The review provides a detailed analysis of main trends in Russia's economy in 2011. The paper contains 6 big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and credit spheres; financial sphere; the real sector; social sphere; institutional challenges. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts.
Section 6
Institutional Issues


The worldwide downturn that hit economies at the end of the first decade of 21st century, has led to a series of socio-economic changes whose effect in terms of radicality requires quite a long time to comprehend. Even today, however, it is quite obvious that both leading market institutions of the western world, namely the US institution based on the principles of free market competition, and the European institution governed by socially oriented principles, have failed to offer adequate countermeasures at the initial phase of the crisis, when the first signs thereof emerged. However, it is only the nations with more powerful influence on their economy that have managed to counteract the developments leading to financial and economic collapse. And Russia belongs to this nations, with some reservations though.

However, the effect of a large-scale government intervention in the economy, which is positive amid crisis, may often become adverse at the stage of stable, long-term economic growth.

6.2.1. “New privatization policy” background

More than 20 years of experience in Russia and other economies in transition proves that the process of denationalization is complex and time-consuming. The dynamics of denationalization process in Russia was conditioned by two opposite trends in the 2000s.

On the one hand, the privatization process continued with different degrees of intensity. The Government of Russia approved annual comprehensive forecast plans (programs) of privatization of federally owned property, which include thousands of FSUEs and shares (interest) of business entities operating in various sectors. As is evident from the previous section, a total number of federal state unitary enterprises and joint stock companies with state participation decreased about 40% in the period between 2007 and 2010. This trend, however, is most typical of the federal level. The number of unitary enterprises changed in different ways at the regional and local levels. Even a formal decrease in the number of state-owned enterprises at the federal level depends largely on the formation of “integrated structures” and state-owned corporations.

The rate of privatization slowed down after 2005, as evidenced by the results achieved in 2006–2008. No positive dynamics was reported until 2010, as evidenced not only by quantity of property assets but also budget revenues. According to the Ministry of Economic Development and Trade of Russia, revenues from sale of privatized federally owned property assets

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1 Based on the materials provided by the Expert Group on Management of State-Owned Property and Privatization which was established in January 2011 as part of the updated Concept of Socio-Economic Development of the Russian Federation until 2020 (“Strategy 2020”).

in 2010 totaled Rb 22,67bn\(^1\) and outstripped many times the federal budget revenues from privatization of state-owned property assets in 2008 (Rb 7,19bn) and 2009 (Rb 1,93bn), and outstripped the target figures, which was not the case in the recent successive years. In 2011 this trend became more evident, with some reservations though (Rb 121bn) (Rb 126bn, according to the Report on the Implementation of the Federal Budget as of January 1, 2012).

On the other hand, the state has strengthened its influence vs. the 1990s. In the period between 2000 and 2003 the state was focused mainly on optimizing its direct participation in the economy which was retained after the implementation of the programs on voucher (1992–1994) and cash (1995–1999) privatization. The next 5-year period (from 2004 to 2008) was characterized by a wider participation through acceleration of the activity of companies with state capital participation which tended to expand and diversify their business by engaging in mergers and acquisitions. The strategy of consolidation of the remainder of scattered state-owned assets into integrated entities was accelerated in the period of 2006–2007. The public ownership policy was distinguished by the establishment of state-owned corporations, some of which were industry-specific (aviation and nuclear power industries, shipbuilding industry), including manufacturing of civil products.

Enhanced state participation in the economy was reflected in the national policy documents as well. It is highlighted in the Concept of Long-Term Socio-Economic Development of the Russian Federation until 2020 (which was adopted in 2008) that public sector fits well into the Russian economy and acknowledges that state-owned enterprises play an important role. However, with regard to state-owned property management (of specific categories of property assets), this document provides for basically the same approaches envisaged in the previous government programs implemented in the 2000s. The requirement that the composition of state-owned property must comply with not only powers and functions of the state, but also structural changes in any given industry, can be considered an important feature.

The recession of 2008–2009 was not responsible for a large-scale growth in the public sector, because the anti-recessionary strategy was focused on minimizing direct participation of the state in the capital of distressed private companies and banks. Furthermore, according to the official data provided by the Rosstat (without consideration of pyramidal ownership in the mixed sector) testifies to the fact that the public sector continued to decrease its participation in the economy in the period between 2008 and 2010 as well. However, most of expert estimates show that the state increased its participation in the Russian economy due to both activities of mixed sector companies in corporate control market and indirect recession countermeasures taken by the state. In particular indirect influence of state-controlled banks and entities acting as its agents in taking recession countermeasures, increased.

