IV. The Government of the Russian Federation Maintains Extensive Ownership and Control of the Means of Production

A. Summary of Comment

While Russia embarked on an ambitious privatization program in the early 1990s and many enterprises have been transferred in whole or in part to private ownership, a robust private sector has not emerged in Russia due to the lack of a clear consensus on the pace and structure of reform, as well as the artificial preservation of Soviet-era corporate structures. The Russian Government is unwilling to cede control of the large natural energy and transportation monopolies to the private sector, and continues to use its control of these sectors to directly and indirectly control many sectors of the economy. The Ad Hoc Committee is particularly concerned with the Russian Government's control of the natural gas sector, because its control and manipulation of natural gas pricing and supply have severe economic implications in many other sectors, including the export-oriented nitrogen fertilizer sector, which uses natural gas as its primary raw material.[1]

B. The Department's Standard

Section 771(18)(B)(iv) of the Act directs the Department to consider "the extent of government ownership or control of the means of production." In applying this criterion in other cases, the Department has considered above all the nature and success of the privatization programs undertaken by the transitioning governments.[2] The Department has also focused on the passage of laws to ensure private property rights,[3] the active commitment by the government to privatization as a fundamental aspect of a market economy and means to distribute wealth,[4]

[1] Russia ranks by a wide margin as the world's top exporter of nitrogenous fertilizers, having exported a total of 3,732,700 metric tons in 1999. See United Nations Food and Agriculture Organization database at www.fao.org.
[2] See Czech NME Memo at 8-11; Hungary NME Memo at 10-13; Latvia NME Memo at 10-14; Poland NME Memo at 17-18; and Slovak NME Memo at 8-11.
[3] See Czech NME Memo at 9; Hungary NME Memo at 9; Poland NME Memo at 18; Slovak NME Memo at 9.
[4] See Latvia NME Memo at 11 and 13; Poland NME Memo at 18-19; Slovak NME Memo at 10.

the continuing effort to reduce government enterprise holdings, especially in profitable large-scale enterprises, and the transfer of land to private owners.

The countries previously examined by the Department have employed a variety of privatization methods. These have included restitution of productive assets to former owners or their heirs,[5] transfer to municipal authorities,[6] auctions,[7] "voucher" or coupon privatization,[8] and the transformation of agricultural collectives into owner-based cooperatives.[9] The Department has considered the pace of privatization for small, medium, and large enterprises separately, noting favorably the transfer of small businesses into private hands.[10]

The Department has recognized that privatization of medium- and large-scale enterprises may be generally slower and more problematic as governments determine the best methods to attract capital, streamline the process, determine the rights and obligations of new owners, and ensure transparency and fairness.[11] When a transition government continued to own a substantial portion of these enterprises, as in Poland in 1993, the Department considered whether they operated independently of government control.[12] While all previously "transitioned" governments had designated certain strategic sectors of the economy (e.g., utilities, telecommunications, railways, postal service) in which privatization would proceed more slowly or in which the government would retain a partial interest, in most cases in which market

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[5] See Czech NME Memo at 8; Latvia NME Memo at 11; and Slovak NME Memo at 8.
[6] See Czech NME Memo at 8; Slovak NME Memo at 8.
[7] See Czech NME Memo at 8; Latvia NME Memo at 11; Slovak NME Memo at 8.
[8] See Czech NME Memo at 9; Hungary NME Memo at 12; Latvia NME Memo at 12; and Slovak NME Memo at 8.
[9] See Czech NME Memo at 8; Slovak NME Memo at 8.
[10] See Czech NME Memo at 9; Hungary NME Memo at 11; Latvia NME Memo at 12; Poland NME Memo at 17; and Slovak NME Memo at 9-10.
[11] See Czech NME Memo at 11; Latvia NME Memo at 10.
[12] See Poland NME Memo at 18.

economy status was granted the clear underlying goal was to reduce government ownership to the greatest extent and as quickly as possible.[13]

C. Notwithstanding the Pro Forma Privatization of Many Russian Enterprises, the Russian Government Has Not Relinquished Control over Certain Major Sectors of the Economy, and in Fact is Currently Reasserting its Control of Certain Sectors

At first blush, the statistics concerning the privatization of enterprises in Russia would appear to show that the Russian Government is ceding control of the means of production to the private sector. However, as outlined below, Russia's privatization program has proceeded in fits and starts, and unlike those countries that have successfully transitioned to market economies, fundamental questions about the commitment – and the ability – of the Russian Government to pursue a rigorous privatization program remain. Above all, notwithstanding occasional declarations of commitment to market reform by Russia's leadership, there is no general underlying consensus, as existed in countries previously reviewed by the Department, that the Russian Government *should* relinquish its hold on the means of production.[14] Indeed, the Russian Duma has wrangled over the shape of land reform legislation for a decade, with the result that comprehensive federal legislation governing the transfer of non-agricultural land was not completed until very recently; legislation governing the transfer of agricultural land has yet to be enacted.[15] While the Department found in Latvia that "many officials felt the moral and legal imperative to undo the expropriation and collectivization that occurred during the Soviet era . . . and restore, wherever possible, the pre-war, private property structure," in Russia it is not

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[13] See Czech NME Memo at 11; Hungary NME Memo at 12; and Latvia NME Memo at 11 and 13.

