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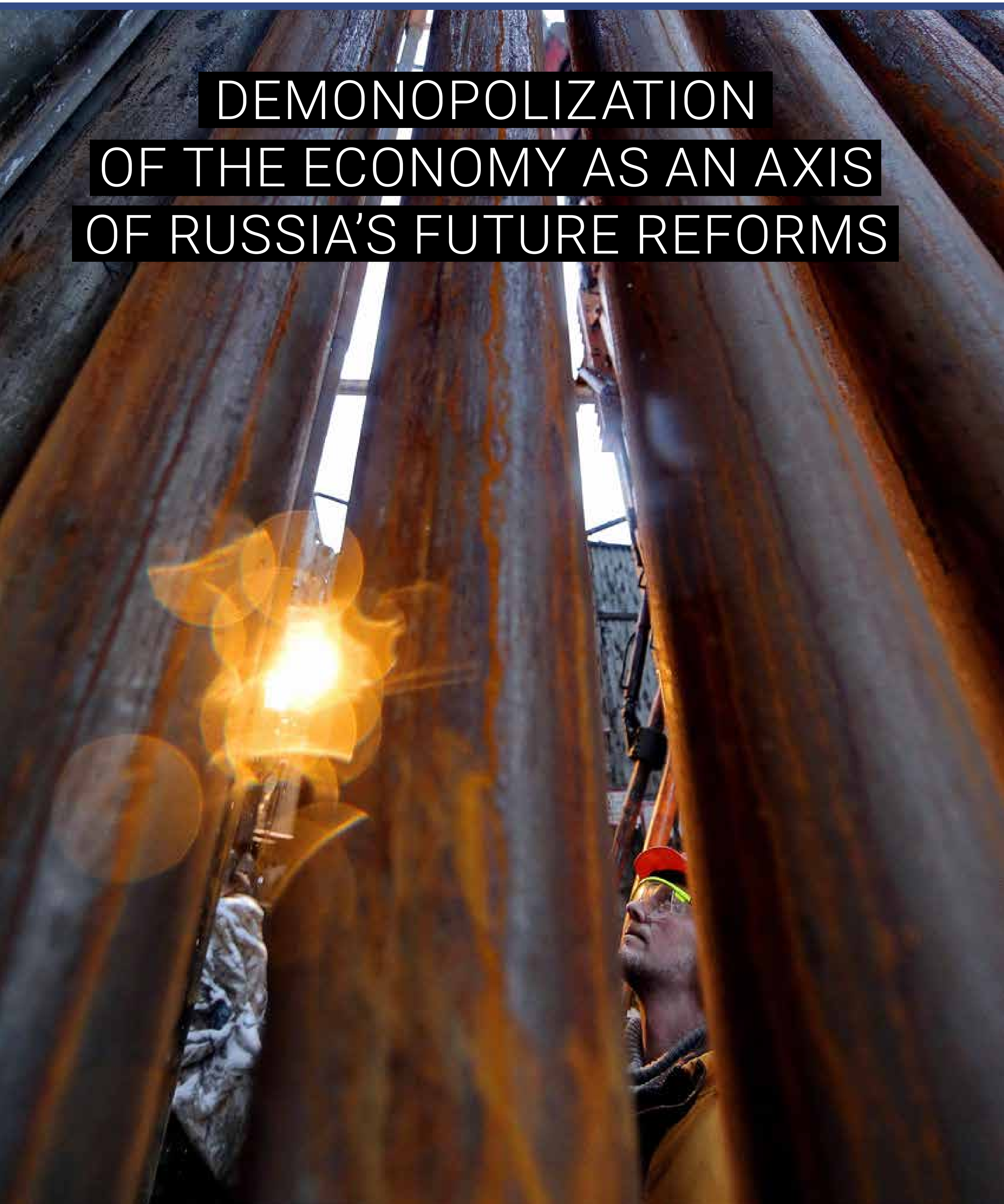
# DEMONOPOLIZATION OF THE ECONOMY AS AN AXIS OF RUSSIA'S FUTURE REFORMS



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This report has been prepared by a research group headed by economist Vladimir Milov

Cover: A drilling rig at the Southern Priobskoye oil field of the Gazprom Neft. Photo: Vladimir Smirnov/TASS.

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# INTRODUCTION

This report, published by a team of researchers led by Vladimir Milov, clearly demonstrates the interdependence between Russia's political future and its current economic structure.

Despite the oft-proclaimed policy of privatization and demonopolization, in recent years Russia has in fact experienced creeping deprivatization, aimed at preserving the dominance of state monopolies. Whereas in 1995, for instance, the state sector accounted for only 7 percent of the country's oil production, by 2016 that share had grown to 63 percent. Small and medium-sized companies independent of the state giants now produce less than 4 percent of Russian oil, despite the fact that the relatively few pockets of untapped deposits and new finds are best developed by small enterprises ready to take on investment risks and pioneer innovative technologies.

Gazprom's artificial monopoly hinders not only development of the domestic gas market, but also efforts to expand Russia's export capabilities. The spurious notion that Russian gas must not compete with Russian gas in foreign markets has long been refuted by Gazprom's own practice of competing with itself, delivering gas to one and the same destination at different prices—under long-term contracts and spot deals.

The monopolization of Gazprom's major contracts by Kremlin-linked entities produces needlessly inflated budgets and undermines the financial position of the client company. Moreover, state control over the company, coupled with project investment decisions of no commercial value at all, makes Gazprom a political tool of the Kremlin in the eyes of foreign market players and impacts its business and reputation abroad.

Russian-style monopolism, particularly in the form of monopolies headed by government officials, is inevitably underpinned by corruption schemes and kickbacks, inflicting huge damage not only on the companies themselves, but also the state budget.

At the same time, questions arise about the primacy of economic monopolism in relation to its political cousin, and hence about the priority of improving the economy and the socio-political situation in Russia. There is reason to believe that the modern structure of the Russian economy, strangled by inefficient corporations ruled by officials, took shape as a result of the purposeful actions of the political establishment. It would be a mistake to presuppose that such economic forms gave rise to the political monopoly of power, and not the other way round.

