

Russia's New "State Corporations"

Locomotives of Modernization or Covert Privatization Schemes?

PONARS Eurasia Policy Memo No. 25

Vadim Volkov

The European University at St. Petersburg

August 2008

At the end of 2007, just a few months before the end of his presidency, Vladimir Putin exercised Russia's largest one-time public investment. To this end, he signed statutes creating several nonprofit nongovernmental organizations dubbed *goskorporatsii*, or "state corporations." Four newly created entities received over 36 billion dollars cash from the state budget. Around the same time, two more state corporations came into being. Subsequently, they were entitled to own about 80 billion dollars worth of former state assets in the atomic and defense industry. The significance of these last-minute decisions is hard to overestimate. Apart from being the first massive investment of oil export revenues in the domestic economy, this was also the most significant redistribution of state property in post-Soviet Russia; critically-minded Minister of Finance Alexei Kudrin referred to it as a "covert form of privatization." Was the creation of state corporations and their generous endowment a way for Putin to reward his cronies as he left the presidential office? Or was this an original institutional solution for investing oil revenues and boosting Russia's infrastructural modernization and technological competitiveness?

What Are State Corporations?

In 2006, Russian state officials invented two basic frameworks for investing public funds and restructuring state enterprises. The first was the formation of an open joint-stock company with majority state ownership, a fairly conventional solution for managing the public sector in many countries. Advocated by then first deputy prime minister Sergei Ivanov, it resulted in the creation, first, of the United

Aircraftbuilding Corporation and, later, of the United Shipbuilding Corporation. Each concentrated all major aircraft or shipbuilding production facilities under consolidated management and state ownership. The creation of these two monopolies was intended to boost Russia's stagnant civil aviation and shipbuilding sectors by placing state orders, stimulating private companies to buy Russian-made civil planes and ships, and advancing them to world markets alongside defense products (such as the much advertised Sukhoi Super Jet). These ambitions were backed by the increased capacity of the Russian state. With the airspace and shipbuilding sectors consolidated, the state could start investing in their modernization. Sergei Ivanov and Igor Sechin, two deputy prime ministers and Putin's colleagues from the intelligence service, were appointed chairmen of the board of directors of the aircraft and the shipbuilding corporation, respectively.

The second framework was invented by Sergei Chemezov, another of Putin's close colleagues and friends, who at the time was head of the Russian arms export trader Rosoboronexport. This second framework represents a truly innovative solution. The idea is to use the legal shell of a nonprofit NGO to create a statutory corporation and delegating to it the power of managing investment funds and enterprises. The 1999 version of the Law on Non-Commercial Organizations contains a peculiar legal form, *goskorporatsiya*, or "state corporation," a noncommercial organization created by a donation of state funds or property to advance the public interest or create public goods. Before 2007 this format had not been used, except to create the Agency for the Restructuring of Credit Organizations, established in 1999 to rescue insolvent banks. In 2007 this legal provision spawned six large resourceful projects. The first, the Bank of Development, was set up as a successor to the formerly state owned Vneshekonombank. It received the latter's assets plus a 7 billion dollar donation from the state. The aim of the Bank of Development is to invest in infrastructural development (roads, communications, ports, and other long-term, low-profit public projects). This type of solution was quickly replicated for other objectives, resulting in five more state corporations in the same year. The Russian Corporation for Nanotechnologies received 5.4 billion dollars in order to allocate grants for advancing cutting-edge research and development. The Communal Services Reform Fund was created with no less than 10 billion dollars for the task of renovating water and sewage pipelines and old houses in Russian cities by 2016. The state corporation Olympstroi became the organizational solution for fulfilling the promise of building infrastructure and facilities for the 2014 Winter Olympics in Sochi.