[14] As expressed by the Central Intelligence Agency in its recent World Factbook, "{a} decade after the implosion of the Soviet Union in 1991, Russia is still struggling to establish a modern market economy . . . In contrast to its trading partners in Central Europe . . . Russia saw its economy contract for five years, as the executive and legislature dithered over the implementation of many of the basic foundations of a market economy." CIA World Factbook, Russia, Section on "Economy," *available at* http://www.cia.gov/publications/factbook/geos/rs.html.

[15] Implementation of the Government's Reform Agenda, The World Bank Group in Russia, The World Bank Group, available at www.worldbank.org.

possible for structural and political reasons simply to "undo" state ownership. The legacy of state control over the means of production is too deep, and its remaining popular support too strong, to be simply unraveled.

As of January 1, 2001, Russia had 2,509,600 privately owned companies, 367,400 state-owned companies, and 144,500 companies with mixed ownership.[16] Available statistics do not reveal the size of the enterprises that have been privatized in Russia since the enactment in 1991 of Russia's privatization law.[17] However, World Bank statistics do show that the private sector share of employment has crept up only very slowly over time – from 12.5 percent in 1990, to 35 percent in 1996.[18] The statistics also show that, since the peak year of 1992 when 46,815 enterprises were privatized, the pace of privatization has slowed considerably. In 1993, 41,762 firms were sold; in 1994, 24,048 were sold; in 1995, only 8,414 were sold; and in 1996, a mere 3,675 were sold.[19] Most privatizations occurred during the first half of the 1990s; "{t}he privatisation process was slow in the second half of the 1990s and virtually stalled in 1999."[20]

While Russia's private sector comprises numerous companies, the number of firms in which the state today retains an exclusive or partial interest, as revealed by the EBRD statistics, remains in the hundreds of thousands. By comparison, by 1997, well before the Department investigated whether its NME status should be revoked, the Government of Hungary had reduced its holdings to a mere 211 companies, and that number was dwindling fast.[21] Moreover, many Russian companies remaining under state ownership are very large companies, including those

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[16] *Russian Federation Investment Profile 2001*, European Bank for Reconstruction and Development, at 13, *available at* http://www.ebrd.com/english/public/index.htm ("EBRD Profile").
[17] Law of the Russian Federation of July 3, 1991 on the Privatization of State-Owned and Municipal Enterprises in the Russian Federation (amended June 5 and 24, 1992, and March 17, 1997).
[18] Public Enterprise Reform and Privatization Database (Russia), World Bank, available at www.worldbank.org/ecspf/PSD-Yearbook/russia/html.
[19] Id.
[20] Russian Federation Investment Profile 2001, at 13.
[21] See Hungary NME Memo at 12.

which control certain massive monopoly sectors such as energy and railroads, which, as explained below, provide the Russian Government with effective means of control over much of the economy.[22] The EBRD characterizes the state-owned sector of the Russian economy as "extremely large."[23]

Several factors distinguish Russia's enterprise privatization program from that of transition countries previously found to be market economies. According to one observer, Russian privatization "contrasts sharply to the very successful experience of Hungary and Poland" in that the Russian Government did not liquidate state-owned companies in order to spur necessary corporate restructuring. Rather, the Russian restructuring program was designed to ensure the continuation of existing, Soviet-era corporate structures.[24] Further, the Russian privatization authorities, in their desire to ensure continuity, disregarded market objectives, "no matter how value destroying."[25] Moreover, "a retrenchment of employee and state ownership in most medium-sized and large privatised corporations," as well as a "growing, albeit slightly, share of the government in the privatised firms," occurred in the aftermath of Russia's 1998 financial crisis.[26]

The continuation of existing, Soviet-era corporate structures is most evident in the state-controlled monopolies, *i.e.*, the electricity generation and distribution monopoly, Unified Energy Systems ("UES"), the Railway Ministry, and OAO Gazprom, which produces and distributes

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[22] *Id*.
[23] *Id*.
[24] S. Nestor, *Corporate Reform in Russia and the Former Soviet Union: the First Ten Years*, Organization for Economic Cooperation and Development, 2001, at 5, *available at* http://oecd.rog/pdf/M000015000/M00015848.pdf. As outlined by Nestor, Russia's privatization occurred in two distinct waves. In the first, during the first half of the 1990s, the Russian Government created 23,000 joint stock companies, the majority of which were privatized through a voucher scheme in which ownership passed to employees and managers. The second wave consisted of a loans-for-shares scheme in which strategic owners were found for some of the large firms that had already undergone partial privatization. *Id*. at 3-4.
[25] *Id*. at 5.
[26] *Id*. at 7.