According to the EBRD, by 2009 the public sector of the Russian economy increased from 30 to 35% of GDP. Though this data is very illustrative in terms of dynamics, it seems to be underestimated as applicable to the public sector scope. According to the available estimates (Troika Dialog, 2008), federal and regional authorities controlled about 40% of capitalization in the Russian stock market at the end of 2007 vs. 24% in 2004. According to the Expert-400 rating, by the beginning of 2008 “the depth of ownership concentrated” in the hands of the

\(^1\) However, according to the preliminary data provided in the Report on the Implementation of the Federal Budget as of January 1, 2011, www.roskazna.ru, federal budget revenues from privatization and sale of property assets (including land plots) totaled Rb 18,68bn.
state stood at 40 to 45%, whereas in 2009 this indicator stood at within 50%, according to various expert assessments.

Active “structural” privatization policy was commenced at the end of 2009, when the Russian economy began to recover from acute recession phase. The following “standard” objectives of privatization were set in the period between 2006 and 2008: generate federal budget revenues, undertake privatization of the property assets which were not involved in government functions, undertake incorporation of unitary enterprises. Public statements of top officials of the Government of Russia in September-October 2009 made notes for the first time of a “structural” privatization aimed at reducing the scope of state direct participation in the Russian economy, enhancing competition in industries, generating investments in long-term corporate development, improving the effectiveness of large companies with state participation.

A new stage of privatization was started when the Government of Russia (November 30, 2009) approved another Forecast Plan of Privatization of Federally Owned Property for 2010 and the Guidelines of Privatization of Federally Owned Property for the Period of 2011–2012. The plan had some specific features, namely generation of extra budgetary investments in the development of privatized companies was set as a top-priority task; the list of sectors (industries) scheduled for privatization was expanded essentially; focus was placed on privatization of a series of the largest (budget revenue generating) companies. The foregoing allows one to say that a “new privatization” policy was launched in Russia at the beginning of 2010.

In general, two groups of preconditions for the transition to “new privatization” can be underlined. The first group included fundamental factors which are not linked directly to the recent worldwide downturn:

- the state has an ambiguous and controversial status (as lawmaker, regulator and direct participant in large companies);
- there is no appropriate environment in place to ensure fair competition and enhance investment activity through private businesses in industries with high level of direct state participation;
- large companies with state participation show active behavior in acquiring assets, including extension of non-core assets;
- there are objective limits which interfere with higher quality of corporate governance in public sector companies;
- there are many public sector entities which are not effectively managed and supervised by the state.

However, radical changes in the contents of state privatization policy in 2010, which were focused on the structural component thereof and denationalization of the largest companies, specific sectors, were, in our opinion, largely conditioned by awareness of the issues which became topical as a result of the recent downturn (second group of preconditions):

- the state is strengthening its participation (influence) in the economy amid crisis, and the level of direct state participation is too high;
- the risk of that in the post-crisis period the state would strengthen its participation in the economy due to uncertainty about what may happen with companies’ shares pledged as collateral for state anti-recessionary support if such companies fail to discharge their loan obligations;
poor competitiveness of a series of public sector large companies, the need to undertake restructuring and technological modernization thereof;

- the need to generate considerable extra budgetary investments, including the development of the key sectors within the infrastructure framework;

- there are stronger doubts about prospects of rapid post-crisis growth in the Russian economy; social budget expenditures have been extended, which may result in the need to impose stronger budget constraints (looking for more budget revenues).

In general, the issues of structural effect of privatization for the development of the Russian economy have been placed to the foreground of ‘state agenda’. In our opinion, the privatization policy’s structural approach is evidenced by both official statements and actions which have been undertook over the last two years to update regulation of privatization, reduce drastically the list of strategic enterprises, plan privatization of the largest public sector companies, improve corporate governance of companies with state participation.

