at that time already a minister in the no longer friendly Georgian government, so everything had to be bought, and very quickly.

In our view, the most successful of these actions, the acquisition by the state of a controlling package in Gazprom does not have a rational explanation either. At the time when that goal was set, the state had 38 percent of the shares, with another approximately 10 percent belonging subsidiaries of the monopoly and 5 percent in the hands of [Ruhrgas](#), a major consumer, from the point of view of loyalty to Russia. The stock buy-up was nothing more than the formalization of the control that had always existed. It is impossible to say anything more than they felt like doing it. It was easy to do, the PR was positive, so why not?

A few common threads unite all of those motivations. Two any way. They first is an underlying idea that high state participation in the economy is good. The second is that consolidation will save the world. If there is a problem in some branch of industry, it is obviously because there are too many parties involved in it. The proposed solution is to concentrate resources in the main areas, unite the small with the large and eliminate duplication and unnecessary competition.

The fact that such logic is antimarket is obvious. But even the Soviet economy, in its most successful branches, was not fully consolidated.

Movers and Shakers

Russia, as it often does, it taking a complex and indirect path to nationalization. The classical method is the direct purchase of assets by the state. Strictly speaking, it was used only in the creation of UACC. In all other cases, private assets were transferred to the partial or complete control of state companies that were commercial structures. Arranged according to level of nationalization, Gazprom is indisputably in first place. Sibneft, SIBUR, the gas producing assets of Itera, Sakhalin 2, the Kovykta deposit and a number of electric generating facilities have come under its control, and SUEK may be added to the list presently. In addition, Gazprom and its subsidiaries can act as intermediaries, as Gazprombank did in the purchase of Power Machines. Second after Gazprom is Rosneft, which moved up from sixth-largest Russian oil company to first-largest through the acquisition of YUKOS assets. Rosoboronexport ranks third by assets, but higher by ambitions. With AvtoVAZ, VSMPO-Avisma, Helicopters of Russia, Russian Special Steel and Russian Composites under its control, it has gone from military hardware trader to a sort of commercial ministry of industry. Number four is Vneshtorgbank, the banking consolidator.

The modesty of the state's direct role can be explained by two reasons. The first is formal. Money for buying assets in the private sector is not allotted in the federal budget, and even with the current subservience of legislators, it would be hard to work that into the budget. The second reason is more important. In our view, the political leadership does not have great confidence in officials and approaches the expansion of functions of state agencies with caution. No one wants to recreate a ministerial system as such. If one looks carefully at current nationalization, it can be seen that it does not involve the complete displacement of private business. The formal strengthening of state control over

Gazprom was accompanied by liberalization of the market for its stock. That is, it was a market step, not antimarket, since a private investor received 49 percent of the normal stock unencumbered by arcane circulation schemes. Rosneft simultaneously acquired YUKOS and held a "people's" IPO, releasing 15 percent of its stock onto the market. At VSPMO-Avisma, a small stock package was left to the general director and the rights of minority shareholders were not damaged. Even in the atomic holding, private business is planned on the level of subsidiaries or lower. Thus the government is planning to work with private business and share its profits, as well as to use its resources, including managerial. The split outlook of the political leadership, with their distrust of officials and preference for state ownership over private, encourages optimism.

In our view, there is not yet reason enough to condemn Russian nationalization completely in its historical, international context. There has not been enough time or cause. But we will allow ourselves a few short observations. Compared to China, where the state still manages the most important assets directly, what Russia has looks more market-oriented. Sectors of industry that are considered strategic have been nationalized sometimes even in Western Europe. We will recall France in the 1950s through 1970s. In the modern world, the tendency toward state domination in profitable sectors is characteristic of Latin America, where there is a dirigiste policy in some countries (Mexico, Venezuela) and the Middle East (Iran, Saudi Arabia). Those associations do not flatter Russia, nor do they make it attractive for non-speculative investment or partnership.

** An article on nationalization in the Russian oil and gas industry will appear on September 17.*

Nationalization of Large Industrial Enterprises, 2002-2007

Instrument of nationalization Object of nationalization

Federal authorities Gazprom Bashneft Bashneftekhim

Gazprom Sibneft, Sakhalin Energy (Sakhalin 2), Russia Petroleum (the Kovykta deposit), Norgaz, major Itera gas-producing assets

Gazprombank Power Machines

Rosneft Enterprises formerly belonging to YUKOS

UACC Irkut (Irkutsk Aviation Production Assoc, Yakovlev Experimental Design Bureau, Beriev Taganrog Aviation Complex), Sukhoi, MiG

Rosoboronexport and Oboronprom AvtoVAZ, VSMPO-Avisma, Russian Special Steel (Volgograd Red October, Stupino Metallurgical Production Assoc.), Helicopters of Russia (all helicopter plants and design bureaus), Defensive Systems

Atomenergoprom Atomstroieksport, EMAlliance-atom (the ZiO-Podolsk plant), Kovrovsky Mechanical Plant

Vneshtorgbank Industrial-Construction Bank, Guta Bank
Yakov Pappé, Ekaterina Drankina

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