We have witnessed the emergence of a very specific economic structure. Those vested with political authority or part of the inner circle at the top of the pyramid control their own cash flows from the state budget to a separate industry, sector or group of enterprises, and back again to the state budget. The Kremlin's task is to prevent competition between these individuals. This was relatively simple during the cash-glut years of the oil boom. But now that the "fodder base" for the controllers of these flows has dwindled, it is becoming increasingly difficult to keep the peace, as demonstrated, for instance, by the conflicts between Rosneft and Transneft.

Consequently, the fight against economic monopolism cannot succeed without radical changes to the system of political governance in the country.

**Mikhail Krutikhin**
Partner, RusEnergy

# I. DEMONOPOLIZATION AS A PHILOSOPHY OF ECONOMIC AND POLITICAL REFORM

Igor Sechin, head of Rosneft (left), and Alexei Miller, head of Gazprom. Photo: Mikhail Metzel / TASS.

Demonopolization of the Russian economy is more than just a new economic policy tool to reverse the country's headlong fall into economic crisis. Demonopolization is a global idea and something of a new philosophy in the field of economic thinking that can—and must—fundamentally alter the fabric of Russian social life.

There is every reason to link the degradation of Russian socio-political institutions from 2000-2015 directly to the monopolization of the Russian economy, with economic power concentrated in the hands of a narrow circle of corporations close to the state and affiliated entities and individuals. It was oversized state monopolies that created the demand for "bad institutions" by restricting competition, using the state to extract preferences, increasing profits at the expense of taxpayers and consumers, and eliminating competitors through unlawful interference in the courts and law enforcement agencies. In Russia, political and economic over-centralization are inextricably intertwined.

Without wholesale economic decentralization in Russia, its political counterpart (i.e., transfer of powers to parliament, development of free media, independent courts and local self-government, etc.) is sure to fail. If the narrow cartel of state-linked monopolies controlling key sectors of the Russian economy remains in place, these monopolies/oligopolies will quickly corrupt any new elite and slow down vital reforms, prompting a new wave of centralization of power for personal gain.

The experiences of other post-Soviet countries, including those that have been through inherently anti-bureaucratic and anti-corruption revolutions, fully corroborate this conclusion. In Russia, state companies account for more than 50 percent of the revenue of the 100 largest firms, and this figure nudges up to 60 percent if "shadow (latent) state companies," i.e., officially private corporations closely affiliated with the state (e.g., Surgutneftegaz, Sibur, Stroygazmontazh, Stroytransgaz, etc.) are factored in. As for the top 30 firms, the figures are 65 and 70 percent, respectively. That is the extent of state control over key sectors of the economy.

The importance of demonopolization is not limited to its influence on politics. There is a purely economic dimension, too.

- Over the past 25 years of reform, Russia has failed to achieve low inflation. Experience shows that inflation drops by 2-3 percentage points without regular increases in monopoly prices. By eliminating this factor, annual inflation in

DESPITE ITS OVERARCHING IMPORTANCE, DEMONOPOLIZATION OF THE ECONOMY NEEDS TO BE BROKEN DOWN BY SECTOR. THE NATURE OF THE TASK IN EACH CASE IS DEFINED BY WHAT IS OBJECTIVELY TAKING SHAPE IN THESE SECTORS.

Russia could be lowered to 3-4 percent, stimulating growth in investments, real incomes, and pensions.

- Excessively high monopoly prices in various sectors (energy, transport, bank loans) and monopoly barriers to market entry reduce the national economy's competitiveness internationally and make other countries with no such monopoly barriers more attractive to investors.
- The public sector's labor productivity is low. Freeing up internal reserves could be a powerful source of modernization and a means to increase the efficiency and international competitiveness of the Russian economy.
- Monopolies' investment performance is poor. In 2013, the combined annual investment programs of the 10 largest state companies in Russia came to almost 3 trillion rubles; at the same time, economic growth flatlined, even before sanctions and falling oil prices.
- Compare: private oil companies from 2000-2004 managed to increase oil production by 50 percent, investing only 100-200 billion rubles a year. It is no secret why state monopolies do not invest effectively: they enrich contractors, the state underwrites their losses, and their market share is not threatened by competition. But the economy can no longer afford to invest trillions of rubles in unwanted gas pipelines, stadiums, dams, and power stations. The private sector would invest the cash far more efficiently.

Many of the failures of the Russian market reforms in the 1990s—hyperinflation, sluggish efficiency improvement, low labor productivity—are directly attributable to the lack of attention paid to demonopolizing the post-Soviet economy. This is exemplified by the fact that by the late 1990s, some at least partially demonopolized branches of the economy were already on a growth trajectory, unlike the stagnant "primitive" monopoly industries still in existence (e.g., the oil and coal industries versus the monopoly Gazprom).

This suggests that 1990s Russia could have climbed out of the post-Soviet hole much faster if a decisive demonopolization program had been implemented.

Despite its overarching importance, demonopolization of the economy needs to be broken down by sector (banking, energy, etc.). The nature of the task in each case is defined by what is objectively taking shape in these sectors.

## Demonopolization of the banking sector

Russia has a huge number of private banks, yet more than half of all banking assets and two-thirds of the corporate loan portfolio are presently controlled by six major state-owned banks. Studies show that the margins and operating expenses of Russian banks are overstated compared to their European counterparts, which adds 4-6 percentage points to the interest rate on loans even after deducting the difference between the respective inflation rates. Sovereign risk is not the only factor. The Russian banking sector is clearly hampered by the oligopoly of the major banks, which must be eliminated.

## Demonopolization of the energy sector

The state and its affiliated structures control about half of oil production, two-thirds of gas production (plus the entire gas transportation system), more than half of electric power capacity, and (together with three large private financial-industrial groups) almost three-fourths of Russia's generating capacity. At the same time, in 2013 domestic wholesale prices in the electric power and gas industries in dollar terms exceeded average wholesale prices in the U.S., where the market share of the largest oil and gas producers is no more than 4-5 percent, and the five largest electric power companies control only a fifth of generating capacity. In Russia, these sectors are seeing endless price rises against a backdrop of industrial stagnation and declining labor productivity.

## Demonopolization of the transport sector

The importance of demonopolizing the Russian transport industry cannot be overstated, since inflated prices here are a key obstacle to economic development given the country's vast territory. The two sectors where the problems are most obvious are railways (where a competitive transport market has not been created) and aviation (where Aeroflot's takeover of Transaero has given it two-thirds of the domestic passenger market, while the rest of the market is occupied mainly by uncompetitive regional carriers).