natural gas and is the largest company in Russia.[27] These monopolies together account for roughly thirteen percent of Russia's GDP. However, as the Department has recently recognized, "they play a much larger role in the economy in terms of price setting and overall asset allocation."[28] These natural monopolies have traditionally been used, and continue to be used, by the Russian Government as tools to subsidize and control a substantial portion of the economy through pricing and provision of energy and transportation. As stated by the EBRD, "{t}he infrastructure monopolies, particularly in the energy sector, continue to be a key source of indirect subsidisation to enterprises. While collection ratios have been improving in recent months, tariff adjustments have lagged behind the rate of inflation, increasing the level of subsidisation."[29]

The Ad Hoc Committee is particularly concerned about the continuing involvement of the Russian Government in the natural monopolies, and especially energy, because many of Russia's principal exports to the United States – including fertilizer products – are highly energy-intensive.[30] By ensuring the continued flow of non-market priced energy to these export-oriented enterprises, and in the process ignoring market signals and structural inefficiencies, the Russian Government is causing serious trade distortions and is contributing to the injury of U.S. industries. The Ad Hoc Committee respectfully maintains that the Department should carefully

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[27] Gazprom is the biggest company in Russia. It controls nearly one-third of the world's natural gas reserves, and produces nearly 94 percent of Russia's natural gas. Gazprom's tax payments alone account for roughly 25 percent of the Russian Government's tax revenues. *See* Russia Country Analysis Brief, U.S. Energy Information Agency (October 2001), available at www.eia.doe.gov/emeu/cabs/russia2/html ("USDOE Analysis"). Gazprom produces roughly eight percent of Russia's GDP, and employs 300,000 people. The Russian Government directly owns just under 40 percent of the shares in Gazprom. *See* Gazprom website, available at www.gazprom.ru. However, as discussed infra, the government's interests are represented by a majority of the company's directors, thereby maintaining effective government control of the company. The Ad Hoc Committee also wishes to point out that under Sec. 771(33) of the Trade Act, a "person shall be considered to control another person if the person is legally or operationally in a position to exercise restraint or direction over the other person." Thus, a majority stake in an enterprise is not necessary for control under the antidumping law.

[28] DOC Guide, Ch. 2, at 7.

[29] EBRD Profile at 14.

review the extent to which the Russian Federation has maintained control over the economy in general and key industries, particularly exporting industries, by keeping a strong grip on the country's energy and transportation sectors. This is particularly important, given that this review is being conducted to determine the appropriateness of market economy status under the antidumping law, and in light of the number of energy intensive products that comprise Russia's exports.

In this regard, the McKinsey Global Institute of McKinsey & Co. analyzed ten sectors of the Russian economy in an effort to identify those factors that distinguish Russia from other former communist countries such as Poland and Hungary and to explain why, unlike those countries, economic reform has failed in Russia.[31] McKinsey found, among other things, that unproductive enterprises continue to receive implicit federal subsidies in the form of lower tax and energy payments.[32] These practices place "potentially productive companies at a cost disadvantage, blocking investments and growth on their part."[33] In the same vein, Jerry Hough of the Brookings Institution argues that, at the end of 2000, far from having loosened its grasp on the Russian economy, the Russian Government "was far closer to the old centrally directed Soviet economy," in part because large enterprises "remained essentially state or quasi-state entities acting on the direction of the central government."[34]

Russia's natural gas sector and the role of Gazprom in the Russian economy provides a vivid example of the continued, and arguably increasing, control of the Russian Government over the means of production. Gazprom does not represent an isolated sector of the Russian

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[30] Top Russian export to the United States include aluminum, fertilizer, nickel, iron and steel, and copper. See U.S. International Trade Commission Dataweb, *available at* http://www.usitc.gov.
[31] *Unlocking Economic Growth in Russia*, McKinsey Global Institute (October 1999), at 1, *available at* http://www.mckinsey.com/knowledge/mgi/index/asp.
[32] *Id*. at 2.
[33] *Id*.

economy; rather, as the largest company in Russia and the world's largest producer of natural gas, it is a behemoth that is used by the Russian Government to influence many sectors of the Russian economy, and even Russia's foreign relations. As explained previously, the Russian Government uses Gazprom as one of its tools to spread subsidies in the form of cheap (or even free) energy throughout the economy.[35] Gazprom has, since its partial privatization in 1992, served as a "big crutch" to prop up the ailing post-Soviet economy.[36] The method is simple: the Russian Government, through its control of the company and as its regulator as well, requires Gazprom by law (as explained in the next section) to sell to its domestic customers at very low prices – prices that are well below the cost of production. In fact, Gazprom is forced by the Russian government to sell gas to domestic users for $12-14 per thousand cubic meters, which is less than the cost of production.[37]