Finally, at the very end of 2007, the two most powerful state corporations came into being. Russian Technologies became the owner of defense industry assets formerly owned by Rosoboronexport, as well as of dozens of automotive, chemical, and other industrial enterprises. All civil nuclear power plants and construction companies as well as nuclear enrichment facilities were transferred to the newly created NGO Rosatom. The basic information on the new state corporations is shown in the table below.

Name	Date Established	Funds, \$ billion	Production assets, \$ billion	Chief Executive Officer (CEO)	Supervisor
Bank of Development	17.05.07	7.5		V. Dmitriev	A. Zubkov
Russian Corporation for Nanotechnologies	19.07.07	5.4		L. Melamed	V. Fursenko
Communal Services Reform Fund	21.07.07	10		G. Tsitsyn	D. Kozak
Olympstroi	30.09.07	13		V. Kolodiazhnyi	D. Kozak
Russian Technologies	26.11.07		30	S. Chemezov	A. Serdiukov
Rosatom	1.12.07		50	S. Kireenko	S. Sobianin
United Shipbuilding Corporation	21.03.07	1.1	2	V. Pakhomov	I. Sechin
United Aircraftbuilding Corporation	20.11.06	0.25	3.9	A. Fedorov	S. Ivanov
		Total 37	Total 86		

Why State Corporations?

According to estimates by Uralsib Bank, in 2000-2007 the state budget received about 700 billion dollars in revenue from oil and gas exports. Not all of this money went to public spending, however. A large amount of oil revenue was sterilized by means of external payments and transfers to the stabilization fund in order to prevent the strengthening of the national currency and to avoid inflation. Of the 340 billion dollars which, according to Kudrin, constituted the "super-profit," 116 billion dollars went to foreign debt payments and 122 billion dollars were secured in the stabilization fund. The remaining 102 billion dollars were eventually destined for public spending, but that happened only at the end of 2007.

Despite the pressing need for rapid modernization of the economy and growing pressure from state industrial lobbies, Duma deputies, and regional authorities, all eager to get a piece of the petrodollar pie, the "super-profit" remained intact. This was not only due to the tough and consistent policy of the Ministry of Finance to resist public expenditure growth, but also because of the lack of efficient institutional solutions for public investments. In other words, it remained unclear which agency should manage public investments, who should control and supervise its proper use, and how to avoid inefficiency and theft. In 2005-2006 Russian state authorities experimented with public-private partnerships, federal investment programs, and so-called "national projects," but none appeared to be successful.

Having defined national developmental priorities and accumulated large capital resources, the Russian leadership needed an easily manageable modernization scheme that would yield quick results. Public-private partnerships stalled because of mutual distrust and availability of capital resources on international financial

markets for private businesses (so they became less dependent upon public funds). Federal investment programs were subject to high bureaucratic costs and corruption risks, since several ministries and hundreds of officials had to be involved in managing budget funds and state enterprises. Subjecting modernization and innovation projects to multiple government procedures and regulations would have dispersed responsibility and slowed down the process.

This led to the decision to transfer budget funds and assets to specially created NGOs and to appoint compact executive management teams and supervision boards responsible for achieving set objectives. What was good for Mr. Chemezov also turned out to be good for Russia. The idea of creating state corporations outside government authority was largely justified by the low efficiency of the latter and testifies to the failure of state reform. To secure direct state control over large funds, the architects of state corporations gave the president the right to appoint CEOs and members of the supervision boards. As a result, about fifteen top government officials were appointed to high positions in state corporations. For example, the minister of regional policy, Dmitry Kozak, heads two state corporations and sits on the boards of another two. The top management of state corporations is outside of the government, as public authority, but it is accountable to selected individual members of the government and to the administration of the president.

This is a double-edged solution. On the one hand, it indeed reduces bureaucratic costs, gives management freedom and speed in decisionmaking, and introduces personal responsibility. On the other hand, the absence of transparency and public accountability creates vast opportunities for arbitrary and self-interested decisions, especially with regard to companies for which no clear efficiency criteria apply.