Pipeline transportation can also be mentioned in the context of demonopolization, given the drive to diversify oil and gas transportation routes. Transneft and the future Transgaz (hived off from Gazprom) could readily be split up into several competing companies that will then be forced to cut costs and reduce tariffs in a competitive environment caused by surplus pipeline capacity.

## Demonopolization of the utilities sector

In recent years, the utilities sector has seen the active displacement of independent players coupled with monopolization—from heat supply to housing maintenance. This directly contributes to an inflated rise in consumer costs for utilities and, as a result, a decline in people's purchasing power.

The nationwide utilities sector must:

- Eliminate monopolies artificially created by government in potentially competitive areas, based on the results of monitoring carried out by independent NGOs;
- Create an effective system of public audit and regulation of grid monopolies with a detailed analysis of individual performance indicators and the establishment of tariffs based solely on public audit results.

## Demonopolization of government procurement and land distribution

More than 92 percent of Russia's land fund remains in state and municipal ownership, with only 0.5 percent owned by legal entities. The system of government procurement and land distribution in Russia serves only the vested interests of the bureaucracy and associated business structures. A *Forbes* report entitled "Kings of the State Order" alleges that businesses close to Putin receive more than a trillion rubles of government procurement funds a year. This phenomenon permeates both the regional and local levels.

The distribution of government procurement funds and land should be placed under the legislative control of independent NGOs. With respect to the land fund, quick and decisive action is needed to create a transparent and liquid market for land transactions, denationalize the land fund to the greatest extent possible, and strip officials of land disposal rights.

### Demonopolization of agriculture

In the agricultural sector, there are two main problems: 1) creeping monopolization of the industry by large agroholdings with the displacement of small private entrepreneurs; 2) traditional monopoly/oligopoly in the wholesale procurement chain.

Barriers, preferential state support for large agricultural enterprises, and low purchase prices set by the oligopoly in the wholesale chain hinder the development of agricultural output in Russia, creating nothing but monopolistic structures that feed off state support and increase profits by squeezing small players out of the market.

The system of state support for the agro-industrial sector should be thoroughly revised with a view to creating a highly competitive environment and eliminating monopolies in the wholesale procurement chain through antitrust measures. Independent non-governmental structures should help identify barriers to independent agricultural producers for the purpose of removing them.

### Demonopolization of defense and machine-building

Over the past 15 years, the defense industry has been overcentralized within the framework of sector-based verticals (United Aircraft Corporation, United Shipbuilding Corporation, Rostec), which has seriously impacted performance and led chiefly to price rises. Even the initiator of the process, Vladimir Putin, has complained about this. Rearming and modernizing the army is a core priority, but one that requires a drastic reworking of Putin's policy of "verticalization" of the defense industry; demonopolization is also necessary.

Likewise, the past 15 years have seen attempts to overcentralize the machine-building industry, with no tangible or justifiable results. The most striking example is Rostec, with its financial problems, bankrupt plants, etc. This sphere, too, needs denationalization, demonopolization, and road maps to develop competition.

### Demonopolization of the retail sector

From 2011-2016, according to Rosstat, retail chains' share of retail trade turnover rose from 18 to 27 percent. There is nothing wrong with the development of retail chains *per se*, but in Russia it often takes place in collusion with officials and the creation of artificial barriers to small merchants. A national inventory of such artificially created barriers (broken down by region and city) is required, along with the abolition of all unjustified discriminatory restrictions on small trade.

### Demonopolization of media and advertising

Robust media freedom in Russia is unattainable without comprehensive demonopolization. It is not even a matter of who controls the major TV stations. The problem is that the public has access to just a tiny number of channels, which leads to informational asymmetry. Advertising needs to be demonopolized: the market is populated by Kremlin-linked monopolists, e.g., Video International, which controls more than a third of TV advertising (according to the Panama Papers, associates of Putin own shares in the company).

The main idea is to create an infrastructure for mass access to a large number of competing electronic media that belong to different owners, and to ensure that the state withdraws entirely from the media landscape.

# II. MAIN DEMONOPOLIZATION TOOLS


Russia's President Vladimir Putin speaks at the Competition Week in Russia forum organized by the Federal Antimonopoly Service (FAS). Photo: Alexei Druzhinin / TASS.

A key tool of demonopolization is structural change in relevant sectors of the economy—large state-owned and related companies should be divided into smaller competing entities. Strict control of market concentration should ensue, based on the example of U.S. and EU antitrust policy.

Another important area is control over market barriers to competition. Non-governmental associations of small and medium-sized businesses should actively assist on a regular basis to identify and monitor barriers and advise the state as to which of them should be removed.

The Federal Antimonopoly Service (FAS) in its present form is not fit for carrying out the policy of demonopolization. Throughout its existence, the department has been politically hamstrung by the top-down demand to preserve and expand monopolies, rendering it incapable of fulfilling its mission. Today, Russia needs an entirely different body to carry out the active structural changes required. Independent non-governmental organizations need to be involved in monitoring and controlling market concentration and barriers. The new-look antimonopoly service should, in fact, be assigned the role of Russia's chief economic department.

# III. DEMONOPOLIZATION OF GAZPROM


Gazprom pipes piled at the construction site of the Dzhubga-Lazarevskoye-Sochi main gas pipeline in the Krasnodar Territory. Photo: Alexei Filippov / TASS.

The centralized structure of the Russian gas industry was predetermined back in 1992 by Presidential Decree № 538 of June 1, 1992, which preserved the unity of the Russian gas supply system and associated assets.