First, a series of significant updates and amendments were made to the Federal Law “On Privatization”\(^1\), in particular:

- the transfer to mid-term planning of privatization of federally owned property was undertaken, the Government of Russia was entitled to define possibilities to draft forecast plans (programs) of privatization for a period of 1 to 3 years (previously, forecast plans were drafted annually) and add new entities to privatization plans;

- the Government of Russia was entitled to make decisions on privatization of state-owned property of the scope of the ‘standard’ procedures established by the Federal Law “On Privatization” for the purpose of creating conditions for investments, promoting the development of the stock market, as well as modernization and technological development of the economy;

- the Government of Russia was entitled to delegate to legal entities the functions of seller of privatized federally owned property assets;

- the use of the principle of standard price of assets subject to privatization was abolished; standard price was defined pursuant to the procedure for minimum price at which such assets may be sold, established by the Government of Russia;

- conditions for privatization of small federally owned property assets were simplified, potential buyers were granted more access to be able to participate in privatization (the possibility to sell state-owned property assets in electronic format was defined; the relevant procedure was refined through public offering – Dutch auction; the required amount of tender or auction guarantee was reduced);

- transparency requirements for privatization procedures were upgraded.

Second, drastic changes in the list of strategic enterprises and joint stock companies\(^2\) should be mentioned in the context of extension of the privatization base: the number of eligible organizations was more than halved, down to 200 in 2010. Making industry-specific ex-

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\(^2\) Russian President Order No. 1009, dd. August 4, 2004, “On the Approval of the List of Strategic Enterprises and the List of Strategic Joint Stock Companies”. It should be noted that under the applicable Federal Law “On Privatization”, strategic enterprises and the shares of strategic joint stock companies may not be included into the forecast plan (program) of privatization of federally owned property unless they are excluded from the list of strategic enterprises and joint stock companies.
amination of the delisted organizations, it should be noted that a major part thereof (about 1/4) are somehow linked to the transport industry and the relevant infrastructure.

Third, plans on privatization of the shares of 10 largest Russian companies and banks (Rosneft, RusHydro, Federal Grid Company of United Energy System, Sovcomflot, Sberbank of Russia, VTB Bank, United Grain Company, Rosagroleasing, Russian Railways, Rosselkhozbank)\(^1\) leading in relevant industries were defined for 2011–2015. The shares of the foregoing companies are planned to privatize subject to relevant decisions of the President and the Government of Russia, i.e. on a case-by-case basis. It was established that state participation would be reduced both through sale of a part of state-held shares and second offering to generate investments for the benefit of companies.

Fourth, in addition to defining plans and preparations for sale of the shares of largest public sector companies and banks, it should be noted that the process of preparation and implementation of privatization of smaller public sector companies and enterprises was accelerated. For example, the Forecast Plan of Privatization of Federally Owned Property for 2010 was largely extended by enlisting about 500 enterprises, of which FSUEs totaled more than 200\(^2\). A special emphasis should be placed on that a series of large JSCs operating in the transport industry and transport infrastructure (sea and river shipping line companies and ports, airports), were added to the list.

It should be noted that high dynamics of actions within the framework of state privatization policy remained unchanged in 2011 (see the previous section herein). Both new political statements (about enhancing the privatization process) and applied innovations in the field of e-trading, development of FSUE strategies, withdrawal of top state officials from boards of directors, creating a greater variety of methods of transformation of unitary enterprises.

Hence drafting and implementation of the “new” privatization policy in 2009–2010 were definitely considered among the top priority objectives of the state. However, in spite of positive developments, this process is quite complex and requires constant maneuvering and temporal trade-offs. In our opinion, drafting and implementation of the state privatization policy are characterized by a special role of political decisions, a particular system of ‘presumptions’ with regard to this field, due to objectively limited possibilities of assessing a socio-economic effect, high diversity of the public sector and specifics of various state-owned assets. In the meantime, it goes without saying that political decisions can’t define all the complementary measures to be taken by the state, thus increasing the role of various stakeholder groups with a positive agenda in defining specific measures on the implementation of political decisions, whereas rivalry between these stakeholder groups defines ‘driftage’ of the privatization policy.

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\(^1\) Refer to, above all, the Forecast Plan (Program) of Privatization of Federally Owned Property and the Guidelines of Privatization of Federally Owned Property for the period of 2011–2013, as well as the information published by the Ministry of Economic Development and Trade of Russia on planned sale of the shares of large companies leading in relevant industries of the Russian economy, in 2011–2015 (http://www.economy.gov.ru/minec/activity/sections/investmentpolicy/doc20101123_08). This list was extended in July 2011.

