EIR Economics

Russia's free trade fanatics target natural monopolies

by Rachel Douglas

Like Tony Blair, the New Age British Labourite who would out-Thatcher Thatcher and considers the New Zealand model of vicious austerity by means of deregulation and privatization to be one of his ideals, the young wizards of Russia's disastrous market reforms are having a new go. The experimenters are First Deputy Premiers Anatoli Chubais, who already presided over excesses of asset-stripping during the first round of privatization of Russian industry; and Boris Nemtsov, a new figure on the national scene, who has spent the last several of his 37 years governing Nizhni Novgorod, Russia's third largest city, as a reform laboratory. At the center of their attention, and in the express charge of Nemtsov, are Russia's so-called natural monopolies: foremost among them, the Gazprom natural gas company, the Unified Energy System electric power grid, and the Ministry of Railways.

On April 28, President Boris Yeltsin signed decrees on the reform of each of these entities, as well as the sale of 49% of the national telecommunications company. The opposition press minces no words: *Sovetskaya Rossiya* of April 29, headlining their view that Chubais and Nemtsov are "young wreckers," identified the natural monopoly reform as being dictated by International Monetary Fund Managing Director Michel Camdessus and World Bank President James Wolfensohn—" 'restructuring,' that is to say destruction, of the so-called 'natural monopolies' . . . and their transfer to private hands." Nemtsov, meanwhile, protests that he will *not* "break up" the firms, which is seen, and not in Communist Party opposition circles alone, as tantamount to breaking up Russia.

In his first nationally televised interview after taking office, broadcast on March 23, Nemtsov insisted, "Regardless of the variants of de-monopolization . . . the integrated power system of the country, [and] the integrated system of gas supply will remain. . . . We should not do anything to destroy the existing system of power transmission. This is impermissible." And, in the same interview: "Work with natural monopolies is the basis for reviving the country's economy."

In a policy geometry designed by the International Monetary Fund (IMF), for which it is now axiomatic that "deindustrialization" is a Good Thing, Nemtsov's disclaimers obscure what is going on. To "revive the country's economy" may no longer have anything to do with goods production, freight turnover, or rising standards of living, and "efficiency" has become a code word for millions of people becoming unemployed. It will shed light through the mystification, if we look at the Russian "natural monopolies" reform from several sides: the physical productive and earning capacities that are at stake; the interests and intentions of the international financial institutions, which the Russian government is constantly straining to satisfy; and the crafting of the current reform, which turns out to be an application of Thatcherite techniques of income-stream extraction, to the wounded giant, Russia.

The natural monopolies

An industry or infrastructure sector is a "natural" monopoly, when its mission and inherent economies of scale allow it to function most efficiently as a single national firm. In post-Soviet Russia, where every branch of industry had been a state-owned monopoly, the natural monopolies that survived the first round of privatization were chiefly in energy and infrastructure.

Gazprom. The natural gas firm, which Premier Viktor Chernomyrdin headed in the late Soviet period, is one of the largest companies in the world. Estimates of its assets, including proven natural gas reserves, range from $100 billion up to $1 trillion. Gazprom is believed to hold 24-33% of total known world natural gas reserves, and is a major gas supplier to Europe, especially Germany, Italy, and France. It is Russia's single largest hard-currency earner. Gazprom was partly privatized, as a joint-stock company, in 1992-93, and 9% of its shares were put up for sale on the world market. The Russian state still controls 40% of the shares (see *EIR*, Aug. 11, 1995, "Gazprom Privatization Is a Strategic Issue").

Gazprom is also the biggest delinquent taxpayer in Russia, with debts to the state budget and extra-budgetary funds, such as the Pension Fund, in excess of 15 trillion rubles, or $2.75 billion. But Gazprom is owed 69.5 trillion rubles ($12.1 billion) by delinquent customers—6.8 trillion rubles ($1.2 billion) by city of Moscow power stations alone. Gazprom chairman Rem Vyakhirev told an April 15 press conference, that the company received only 45% on current charges due during the first quarter of 1997, and only 6% in cash!

Unified Energy System. The national electricity company is still 51% owned by the state. UES has 110 gigawatts of generating capacity, and transmits power across 11 time zones. Its plant and equipment comprise 600 thermal electric power plants and 100 hydroelectric power plants (nuclear power is administered separately, by the Ministry of Atomic Energy), and 2.5 million kilometers of transmission lines; estimates of the value of these assets approach the range of 1 quadrillion rubles, or almost $200 billion.