Organizational and Legal Contradictions

What becomes immediately apparent is that the eight new state corporations include two different types of content, cash funds (four) and industrial assets (four), as well as two different legal forms, non-commercial NGO (six) and open joint-stock company (two). That cash funds were legally structured into non-commercial NGOs assigned to invest into low- or deferred-profit projects of public significance, such as transport infrastructure, sports, urban communications, and research and development, is economically justified. The big question is why Russian Technologies and Rosatom, which are not funds but industrial holdings, have also been constituted as NGOs. From the standpoint of economic logic, they should have been organized as open joint-stock companies with majority state ownership, as United Aircraftbuilding and United Shipbuilding Corporations were. The solutions for Russian Technologies and Rosatom suggest an implicit noneconomic agenda.

The creation of NGO-type state corporations is regulated by the Law on Non-Profit Organizations, and a separate statute exists for each of them. The combined application of both regulations has created a truly unique status for these entities. The label “state corporation” denotes an NGO that has been created by the state rather than by private companies or individuals. But it does not mean state ownership. Once state property is donated to a state corporation, it becomes legal property of the latter. Thus, about 400 former state enterprises and companies that

were transferred to Russian Technologies are now the legal property of this state corporation. Moreover, presidential statutes made state corporations exempt from the control of the State Audit Chamber and from government interference. Thus, in addition to the managerial control that the Chemezov group had over the defense enterprises which formerly belonged to Rosoboronexport, it has now added legal ownership. As a result of the lobbyist effort, the Chemezov group has also claimed state shares in automobile, machine-building plants, and air companies for Russian Technologies. Thus, the choice of NGO framework for Chemezov's conglomerate becomes more justified if covert privatization was indeed its aim. The reason for shaping the country's nuclear industrial complex as an NGO remains unclear.

De jure and de facto status of state corporations is fuzzy. Their ownership is separated from control. In the six corporations that are NGOs, the state has preserved control through its selected representatives but given up formal property rights. In the two state corporations that are joint-stock holdings, the state has retained ownership rights through controlling majority interest but maintained a much softer line with regard to operational control, hoping to attract foreign investors. Whatever the economic performance of this new combined form of property, this bold experiment carries potential legal problems. It does not correspond to any of the three forms of property specified in the Russian constitution (public, private, and municipal).

Conclusion

By creating state corporations the Russian authorities intend to achieve several objectives simultaneously. First, they seek to create new instruments for investing capital resources into the domestic economy, bypassing the state bureaucracy in order to accelerate modernization and infrastructural development. Second, state corporations serve to restructure selected high-tech industries by increasing concentration, as well as consolidating ownership and management. They result in large integrated companies that could potentially meet the challenges of global competition. Third, Russian authorities have invented a new formula for the independent management of large state assets without fully privatizing them. Powerful industrial lobbies and Putin's cronies have now received formal rights to control several sectors of the economy, but in exchange they are expected to deliver tangible results and global competitiveness. The whole project, nonetheless, faces the risk of inefficient use of funds and depends upon personified mechanisms of control.

The role of the state tends to increase in times of crisis, reconstruction, or rapid modernization in the West as well as in the East. However, each country creates its own institutional arrangement for investing public resources. State corporations (or statutory corporations) are well known in the United States, the United Kingdom, and Canada. The United States, for example, created the Federal Deposit Insurance Corporation in 1933, while the United Kingdom set up the National Coal Board in 1946 to rescue the national energy sector. In Southeast Asia, states accumulated capital resources and loaned them to select business tycoons. Russia seems to have combined the patterns of both, charging state corporations with long-term developmental tasks but substituting state officials for business tycoons.

PONARS Eurasia publications are funded through the International Program of Carnegie Corporation of New York. The views expressed in these publications are those of the author alone; publication does not imply endorsement by PONARS Eurasia, Georgetown University, or the Carnegie Corporation.

© PONARS Eurasia 2008