\(^2\) No unitary enterprises were originally listed in the Forecast Plan (Program) of Privatization of Federally Owned Property for 2010.
6.2.2. Stakeholder groups and principal risks

In our opinion, the development of “new privatization” ideology can be distinguished, with certain reservations, by three different but not mutually exclusive approaches which are somehow linked to different stakeholder groups in constructing the relevant public policy.

First – ‘budget’ – approach implies that privatization should firstly serve as a tool for generating more budget revenues and eventually ensuring current and mid-run macroeconomic stability. In doing so, however, revenues from renewable sources, including privatization, are supposed to be made much less available to finance current budget expenditures. Shrinking of the public sector as a result of privatization is also considered a way to reduce the number of ‘recipients’ of state support.

Second – ‘structural’ – approach means that privatization should basically be used as a tool to improve competitive power of companies subject to privatization as well as the structure of selected industries and activities. Decisions on privatization of companies should be governed by expediency-based practice of engaging strategic private investors, investment inflow (including a secondary issue of shares to reduce a state capital participation), higher level of corporate governance, promotion of competitive and business environments, etc., rather than fiscal interests.

Third – ‘sectoral’ – approach is focused on ensuring social stability and control over the situation, triggering processes of modernization of specific industries through direct state participation. This may result in the need to maintain (increase, as appropriate) direct state influence on the development of industries and sectors ‘sensitive’ for the general public and the development of the economy at large. This approach is based on large and extra large state-owned companies. The principal tools are implementation of large investment projects and programs (innovative ones, whenever appropriate), establishment of state controlled (state-owned companies) integrated structures, etc.

Each of the approaches has both advantages and is exposed to certain issues and risks. This is why forecasts of expected revenues from privatization may differ largely in the level of declarativity of selected revenue base as well as the status of a regulatory document, and quite often are conventionally estimative (see Table 12).

<table>
<thead>
<tr>
<th>Table 12</th>
<th>Forecast of revenues from privatization in the period between 2011 and 2014: assessment, Rb billion</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Forecast Plan (Program) of Privatization of Federally Owned Property for the period of 2011–2013 (approved by Russian Government Order dd. November 27, 2010)*</td>
<td>6 5 5 -</td>
</tr>
<tr>
<td>Federal Law “On the Federal Budget for 2011 and Planning Period of 2012 and 2013” No. 357-FZ, dd. December 13, 2010, (as revised on June 1, 2011, No. 105-FZ)</td>
<td>- - - -</td>
</tr>
<tr>
<td>Basic principles of the budget strategy for 2011 and planning period of 2012 and 2013; for 2012 and planning period of 2013 and 2014.</td>
<td>298 276,1 309,4 300,0</td>
</tr>
<tr>
<td>Budget quarterly breakdown for 2011, item “revenues from sale of shares and other forms of capital participation, federally owned property” (<a href="http://www.roskazna.ru">www.roskazna.ru</a>)</td>
<td>297,954 - - -</td>
</tr>
<tr>
<td>The Office of the President of Russia (11.07.2011, Moscow News): at least</td>
<td>450 450 450 450</td>
</tr>
<tr>
<td>Government of Russia (17.06.2011, <a href="http://www.rg.ru/2011/06/17/privatizacija-site.html">http://www.rg.ru/2011/06/17/privatizacija-site.html</a>): about</td>
<td>500 - - -</td>
</tr>
<tr>
<td>the Ministry of Economic Development and Trade of Russia (25.07.2011, Vedomosti)</td>
<td>1000 1000 1000 1000</td>
</tr>
</tbody>
</table>
It was assumed that “The forecast of revenues from sale of federally owned property can be updated if the Government of Russia makes relevant decisions on privatization of the shares of the largest companies which are highly attractive for investment, in which case revenues from sale of federally owned property in 2011–2013 may total (with consideration for a market situation) about Rb 1 trillion”. The forecast remained the same in spite of five amendments made in the period between December 2010 and July 2011.