## Negative consequences of gas market monopolization

The preservation of the centralized structure had catastrophic consequences for Gazprom:

- In 2015, the company's natural gas production hit a record low of 418.5 billion cubic meters, down 23 percent from 1999.
- Despite having one of the world's largest proven gas reserves, the company's share in global gas production fell from 23 percent in 1999 to 12 percent in 2015. The U.S. now outstrips Gazprom by a factor of approximately 1.8, despite having roughly a quarter of Gazprom's proven gas reserves.
- Gazprom's operational performance and labor productivity have fallen dramatically. Despite declining gas production, the company's staff has risen to 450,000, up from 300,000 in 2000.
- Gazprom has an extremely negative impact on the Russian economy and inflation rates on the back of constantly rising gas prices. In 2015, for instance, the average price of gas for the company's Russian consumers, ignoring devaluation (in 2013 dollar terms), was almost $135 per thousand cubic meters including VAT, against a Henry Hub price of $93. Gas prices in Russia are mechanically pegged to the export price of Gazprom's contracts in continental Europe—the most expensive price benchmark, hence the upward trend.
- Prices for gasification of new consumers are very high, running to several hundred thousand rubles per household. The sharp rise in gas prices has led to a hike in electricity and other utility bills.
- Gazprom's return on investment is extremely low. Recent years have seen tens of billions of dollars spent on underutilized or written-off pipeline projects (Nord Stream consistently operates at two-thirds capacity) and the acquisition of assets, instead of investing in, say, the development of LNG plants.
- Gazprom has become a major source of semi-legal financial influence over state policy and a feeding trough for the corrupt ruling elite. Two of its largest contractors, owned by close friends of Putin (Arkady Rotenberg's Stroygazmontazh and Gennady Timchenko's Stroytransgaz), alone have a combined annual revenue of 400-500 billion rubles, placing them among Russia's top 40 companies.

## Focal areas of gas market demonopolization

**a. Demonopolization of the gas production segment**

Fostering a high level of competition in the field of gas production is a vital part of creating a competitive gas industry. All Gazprom field operators should become independent companies with ownership of production licenses and according reserves. These independent operator companies should be sold at public auctions to independent owners, with companies already accounting for more than 3 percent of gas production in Russia barred from taking part; strict control should then be established over subsequent mergers and acquisitions. This will help create a reasonably competitive gas production environment with at least 30-40 independent gas producing companies, the largest of which will control no more than 10 percent of national production. The gas assets of state-owned Rosneft should also be sold on the market, with independent field operators having been selected in advance.

**b. Unbundling of the transport-dispatch system**

It is vitally important in creating independent gas transport operators to supply full transparent information about the current and target capacity utilization of the gas transportation system and to ensure access to this capacity at auction. In the past few decades, Gazprom has vigorously opposed disclosing this information, for it would immediately lift the lid on market manipulation—many gas transportation networks inaccessible to independent players are in reality operating at no more than 30-40 percent load capacity.

**c. Other issues:**

- Consider establishing not one, but several mutually independent trunk gas transport companies competing in similar geographic areas.
- Allow operators of new gas fields to build their own backbone transport infrastructure to connect to existing gas hubs.
- Assign gas-flow dispatching duties to a separate, independent dispatch unit with powers enshrined in law.
- Create several gas transportation system operators instead of one.

## Creation of a wholesale gas market

The technological specifics of the gas industry require a nationwide wholesale gas market with transparent rules for suppliers (gas producers), large consumers and gas sellers. Rules must be established for gas trading on the spot market and under long-term contracts that ensure equal rights for all market participants.

## Demonopolization of the gas distribution and sales segment

Connecting to gas networks is often cited by Russian enterprises as a key barrier to implementing investment projects.

In the area of gas sales, the following must be done:

1. Strictly unbundle gas distribution (transportation via medium- and low-pressure gas pipelines) from gas sales (to end users). Gas distribution companies should be prohibited from buying or selling gas. Gas sales should be the exclusive realm of specialized retail sales companies that are not affiliated with transport service operators. Gas producers and sales companies and their affiliates should be prohibited from owning shares in gas distribution companies (as is the case in Europe).
2. Make regional gasification fully competitive. Opening up this process to competition will sharply reduce prices for gasification services

and connecting new consumers, and will accelerate the pace of gasification across Russia.

3. Use budget funds for regional gasification only on the basis of transparent auctions and contracts open to all.
4. Modify the mechanisms for charging connection fees to gas networks so as to exclude the practice of promptly compensating all investor costs. (Today, monopolistic operators of gas distribution pipelines try to maximize and reimburse their costs immediately, and have no incentives to continue providing decent services. As a result, many new distribution pipelines stand idle and create no consumer interest.)

## Demonopolization of gas exports

For many years, the continued existence of a "single export channel" was an obstacle to any practical discussion of gas industry demonopolization. But nothing prevents the creation of a single gas export operator—the holder of an existing export contracts portfolio—by committing independent gas field operators (when unbundled from Gazprom) to conclude vesting contracts with the single export operator for the supply of gas for exports (under a commission or agency-based scheme).

It is mutually beneficial: the single export operator—Gazprom's successor in terms of external contracts—receives guaranteed gas supplies for years ahead, while independent gas producers get part of the proceeds from gas exports in hard currency and at export prices. The emergence of an independent gas export operator earning exclusively from commission fees (and not just implementing political decisions on export prices and export contract terms and conditions) will promote a more flexible price export policy, raise the competitiveness of Russian gas in foreign markets, accelerate the development of new forms of trade (spot market), and help return foreign markets that have been partially lost in recent years due to inflexible pricing.

Liquefied natural gas exports should be immediately and fully liberalized, because the construction of new LNG export plants is extremely capital-intensive and does not allow price dumping.

## Taxation in the gas industry and topping up the Pension Fund

A major problem in the gas industry today is the low level of taxation. Thanks to the patronage of the Russian leadership and the conscious policy of transferring rents from the state into private hands at Gazprom, industry taxes are unjustifiably low, which leads, inter alia, to superprofits inefficiently invested in unwanted gas pipelines, its purchase of media companies and football clubs, and enrichment of an excessively monopolized sector of construction contractors affiliated with the authorities.

Gazprom currently pays only about 1 trillion rubles of mineral extraction tax and export duty a year, against about 5 trillion rubles paid by oil companies (at comparable volumes of production of oil and gas). The effective MET rate for gas in 2015 was just over $20 per thousand cubic meters, against roughly $100 per metric ton for oil companies.

Increasing the tax burden on the gas industry (to about the level of the oil industry) would generate substantial additional revenue for the capitalization of the Pension Fund, which now operates in conditions of artificial deficit and is replenished largely by insurance contributions from non-extractive industries.

Additional capitalization of the Pension Fund could come from selling shares of independent gas companies hived off from Gazprom and Rosneft. This income should go toward topping up the Pension Fund as a priority.