The Railways Ministry (MPS). Even after a one-third decline in freight shipments, during five and a half years of "reform," the Russian national rail system carries 1 billion tons of freight and 2 million passengers in a year. The railroads employ 2.5 million people.

Goal: dismemberment

The very way the phrase "breaking up" the natural monopolies is used in Russia, suggests how explosive the concept is: An analyst writing in *Nezavisimaya Gazeta* last December, for example, remarked that the relative silence of both the IMF and the (at that time barely functional) Russian government, about the proclaimed priority goal of reorganizing of the natural monopolies, meant that there must be a compromise in the works, by which "the notorious 'breaking up' " could be avoided.

A dossier of pronouncements by leading officials and associations of the international financial institutions, nonetheless, keeps in focus that "breaking up" *is* an end-phase goal, even as interim looting mechanisms are instituted in the name of achieving "efficiency."

- Camdessus, at a Moscow press conference on Feb. 22, 1996, on the continuing Russian commitment to privatization: "The purpose of privatizing the enterprises in all the domains, except for strategic domains or very specific natural monopolies, *where before privatization special regulation will have to be introduced*—there are no changes in the philosophy, but, I repeat, the reaffirmation that the privatization must be maintained."
- Camdessus, April 3, 1997 in Moscow: "Well, it is part of the agreed strategy between the IMF and your great country to continue with the policy of opening the natural monopolies to the disciplines of the market. . . . These natural monopolies handle a huge part of the wealth of this country. It would be wrong in a context of market economy to allow this huge part of your economy to be protected or exonerated from the disciplines of the market."
- Marshall Goldman, Soviet and Russian economy specialist at Harvard University, interviewed March 24, 1997 by the Voice of America: "I am dazzled—and that's a very strong word for me—by the fact that Boris Nemtsov . . . has agreed to come and be a second first deputy prime minister. His specific assignments are to address the wage arrears problem . . . and also the anti-monopoly effort, to break up some of the large monopolies."

The income stream

Why such enthusiasm; what is the goal pursued with such zeal? The name of the game is: *income stream.* Having inherited the Soviet Union's foreign debt in 1991, then estimated at $60-80 billion, Russia today carries foreign debt of nearly $150 billion.

Chubais is going to borrow more. Speaking on April 28 in Washington, where he attended the IMF spring meeting, Chubais said that accord with the Fund—conditioned on the natural monopolies reorganization, tax collection, and other measures—was critical, in order to ensure Russia's credit rating for its placement of state bonds on the London market. Revenues from sale of these Eurobonds—$2.2 billion so far and planned to double by the end of this year—are being used, fire-brigade style, for the payment of the politically most pressing state-sector wage and pension arrears!

In addition to interest payments on debt, another special value of Russia to an international financial system dominated by an insatiable appetite for income to feed the biggest financial bubble in history, is as a supplier of raw materials and other tangible assets.

These two circumstances, the debt and the availability of saleable assets, raise the specter of out-and-out asset-stripping during natural monopolies reform. Russian opponents of "breaking up" the monopolies are mindful of the fresh case of Kazakhstan, where a cash-strapped government has sold fixed capital as a major source of revenue. With some 90% of Kazakhstan's industry privatized, including by sale to foreign investors, much of its manufacturing (as opposed to extractive) component has been shut down; a Kazakhstan trade union leader speaks of 56 "ghost towns" in the country, formerly industrial centers.

Kazakhstan's 4-gigawatt Ekibastuz power station, built in the middle of a coal basin that was a major Soviet energy project, was sold last year to AES of Virginia, for $3.7 million! The plant was in disrepair, working at only 20% of capacity, and in dire need of maintenance, but the price was *two orders of magnitude* below the $300 million AES paid for a power plant in Northern Ireland, which, at 800 megawatts, has only one-fifth the capacity of Ekibastuz. Hence the alarm bells in Russia, when it was reported in December 1996 that State Committee on Property Chairman Alfred Kokh (now a deputy premier) had agreed to sell 7.5% of the shares of UES for as little as 1.5 trillion rubles, under $300 million. The purpose of the sale, *Nezavisimaya Gazeta* observed, was budget cash flow, but the assets should have a fair market value of over $12 billion.