Realistic assessment of available sources of financing of ambitious privatization plans is a special and extremely complicated problem as part of the ‘budget’ approach. Putting aside any options relating to active behavior of largest companies and banks with state participation (as buyers who have indirect, preferred access to state financial resources), the first thing that comes to mind is international financial markets, where, however, competition between national governments wishing to implement certain privatization projects resumed its intensity in the period between 2010 and 2011.

Furthermore, according to a severe assessment of A. Vedev, “when we talk about prospects of privatization of, say, state-owned corporations, state-owned banks, state-owned property assets, we must understand clearly that we have no internal resources for privatization”. Referring to analysis of the structure of institutional cash flows of the Russian economy as of January 1, 2011, enterprises have been net borrowers over the last decade (net debt due by accounted for 15% of gross assets of the banking system, or accounted for about 10% of GDP)\(^1\).

From this it is inferred that “the new privatization policy” can be implemented with success depending on a set of decisions relating to the system-wide development of the institutional and investment environments, and the financial system of Russia. First of all, it means constraints on foreign legal entities with regard to strategic industries, title guarantees and law enforcement in general, promotion of internal long-term sources of investment, also through modernization of the funded pension system, collective investment institutions and stock market technologies.

However, the ‘budget’ approach neither is focused on fundraising to develop privatized companies, nor requires any mandatory transfer of control over privatized companies from the state to private owners. These are advantages of the ‘structural’ approach which, however, is exposed to the risk of subsequent state intervention in the activity of privatized companies, ensures no efficient use of companies’ borrowings and is not focused on the development of most “notable” business entities. Though the ‘sectoral’ approach can be used for aggressive, relatively rapid reconstruction of selected sectors in creating “national champions”, it may result in unregulated overgrowth of the public sector, deterioration of the competitive environment and restriction of private initiatives (see Table 13).

**Table 13**

<table>
<thead>
<tr>
<th>Approach</th>
<th>Advantages</th>
<th>Problems and risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Budget” approach</td>
<td>Lower (or full absence of) barriers for buyers; reasonable presales preparation; focus on privatization of largest companies; general reduction of the number of SUEs and OJSCs with state participation</td>
<td>Value of privatized shares is not important; possible state control in large companies; focus on sales of “no-problem”, liquid assets; focus on a relatively short-term perspective</td>
</tr>
<tr>
<td>“Structural” approach</td>
<td>Increasing investment trend in using revenues from privatization; Focus on attracting strategic investors;</td>
<td>Ill-defined mutual obligations in the long-term outlook; Issues relating to the selection of efficient strategic investors;</td>
</tr>
</tbody>
</table>

-- Table: RUSSIAN ECONOMY IN 2011: trends and outlooks

<table>
<thead>
<tr>
<th>“Sectoral” approach</th>
<th>actual reduction of a public sector share in the economy</th>
<th>focus on the development of basically large and extra large companies; problems of inefficient usage of extra budgetary borrowings by companies</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Development and advanced modernization of largest public sector companies; higher level of attractiveness of large state-owned companies for potential investors; provision of social stability</td>
<td>Poor incentives to develop sectoral regulation; retained (increased) direct state participation in the economy; risk of uncontrolled “overgrowth” of companies with state participation and deterioration of competitive environment; risks of “nontransparent exchange”, “administrative bargaining”</td>
</tr>
</tbody>
</table>

Competition for influence between the selected “stakeholder groups” leads to some investigations.

First effect – a certain frequency of increase (or decrease) in influence of “stakeholder groups” on decisions made in the world of privatization. Seniority of a specific approach depends largely on a situation (expectations) relating to budget balance, serious problems encountered in some of the “socio-sensitive” markets. For example, it was in the period (May thru June) of discussion of the draft budget parameters when a trend towards increase in the role of privatization in generating extra budget revenues became well-marked, when deficiencies in regulation of certain markets came into surface, the rationale increased for the need to maintain direct state participation in certain large companies as “compensation” for market failures.

Second effect – half-way nature of decisions made, incompleteness and inconsistency of implemented measures. Following are some of the recently (2010 – 2011) available examples:

- positive decision on widening the representation of independent directors in companies with state participation is not supported by measures aimed at increasing the role and liability of boards of directors, changing the procedure for appointment of senior managers therein;
- generation investments for corporate development in the course of privatization (denationalization, to be more precise) is possible for only a small number extra large companies on the basis of individual decisions, whereas no relevant tools and mechanisms (methods of privatization) are available for other companies;
- refusal to use state-owned corporations as a type of business entity is accompanied by setting a task on working out a new form of “public entity”\(^1\);
- given a general focus on reduction of the use of the institute of unitary enterprises, no efforts are made to determine tools of transparent financing of solution of public objectives (functions) through companies, including the private sector.