# IV. DEMONOPOLIZATION OF THE OIL INDUSTRY


Oil storage tanks on the premises of the Tuapse oil refinery operated by Rosneft. Photo: Vitaly Belousov / TASS.

The Russian oil industry is over-centralized. The four largest oil companies control over 75 percent of oil production and refining capacity; approximately half of both segments are controlled by two state companies—Rosneft and Gazprom Neft. The retail market for petroleum products is controlled by a cartel of traders linked by informal relations with oil majors and regional and local authorities. Market access is barred to independent participants.

## Negative consequences of oil market monopolization

Russia has double the proven oil reserves of the U.S., yet in recent years has fallen behind in production in terms of both amount and efficiency. Whereas North America has seen rapid growth in well productivity, drilling rigs, etc., in Russia average well production rates have been steadily falling for a decade.

**The low-competition structure of the Russian oil industry raises a number of issues:**

**1.** Industry productivity is declining noticeably.
**2.** Oil majors' return on investment is extremely low.
**3.** The above problems could precipitate the collapse of oil production in the country, similar to the crisis in the Soviet oil industry from 1987-1994, when oil production nearly halved on the back of low productivity and underinvestment.
**4.** The rate of oil refining modernization in the past quarter century has been very low.
**5.** There is no competitive pricing structure for petroleum products.

**Systemic problems of the Russian oil market**

The Russian oil industry in the past 25 years has been built on creation of vertically integrated oil companies (VIOCs). Supporters of this model have argued that, for reasons of economy of scale, VIOCs will become the locomotives of oil industry modernization and new field development. This philosophy only worked in the 2000s, when the rise in crude oil production came mostly from private companies at a time when the oil industry was least monopolized (2000-2004). The main increase in production was achieved not through economy of scale, but by importing leading global technologies that the Soviet oil industry lacked. These technologies drastically increased well productivity.

The VIOC model has led to some notable setbacks:

- Modernization of oil refining capacities on the desired scale has not occurred; refining remains on the periphery for companies interested primarily in developing crude oil exports.

- VIOCs arrived hand in hand with monopolization and the rigorous cartelization of the domestic market of petroleum products.
- Centralized VIOCs have been easy prey during the past decade of industry enlargement and nationalization.
- Private VIOCs that have survived to the present day, and continue to operate, will in future be perfectly capable of coexisting alongside elements of another structural model of the oil industry—independent small and medium-sized extractive companies and independent refineries. Looking ahead, competition between these two models seems the optimal solution to counter the VIOC.

## Ways and mechanisms to carry out oil market demonopolization

Demonopolization of the oil market is a complex and multifaceted task requiring both time and political will. It entails the simultaneous resolution of a whole set of interrelated problems.

**Demonopolization of the oil production segment**

- In Q1 2016, two Russian state-owned companies, Rosneft and Gazprom Neft, accounted for 47 percent of total oil production in Russia.
- Eleven of their subsidiaries each produced 1-4 percent of oil in Russia, and another 14 of their subsidiaries each produced less than 1 percent of oil in Russia; two of Gazprom Neft's most promising fields—Novy Port and Prirazlomnoye—are each projected to account for 1 percent of oil production from 2018-2021.
- Rosneft's largest producing subsidiary, Yuganskneftegaz, provides more than 11 percent of Russia's total oil production.

Demonopolization of the oil production sector should be based on the standalone sale of state companies' producing subsidiaries to investors. As a result, the market will see the appearance of more than 30 independent upstream oil-producing companies with up to 3-4 percent of total Russian output. Companies already producing more than 3 percent of oil in Russia should be barred from the auctions, and subsequent mergers and acquisitions should be subject to strict controls.

If the respective assets are purchased by independent investors, only two oil companies will remain in Russia producing more than 10 percent of the country's oil—Lukoil (15 percent according to H1 2016 data) and Surgutneftegaz (11 percent). The remaining oil companies (Tatneft, Bashneft, Russneft, and Novatek) produce 1-5 percent of Russian oil and pose no threat of excessive concentration of assets.

As a result of all these changes, the structure of the Russian oil industry will become highly competitive, and the proceeds from the sale of the respective assets can be channeled toward paying off debts and capitalizing the Pension Fund.

The field development investment model, given the unbundling of oil-producing companies, will be based on the following principles:

- The state will encourage the creation of consortia of oil companies to develop major deposits (in accordance with global practice) and adopt relevant legislative amendments to facilitate the creation and operation of these consortia.
- Oil companies' foreign expansion will be encouraged to achieve economy of scale through international expansion, rather than monopolization of the domestic oil market.
- Parallel reforms of financial markets and the banking system should facilitate the use of debt financing for the development of major deposits (now companies' own funds dominate the structure of investments in fixed capital).

**Demonopolization of the oil refining segment**

About half of oil refining capacity is controlled by two state-owned companies, Rosneft and Gazprom Neft. Their refining capacity (more than 140 million metric tons per year combined) should also be put up for sale. Moreover:

- Independent consultants should be hired to work out the optimal structure of oil refining assets before they are put up for sale to ensure maximum competition.
- The largest single refineries (Omsk, Yaroslavl, etc.) can be assigned the legal status of independent refineries, prohibiting integration with producing companies and the sales segment, with the adoption of non-discriminatory rules of access to refining capacity.
- The VIOC model, under which refineries were transferred under control of producing companies, did little to modernize refinery capacities, and also facilitated the monopolization of the downstream segment. Selling large refineries to independent investors and operating them according to the "independent refiners" principle (such as Tesoro or Valero in the U.S.) would stimulate competition between the oil refining operating models—vertical integration versus independent refining, which would allow the structure of the refining segment to be optimized later on.

Modernization of Russian refineries whose production is up to one-third residual fuel oil, with light petroleum products yield amounting to only about 60 percent, has long been on the agenda. However, given the cartelization of the market and the priority focus on raw materials export, VIOCs are not interested in a rapid modernization of the refining industry.

Should the oil production sector ever become highly competitive, new owners of oil producing companies will have a direct incentive to invest in new modern refineries (most likely, small capacity) with high processing depths and high yields of light petroleum products. This will strengthen competition in the oil refining segment and reduce market dependence on a handful of Soviet-era supergiant refineries.