Not only are the prices required to be low, but Gazprom is required by the Russian Government to continue supplying certain strategically vital customers that cannot or do not pay – including the roughly 40 percent of its customer base comprising power utilities.[38] Indeed, an estimated three-quarters of Gazprom's gas goes to nonpaying customers within Russia and the former Soviet Union that do not pay their bills yet are allowed to continue operating.[39] These examples put Russia on a markedly different footing from the transition countries previously

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[34] J. Hough, *The Logic of Economic Reform in Russia*, Brookings Institution (2000), at 3, *available at* http://www.brookings.org/press/books/reform_in_russia/htm.

[35] Russian Government control over Gazprom is also explained more generally by the utility of the company as a tool for the conduct of domestic and foreign policy. According to a European government official quoted in *The Evening Standard (London)*, Gazprom at one point cut off gas supplies to the Republic of Georgia to enable the Russian Government to apply pressure to the Georgian Government. The same official observed that the Russian Government can use Gazprom to control Russian regions, *i.e.*, to assert central government control. *See* S. Fleming, "But the bad old ways are still typified by giant Gazprom," in *The Evening Standard (London)* (October 30, 2001), at 36, attached at Exhibit 2.

[36] Gazprom's Dilemma, *The Wall Street Journal Interactive Edition* (August 30, 1999), www.wsj.com/public/current/articles/SB935787825339902555.htm

[37] USDOE Analysis at 3.

[38] "Gazprom's Dilemma."

[39] Id.

examined by the Department, especially Poland, which as part of its market-oriented "shock therapy" moved quickly to eliminate energy subsidies.[40] The examples also demonstrate that the Russian Government uses its control of Gazprom in ways that seriously hinder the economic development that would be dictated by market forces.

Compelling evidence of President Putin's drive to ensure continuing state control over Gazprom came in May 2001, when the board of directors voted to oust longtime chief executive Rem Vyakhirev and to replace him with a Putin protégé, Alexei Miller. Observers credit the shift to the government's concern that Gazprom was attempting to operate independently of the state.[41] Mr. Miller's pronouncements upon assumption of office left little doubt about the strength of the ties between the Russian Government and Gazprom. As he said on May 31, 2001, "{t}he state's role in the management of Gazprom will grow."[42] Consistent with this commitment, Miller quickly moved to consolidate state control over Gazprom by reconfiguring the eleven-member board to ensure that government representatives obtained a majority of six seats.[43] Russian Government control of Gazprom may be further strengthened through an increase in the government's equity stake to 50 percent.[44]

The Russian Government continues to pursue its economic and social agenda through its control over Gazprom even though this pursuit cuts deeply into the profitability of the company (with attendant losses in tax revenue to the government):

> The combined freeze in rates during 2001 and 2002 means that highly subsidized tariffs will remain unchanged for nearly a year. But domestic prices, which are about one-eighth of export charges, are seen as a key to investment in the gas sector. Gazprom's plight was underscored this week as it reported that net profits

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[40] See Poland NME Memo at 23.
[41] See R. Newbold, "Gazprom sacks CEO but is it any more than hot air?" in *Asia Times Online* (June 1, 2001), available at www.atimes.com/c-asia/CF01Ag02.html; S. LaFraniere, "Putin Puts Ally at Helm of Gazprom; Kremlin Sees Bigger Role in Russian Gas Monopoly," in *The Washington Post* (May 31, 2001), at A20.
[42] Russian Observer, www.russianobserver.com/stories/2001/05/30/991230061/
[43] V. Isachenkov, "Putin Clears Share Trade in Gazprom" (AP Online, September 6, 2001).
[44] S. Fleming, "But the Bad Old Ways are still Typified by Giant Gazprom."

> in the first half of the year fell 60 percent according to international accounting standards, while sales rose 5 percent.[45]

The Russian Government, in short, has tightened its grip on Gazprom and, contrary to market principles, continues to use its control of the company as an instrument for intervention in the economy. Given its monumental position in the economy and the centrality of energy to industrial production, the government's control of Gazprom provides a key example of how the Russian Government continues to control the means of production.

The Ad Hoc Committee respectfully submits that the Russian Federation's continuing control of Gazprom and, through its control of Gazprom, the nitrogen fertilizer (and undoubtedly other) industries, presents a clear indication of the absence of a market economy in Russia. As discussed below, the Russian Government's control of the supply and pricing of natural gas to the fertilizer sector determines – rather than the market – whether and how much nitrogen fertilizer is produced in the Russian Federation.

[45] Id.