Third effect – predominantly concealing nature of lobbying interests as part of privatization, more opportunities for making individual decision amid ill-defined legal framework, poor official rationale for decisions made. In our opinion, a certain “lack of focus” regarding the conditions of privatization, in particular of large companies, is, to a certain extent, reasonable costs conditioned by an effort to change in reasonable time the situation amid high administrative barriers as coordination of well-defined regulations and rules of privatization between ‘stakeholder groups’. The same, however, boosts “competition” between different approaches.

\(^1\) See the schedule of measures of transformation and liquidation of state-owned corporations and Avtodor state-owned company, approved by the Chairman of the Government of Russia on December 29, 2010, No. 6793p-P13.
towards privatization and leads to lesser predictability of its conditions at the level of every large company with state participation.

With respect to prospects of privatization, provision of the effective socio-economic development given the significance of a series of political decisions (provision of structural effect, restriction on direct representation of sector-specific ministries in the governance of companies, defining the possibility for the state to give up its controlling interest in a series of largest companies), the following significant risks are worth noting.

First risk – expansion of the public (quasi-public) sector amid privatization processes. In our opinion, the scales of denationalization, on the one hand, and consolidation of assets within specific large companies (banks) with state participation, their “growth” in competitive activities, on the other hand, can be found to be comparable. This risk seems to be more important in the near term.

Second risk is more important in the mid- and long-term prospects: lack of efforts for the development of sector-specific regulation of privatization of large companies will subsequently increase an informal effect on them from the state. This can be explained by that given poor regulation in certain sectors, which previously was “offset” by direct state participation in the governance of certain large companies, if the state withdraws from such governance, it would need other tools for resolving publicly relevant objectives. The major problem here is represented by even more deteriorated transparency of public interests with regard to such companies, preconditions for replacement of public interests with parochial (both departmental and administrative) interests vs. the option of direct state participation in the capital. In addition, a positive structural effect of privatization may be limited significantly by the retarding nature of “external” measures aimed at improving the investment environment.

Third risk – ill-defined conditions and criteria of privatization of large companies with attracting investments for the development thereof; discrepancies which may arise between the state and the owners of such companies in perception of mutual obligations. This makes the parties put more pressure on each other, and provides politicians with more chances to appeal to a segment of the society which is traditionally focused on “injustice” and “cheapness” of privatization.

Fourth risk – the quality of state-owned property management tools available for the state (it means unitary enterprises and shareholding) seems to have reached its objective ceiling. The risk of conservation of the prevailing model of governance remains very high, which may result in palliative measures and reduce the effectiveness of any measures aimed at further denationalization.

6.2.3. “New dimension” of denationalization

The policy of state-owned property management and privatization must move to a “new dimension” in the near future. The following important approaches should be considered.

‘Gradual’ approach. The remaining scope and “quality” of most of public sector assets prevent from implementing an analogue of accelerated “large-scale” privatization. Denationalization should be based on the principle of “controlled steadiness” of privatization, which requires a whole package of preparatory measures and stepwise approach. Unnecessary radicalization of the approaches makes equal the expected advantages and losses.

‘Multisector’ approach. A big variety of public sector assets implies availability of differentiated models (planning) of privatization and governance.
'Strategic nucleus model'. There are no visible arguments against (temporal) retaining a series of largest companies in state ownership, but there are reasonable arguments in favor of gradual decrease in control thresholds, creating equal competitive conditions, transparency and modification (of quality) of corporate governance.

'Structural' approach. Economic effect of privatization (efficient owner) is unlikely to be achieved without having to implement modernization of the sector; the sector can’t be modernized amid state domination/without widening the private sector; there is no point to widen the private sector without changing the quality of the institutional environment.

'Pragmatic' approach means identification of strategic nucleus of the economy (strategic, core enterprises), priority of “deep” privatization of large companies, getting rid of anachronistic and palliative types of business entity and illiquid assets, modernization of the existing system of state-owned property management.