The development of competition in production and refining will also help optimize the installation of future oil refineries. It will likely be more optimal to build new refineries near ports, as the distances between inland plants and sales markets (a Soviet-era legacy) make it difficult to economically motivate refinery upgrade.

**Demonopolization of the petroleum products sales segment**

The main problem here is not so much the dominance of large companies as the existing informal links between existing sales networks that have carved up local markets and stymied competition (in collusion with regional and local authorities). The result is a coordinated cartel pricing policy and inflated retail margins on petroleum products, up to 30 percent in Russia (compared to about 15 percent in the U.S.).

In the area of sales, the unbundling of enterprises (though almost 4,000 filling stations and around 200 oil depots owned by Rosneft and Gazprom Neft should be sold at open competitive auctions) is secondary to unlocking barriers to the acquisition of land for the construction of new filling stations and the receipt of permits and approvals from local authorities. Independent oil producers, refiners, and traders should be able to open their own filling stations anywhere in the country and compete with established trader networks linked to major VIOCs and local authorities.

# V. DEMONOPOLIZATION OF THE RUSSIAN ELECTRICITY INDUSTRY

Federal Grid Company of Unified Energy System (FGC UES) in Feodosia, Crimea. Photo: Alexei Pavlishak / TASS.

Despite the reform of the Russian electricity industry carried out in the 2000s, the stated goal of creating a full-fledged competitive electricity market in Russia was not achieved. Consumers faced a significant rise in electricity tariffs. In 2013, prices in Russia exceeded those in the U.S.

## Negative consequences of electricity industry monopolization

One of the reasons for the continuous rise in tariffs is the dependence of the electricity industry on the monopolized gas sector. Natural gas accounts for 50 percent of electricity generation in Russia (about two-thirds in European Russia), and the sharp increase in natural gas prices in recent years has made electricity more expensive. It is not just a matter of rising gas.

The reform failed to create a competitive generating capacity market. Today, around 55 percent of the country's generating capacity is controlled by the four largest state companies—RusHydro, Rosatom, Inter RAO, Gazprom Energoholding—rising to 73 percent if three other large financial-industrial holdings are counted (RUSAL, Renova, SUEK). By comparison, in the U.S. the five largest energy companies control just 20 percent of the country's generating capacity, and state structures do not play any significant role in the market. In Russia, producers have no incentive to improve operational efficiency; there is only the appearance of competition.

Furthermore, the past decade has seen the unplanned and unprecedented consolidation of power grid companies under the superholding Rosseti. Measures need to be adopted to stop the facilitation of electricity market monopolization.

## Focal areas of electricity industry demonopolization

Nevertheless, the reform achieved the much-needed organizational separation of the spheres of production, sale, and transmission of electricity, and the creation of a wholesale market. Thus, the electricity industry requires the implementation of only a limited set of measures to create a truly competitive environment.

### Demonopolization of the electricity generation segment

The four state majors have a significant distorting effect on the structure of electricity generation. At least three of them (RusHydro, Gazprom Energoholding, and Inter RAO) should be disaggregated through hiving off no fewer than 15-20 independent generating companies, including the division of Gazprom-owned Mosenergo into 3-4 independent, competing generating companies. Gazprom Energoholding and Inter RAO should be liquidated entirely.

Likewise, the over-centralized RusHydro has failed to justify its existence. Its creation was originally motivated by economies of scale in the drive to implement major investment projects. However, these projects are mostly complete and problematic—primarily large hydroelectric power plants in the east of the country running at 30-40 percent capacity utilization with no prospect of securing demand for electricity or raising the utilization rate. The initial idea of creating not one, but four generating companies on the basis of Russia's large hydroelectric power stations should be revived. The structure of hydro generation should perhaps be unbundled even further to strengthen competition.

It would be advisable to consider the option of creating several generating companies on the basis of Rosatom, instead of just one. This can be accomplished far more readily through the commissioning of new nuclear power plants and the forthcoming decommissioning of a large number of old nuclear stations, which can also be hived off into a separate structure.

**Deconsolidation of the power grid economy**

Recent years have seen the super-consolidation of the power grid economy and transmission/distribution networks under the single holding Rosseti. This path threatens the development of a single power grid holding with excessive political influence—the "regulatory capture" effect. This is illustrated by the 2.5-fold increase in the tariff revenue of Federal Grid Company (FGC) from 2008-2014, while the physical volume of power transmission services grew by less than 10 percent in the same period.

In Russia, where grid connection fees are among the highest in the world, this problem is cited by businesses as one of the main obstacles to investment. Decisions that have led to the excessive consolidation of power grid companies in the past decade should be undone.

The power grid economy needs to go down the path of developing a broad range of financial instruments to finance investment, with appreciable disaggregation of the sector and the creation of a large number of independent distribution companies. FGC should only retain control over networks with a voltage of at least 330 KV.

**Unbundling of energy sales from distribution networks**

Energy retail companies should be prevented from integrating with distribution networks. In recent years the practice has been allowed under the pretext of tackling non-payment. The solution to the problem of non-payment lies elsewhere, including through the creation of a system of financial guarantees on the part of the authorities with respect to socially significant consumers.

**Adjustment of electricity market operating mechanisms**

The main electricity market operating mechanisms implemented during the reform should be identified with a view to their impact on competition in the electricity industry. Some are cause for concern: for instance, old low-performance capacities are not being withdrawn, yet new ones are being introduced that are subject to guaranteed remuneration. There is estimated to be roughly 50 GW of surplus generating capacity nationwide, which consumers will pay to maintain. Against this backdrop, the key mechanism for stimulating the development of high-performance generation and the rapid decommissioning of overly expensive capacities has to be competition.

# VI. DEMONOPOLIZATION OF THE BANKING SECTOR


Herman Gref, head of Russia's largest bank, Sberbank. Photo Mikhail Pochuyev / TASS.

The Russian banking system in its current form is a huge impediment to the country's economic development. It is not capable of providing the economy with affordable financing. This is largely the result of the monopolization of banking services.

## Negative consequences of banking sector monopolization

The key problem with the banking system is the high level of monopolization and integration with the state.