In the railway sector, Anatoli Zaitsev was fired as minister of the MPS, as the revamped Chubais team came in this March. Zaitsev was on record with his belief that "it is fortunate that the railroads are still in the hands of the state." Nemtsov criticized the MPS for keeping freight tariffs too high, despite the crash in freight turnover, and Zaitsev is now out of the picture.

Regulation, for what?

The April 28 natural monopolies reforms mandate not the "breaking up," but an array of measures to rationalize utilization of these capacities and eliminate price subsidies. The justification is to put an end to over-pricing by the monopolists.

After a political offensive in April, during which he addressed the State Duma, Rem Vyakhirev has kept control of the state's shares in Gazprom in the hands of his current board of directors. But Gazprom loses its monopoly on the development of natural gas deposits. Hypothetically, other natural gas companies will have access to the Gazprom pipeline network, while competing with Gazprom.

UES is under orders to lower its prices for industrial electricity users by 13%, while prices for consumers are to rise. Large industrial firms will be allowed to purchase electricity directly from physically proximate electricity purchasers, including atomic power plants, instead of buying only through UES.

If this sounds like re-regulation, rather than the "deregulation" familiar from the assault on infrastructure systems in the West (see "Electricity Deregulation Threatens America's Economy and Security," *EIR,* March 7, 1997), it is because in Russia the natural monopolies are the partly privatized former state behemoths, now vulnerable to attack as "vested interests," while the state, guided by Camdessus through Chubais, intervenes as agent for "the market." But, the measures applied are drawn exactly from the deregulation/privatization sequence of Thatcher's England, or New Zealand, or Victoria, Australia. In those models, the typical maneuver has been not the immediate "breaking up" of the natural monopoly's physical core, but hiving off the sales and services aspects, with a proliferation of firms competing in "efficiency" in these areas. Camdessus proclaims the goal to be "promoting competition and efficiency to better serve the customers, namely, the people of Russia," but the measure is the income stream. The hallmarks of "efficiency" are workforce reduction and success in bill collection.

Gennadi Kazakevitch, a Russian-born economist now working in Australia, previewed what would happen to Gazprom, in an April 1996 article in the *Russian and Euro-Asian Economics Bulletin.* "The key aim of natural monopoly restructuring," he wrote, "is to localize and extract the 'natural monopoly component' of an industry. In the electricity supply industry this component is the high power transmission network, or 'the grid'; in the natural gas and oil industries it is the network of pipelines, and in railway transport it is the network of railways. Restructuring aims at a situation whereby only the extracted indivisible component remains under government control. All remaining parts of the former natural monopoly are then commercialized, disaggregated (the measure currently under consideration for the Russian gas industry) and, eventually, privatized."

At his monthly press briefing in Moscow, April 14, London School of Economics professor and resident adviser to the Russian government Richard Layard drew the parallel with Britain. "Natural monopolies should be properly regulated. The first step is to introduce whatever amount of competition is possible in these industries, and more competition is possible than some people think. The problem of natural monopoly arises, of course, because of the economies of scale, in having only one physical link to a consumer. That's one gas pipeline, one electricity connection, one telephone connection, one rail connection. . . . There is a strong case for putting the ownership of the connections, the physical channels, into a separate company from the producing company. Then you would let different producing companies sell their output down the same channel. This is, in fact, what we now do in Britain for both gas, electricity, telephone, and rail."

Anticipating this approach, Vyakhirev's managers began restructuring Gazprom last year, creating a subsidiary for sales, and regional sales branches.

Kazakevitch acknowledged that the greatest difference between Australia and Russia, regarding natural monopolies reform, was the labor force. Even if "physical capital" is not rationalized (shut down) in the first phase of reorganization, there is an immediate reduction of employment. In Russia, the problem of "reabsorption of retrenched workers . . . would occur in a completely different economic environment" than in Victoria, or Britain, and would set the stage for an already desperate workforce to plunge into desperation, with no capability to move somewhere else in search of employment.

As we go to press on May 8, the political and social explosions, implicit in the Chubais-Nemtsov measures, have begun to go off. The Communist and other opposition factions in the Duma, along with Moscow Mayor Yuri Luzhkov, are on a political offensive against the deep budget cuts, and the phased elimination of housing and municipal services subsidies, which Chubais and Nemtsov presented as part of their package, along with the reform of the natural monopolies.