In our opinion, the state long-term policy of state-owned property management and privatization must be governed by the following general principles:
- make sure that privatization is “reasonable”; follow the principle under which all companies, save for a selected group of companies, with state participation, unitary enterprises, state-owned corporations and state-owned companies may be subject to privatization;
- make sure that participation of foreign investors in the capital of privatized companies, including large companies, is reasonable;
- maintain the existing social commitments and/or provide direct reduction of public sector functions;
- create alternatives to direct state participation in the capital of companies in terms of meeting public interests; constantly combine efforts of privatization and widening of institutional and economic preconditions for privatization;
- take any measures which directly or indirectly increase the state “weigh” in the economy, including through the mixed sector, must be exclusive, reasonably sufficient and well coordinated;
- state controlled companies must not operate in the sector with private entrepreneurial initiative, establish terms of competition, on the one hand, build up barriers to prevent new companies from entering markets within “their” scope, on the other hand;
- ensure high priority of structural effect of privatization on economic development;
- the principle of “reasonable aggression”, succession and “gradualism”, limitation of risks;
- ensure transparency of the processes of state-owned property management and rationale for decisions made; openness to various forms of public control and assessment;
- create an integral system of incentives for all players; inviting the society and business community to participate in a dialogue with the state on the policy of privatization and state-owned property management.

Two stages should be reasonably highlighted from the point of view of general top objectives of the state policy of state-owned property management and privatization: 2012–2015 and 2016–2020. These stages differ in objectives to achieve, the level of expected risks and the need to take a series of preparatory measures.

Ensure high priority of implementation of current plans, making minimum radical decisions, getting rid of illiquid assets, making a “site” ready for the second stage at Stage 1. The level of potential risks can be assessed as minimal. In particular the following should be reasonably foreseen as part of this stage:
implement the target plans on reduction of a share of state participation in largest and large companies;

impose constraints on companies with state participation (their subsidiaries and related entities) for purchase of privatized assets, receive financing from state-owned banks and state-owned companies, consolidation of assets within state-owned companies;

increase the number of large companies with mixed ownership (privatization up to a level of 75% +1 share);

enhance significantly the quality of corporate governance at companies with state participation (enhance the status of independent directors, incentives for managers and their reporting to boards of directors, etc.);

reduce the number of state-owned entities through liquidation of a wide range of FSUEs which went out of business;

undertake privatization of illiquid assets (small value minority shares);

implement a package of measures aimed at widening the potential base for privatization at Stage 2;

identify principles and special features of privatization at the regional and municipal levels;

implement a ‘small-scale action’ strategy (ensure transparency of progress reports on privatization, changes in the public sector’s socio-economic role, accounting and registration of all assets owned by unitary enterprises, state-owned corporations, integrated structures with state participation, etc.);

create a single media space of sale of federal, regional and municipal property assets.

At Stage 2, provision should be made for drastic reduction of direct state participation in the economy, which may be exposed to a higher level of multidimensional risks. The following key measures can be implemented at this stage:

undertake “deeper” privatization with regard to largest companies (or full privatization or privatization through holding a blocking interest);

restrict state participation in state-owned institutions for development and special banks;

restructure assets of large companies, identify and privatize sub-holdings of conglomerate integrated structures;

reorganize state-owned corporations (a part thereof are to go out of business, another part thereof are to be incorporated into OJSCs and subject to a certain degree of privatization);

applying the principle of multiplicity of options, transform unitary enterprises operating on the basis of economic management, depending on the nature and scope of the core activity, into OJSC (standard scheme); into state-run enterprises; into non-profit organizations; into public institutions;

undertake privatization of most mid-sized and large companies with state participation (even a blocking interest, whenever appropriate).

The foregoing stages can be identified with two different (in terms of the degree of radicality) scenarios of state policy in the field of privatization and state-owned property management. With some degree of conventionality, the first (inertial) scenario suggests extrapolation of the first stage objectives in the period of 2012–2020. The second (radical) scenario implies full-fledged implementation of the key measures at the first and second stages in the period of 2012–2020.
This suggests development of the existing mechanisms and implementation of a wide range of measures which serve as the basis for six most significant functional lines of state policy in the field of state-owned property management and privatization.