- Nearly two-thirds (62 percent) of total banking assets, and roughly the same share of loans extended to legal and physical entities, are controlled by the six largest state-owned banks: Sberbank (~31 percent), VTB (~13 percent), Gazprombank (~7 percent), Vnesheconombank (~4 percent), VTB 24 (~4 percent), Rosselkhozbank (~4 percent).
- The controlling shareholder of Sberbank is the Central Bank of Russia (with a slightly more than 50 percent holding), which itself is the regulator of the banking market. A situation has thus arisen whereby the banking market regulator directly manages almost a third of the country's banking assets.
- Also present in the market is Vnesheconombank, which does not possess a banking license and is, therefore, not included in the banking ratings. Yet despite its formal status as a "non-bank organization," it carries out very real banking activity, ranking fourth in the list of top banks, with a share of around 4 percent of banking assets.
- Russian state banks have an obvious advantage when it comes to receiving assistance from the state. According to Standard & Poor's, state support for Russian banks since December 2014 exceeds 2.5 trillion rubles. The main recipients are state-owned banks.
- At the same time, the state pursues a consistent policy of squeezing small and medium-sized banks out of the market. The period 2008-2016 saw a 1.5-fold decrease in the number of banks in Russia (down from 1136 to 733) under the pretext that the state was tackling unscrupulous banks. But this issue should be addressed through higher-quality banking supervision, since the Central Bank is systematically incapable of dealing with it.
- Another serious barrier to competition is foreign banks' restricted access to the Russian market: foreign banks are prohibited from directly opening branches, and the purchase of a stake worth 10 percent or more in a Russian bank by a foreign entity (physical or legal) is possible only with the

permission of the Central Bank.

- The margin between the deposit and lending rates for major banks is very high, and smaller banks cannot hope to compete due to their lack of scale and inability to borrow funds at the same low interest as state-owned banks.

Past economic crises (those of 1998 and 2008-2009) have engendered a feeling of invincibility among large state-owned banks: the state traditionally provides ample emergency funding for banks that are not held accountable for past inefficiencies. During the 2008-2009 crisis, not a single bank went bankrupt, even though it was the policy of investing in low-performing assets that pushed Russia onto the list of the 15 economies hardest hit by the global financial crisis. The non-competitive banking system, closely linked to the state, seriously hinders the development of the Russian economy and needs to be demonopolized.

## State pull-out from banks' capital

The state should keep out of the shareholder structure of banking institutions. Its presence only strengthens the oligopoly and promotes favoritism and corruption. State-owned shareholdings in a number of banks (primarily Sberbank) are often justified by their "social significance," yet the task of protecting individual depositors falls entirely to the state deposit insurance system in operation.

The state and its subsidiaries must sell their entire stakes in Sberbank, VTB (and all its subsidiary banks, including VTB 24), Gazprombank, and Rosselkhozbank. Independent consultants should draw up proposals to divide the largest state banks into more numerous independent competing banks prior to their sale, based on the respective levels of market concentration. Vnesheconombank should be required to obtain a banking license and operate according to the general rules (its assets should then be divided and sold on the open market), or it should be liquidated. The Central Bank should be prohibited by law from combining the roles of financial market regulator and bank shareholder.

## Measures to promote banking sector competition

The state should abandon once and for all the liquidation of small and medium-sized banks and the amalgamation of the banking sector as policy goals. The problem does not lie in the number of banks or the presence of many small and medium-sized banks, but in the absence of proper banking supervision.

The core measures to promote competition in the banking sector should be as follows:

1. The focus on the number of banks in the country and the use of banking supervision levers as a tool for managing the structure and number of banking market participants should be abandoned. Banking supervision should: a) be carried out in a timely and high-quality manner, and b) have the sole objective of limiting and suppressing unscrupulous activities by banks.
2. Barriers to market entry for foreign banks should be greatly relaxed, and foreign legal entities (branches of foreign banks) should be allowed to do banking business.
3. It should be mandatory for state institutions to sell their shareholdings in banks on the open market; the target structure of the banking sector should presuppose a large share of independent, private medium-sized banks.
4. The state should abandon the policy of favoritism toward state-owned banks.
5. The Law on Banks and Banking Activities should be supplemented with a special chapter regulating the procedure for non-discriminatory provision of state support to banks so as to preclude favoritism and preferences for certain major banks.

# VII. DEMONOPOLIZATION OF THE TRANSPORT SECTOR

Freight trains at Inskaya marshalling yard (Novosibirsk). Photo: Kirill Kukhmar / TASS.

Given the expansiveness of Russia, the country's transport system plays a huge role not only in ensuring the proper functioning of the economy, but also in fully realizing the country's human potential. Yet various estimates indicate that Russia loses 2-3 percent of GDP per year due to transport limitations.

## Negative consequences of transport sector monopolization

Russia's transport system is not short of absurdities. Air travel to Europe is often cheaper than the cost of flying from one Russian city to another. The average speed of delivery of goods by rail barely exceeds the average speed of a pedestrian and lags behind the average speed of a cyclist (!). Russia lacks a decent network of high-speed roads or railways. Transport tariffs, according to the Federal State Statistics Service, have been outpacing inflation in recent years. The various attempts to resolve these issues over the past quarter century have led nowhere.

## Focal areas of transport system demonopolization

Most segments of the Russian transport sector are either dominated by state monopolies or dependent on public funds, which are not disbursed transparently or efficiently. To significantly improve this state of affairs, radical demonopolization of the transport sector is required, with budgetary expenditure placed under strict public control.

**Demonopolization of rail transportation**

- Certain steps have been taken to create competition in the sphere of rail transportation, especially as regards freight traffic, but overall the industry has failed to shake off the domination of a single monopoly structure.
- Russian Railways is still well placed to manipulate the rail transportation market by continuing to combine competitive and monopolistic activities.
- Around 15 percent of haulage is controlled by Russian Railways either directly or through subsidiaries, primarily Federal Freight (FGK). In general, competition in the freight market is limited: almost 60 percent of rolling stock is controlled by around ten large operators, a significant part of which is either controlled directly by state structures or by operators subordinated to persons close to the Russian leadership or the Russian Railways management.
- The locomotive traction market has yet to be liberalized, and private operators do not have access to the use of locomotives.
- Russian Railways and its subsidiary and affiliat-

ed companies account for 96 percent of passenger traffic on long-distance routes. Private operators are being admitted to the passenger traffic market at a very slow pace. As a result, the cost of rail travel is comparable to—and often in excess of—the price of an airline ticket for the same trip.