1. Limit risks of “overgrowth” of the public sector in the economy, increase its “weight” in certain sectors, widen the range of state-owned entities.

2. Ensure sustainable and orderly reduction of direct state participation in the economy.

3. Achieve structural effect of privatization: “depth” of privatization of large companies; modernization of the sector and replacement of direct control with sector-specific regulation; improving the terms of participation in privatization of foreign investors; engaging efficient owners and developing a competitive environment.

4. Undertake institutional optimization of the public sector: reduce the number of state-owned entities, liquidate and reorganize inefficient enterprises of the public sector.

5. Enhance effectiveness of the “nucleus” of public sector, define its scope, and optimize levels of required direct state participation.

6. Enhance corporate governance in companies with state participation.

Each of above listed lines provides for a wide range of potential innovations and applied measures with the possibility to vary the degree of radicality. Without getting into a detailed analysis, let us provide just a few examples (see Table 14).

**Table 14**

<table>
<thead>
<tr>
<th>Line</th>
<th>Available approach</th>
<th>Suggested approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Determining the composition of state-owned property assets for privatization</td>
<td>Drafting privatization plans on the basis of proposals of federal executive bodies</td>
<td>“Declarative principle” – drafting privatization plans on the basis of business proposals, potential investors in combination with the “privatize or explain publicly” principle for federal executive bodies</td>
</tr>
<tr>
<td>Constraints on privatization</td>
<td>Regulatory restriction system</td>
<td>Replace a part of constraints with legally established encumbrances for owners</td>
</tr>
<tr>
<td>Privatization under conditions (under the Federal Law “On Privatiza-</td>
<td>Investment tender; sale based on the results of as a result of trust management</td>
<td>A combination of investment tender and trust management</td>
</tr>
<tr>
<td>tion”)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Generating investments to companies in the course of privatization</td>
<td>For extra large companies privatized on the basis of custom-made schemes</td>
<td>Define “investment mechanisms” under the Federal Law “On Privatization” for all large enterprises (e.g., with a net asset value of more that Rb 3m against the minimum monthly wage)</td>
</tr>
<tr>
<td>Unitary enterprises</td>
<td>The single possible option of transformation – into OJSC with a 100% state</td>
<td>Provide many options of transformation: – в OJSC with a 100% state-held interest, в LLC, into a public institution, non-profit organization</td>
</tr>
<tr>
<td>Privatization of unitary enterprises</td>
<td>Two separate procedures: incorporation, sale of shares</td>
<td>Provide a single procedure (incorporation with subsequent privatization of a part of the shares)</td>
</tr>
<tr>
<td>Interest in the development of companies with state participation</td>
<td>State interest maximization model (both short- and long-term), costs incurred on the majority model of corporate govern- ance</td>
<td>Undertake transition of the “positive conflict” model (long-term state interests – short-term business interests) with delegation actual rights to boards of directors within the “influence – independence – awareness” reference system</td>
</tr>
<tr>
<td>The mechanism of representation of state interests</td>
<td>Directive institution</td>
<td>The institution of recommendations in combination with higher responsibility of the members of boards of directors and delegation of more rights to independent directors</td>
</tr>
<tr>
<td>The institution of independent directors</td>
<td>Not representatives of federal executive bodies</td>
<td>Impose restriction on “cross government” between companies with state participation</td>
</tr>
<tr>
<td>Appointing top managers in companies with state participation</td>
<td>Political decisions, nontransparent selection, limited role of boards of directors</td>
<td>Open tender, public recommendations of boards of directors to general meetings of shareholders</td>
</tr>
<tr>
<td>Assessing parameters of the public sector and privatization</td>
<td>Administrative approach – assessment of the number of state-owned entities, privat- ized entities (by type of enterprise, by</td>
<td>Economic approach – assessment of the socioeconomic role of the public sector and effect of privatization on the development (contribution to GDP,</td>
</tr>
</tbody>
</table>
It still remains to be seen whether the “new dimension” of the privatization policy is feasible or not. State measures may both increase and mitigate the afore mentioned risks. However, a major lesson learned in the 1990–2000s is still of extreme importance: effect of privatization can be nothing but long-term, while the rate of achieving the effect depends on the quality and rate of implementation of the entire package of lines of socio-political and economic reforms (the “institutional environment” factor).