**Measures to be taken in the railway industry:**

- Russian Railways should completely withdraw from all competitive spheres of activity and focus solely on railway infrastructure; all competitive businesses should be sold off.
- State-linked structures should sell all cargo companies belonging to them.
- The locomotive traction market should be liberalized forthwith and private operators granted immediate access to the use of locomotives.

A key issue of rail transport demonopolization is the admission of private transportation companies to the passenger traffic market. There is much evidence to suggest that the perennial arguments about the "unprofitability" of passenger traffic are nothing more than a pretext for extracting state subsidies. Passenger traffic could well be profitable. To make it so, the transportation routes in question should be auctioned with free and fair access for private operators that have fulfilled the conditions of the auction.

An independent council should also be set up to improve the management of railway infrastructure, represented by all independent carriers, which would develop a program of measures to sharply improve operating performance, above all increasing the speed of rail traffic and easing bottlenecks.

THE AVERAGE SPEED OF DELIVERY GOODS BY RAIL BARELY EXCEEDS THE AVERAGE SPEED PF A PEDESTRIAN AND LAGS BEHIND THE AVERAGE SPEED OF A CYCLIST.

**Demonopolization of air transportation and the airport economy**

Following Aeroflot's acquisition of Transaero, the largest air carrier in the passenger traffic market has approximately 65 percent of market share; the only other relatively large carrier left in the market is S7 Airlines (less than 10 percent of market share). Such concentration is unacceptably high and leads to inflated prices for airline tickets. As a result, civil aviation in Russia is significantly less affordable than in developed countries.

As regards air transportation, it is necessary to:

- Disaggregate Aeroflot by completely selling off subsidiary companies that are focused on the domestic market, including the partial sale of the actual fleet; Aeroflot should be retained primarily as an international carrier; domestically it should serve only backbone routes.
- Engage independent consultants to work out the optimal structure of airline companies hived off from Aeroflot, based on market concentration levels.
- Denationalize all regional airlines that presently belong to regional and local authorities or state structures and that tend to monopolize routes to certain geographical areas and bolster inflated ticket prices.
- Create a legal and regulatory framework for the mass development of competing private low-cost carriers to ensure the air connectedness of the regions.
- Likewise, special attention should be paid to the demonopolization of the airport economy.

Truckers go on strike over a double increase in road tolls collected by the Platon electronic system (Ulan-Ude, Buryatia). Photo: Mark Agnor / TASS.

ROAD CONSTRUCTION IS HEAVILY MONOPOLIZED BY CONTRACTORS CLOSE TO THE RUSSIAN AUTHORITIES. MANY OF THEM ARE AWARDED STATE CONTRACTS TO BUILD TOLL ROADS, RESULTING IN ARTIFICIALLY HIGH PRICES AND UNDERUTILIZATION OF THESE ROUTES.

**Reduction of barriers to competition in road transport**

Road haulage is still a fairly competitive segment, but recently the state has taken a number of measures to restrict competition, ruin small carriers, and concentrate the market in the hands of large haulage companies by introducing:

- The Platon levy system for heavy vehicles on federal highways;
- Excessive regulatory measures (stricter weight controls, equipping vehicles with tachographs, etc.);
- Measures to stimulate artificial price rises on petroleum products (including a constant increase in excise taxes on fuel).

A nationwide scheme is needed to lift redundant, competition-restricting barriers from independent road haulers. The Platon system should be abolished, since its introduction is not fiscally justified.

**Demonopolization of urban passenger transport**

Urban passenger transport in Russia generally retains a Soviet-style system of management. The field is dominated by state-owned enterprises in the form of state and municipal unitary enterprises, whose operations are not transparent. They are not subject to public audit. Theft and corruption prevail, while tariffs for urban passenger transport services continue to rise, increasing the cost of living for ordinary citizens. The sector enjoys large budget subsidies, and private carriers are squeezed out of the market.

Although every Russian municipality has its own specifics, there are a number of unified measures that should be applied centrally across the country:

- Mandatory corporatization of all urban passenger transport enterprises and obligatory requirements on the regular publication of open financial and management reports;
- Regular public auditing of municipal passenger companies by independent public bodies;
- Maximum market access for independent small and medium-sized private carriers to create competition;
- No indexation of urban passenger transport tariffs or granting of budget subsidies without carrying out a clear-cut public audit.

Note also that the demonopolization of the oil, petroleum products, gas, and electricity industries would help stabilize urban passenger transport prices.

**Reform of the financing system for road construction and repair**

The Federal Road Agency (Rosavtodor) currently has an annual budget in excess of 550 billion rubles, which is equivalent to the cost of building 5,500 km of roads, based on an average price of 100 million rubles per kilometer. However, only 280 km of new federal highways were due to be put into operation in 2016, while in 2014-2015 just 400-600 km of federal highways were commissioned each year. A significant portion of the funds is spent on road repair, which is largely a consequence of poor-quality road construction—many highways need repairing just one year after construction.

Road construction is heavily monopolized by contractors close to the Russian authorities (Arkady Rothenberg's various structures, Russian Railways, Ziyavudin Magomedov's Summa Group). Many of them are awarded state contracts to build toll roads, resulting in artificially high prices and underutilization of these routes.

The idea of toll roads in Russia has been discredited not only by the monopoly of contractors and their connections to corrupt authorities, but by the poor overall investment climate in the country.

A key tool to accelerate the process of modernizing and developing Russia's road network is to make budget spending efficient. Put bluntly, the money is there, and spending could even be increased slightly, but this would require regular public auditing of Rosavtodor's budget and a sharp increase in spending efficiency in modernizing the network of federal highways.

This requires:

- Full transparency of Rosavtodor outlays with the mandatory involvement of independent public bodies in the audit of expenditures;
- Fully open tenders for the publicly funded construction and repair of roads, and mandatory approval of the results by a council of independent public bodies exercising control over the transparency of Rosavtodor expenditure;
- The same mechanism of openness for tenders aiming to attract investments in toll road construction projects;
- Bonus payments for contractors for ensuring that newly constructed or repaired roads do not require unscheduled maintenance.
- In addition, the nationwide scheme to develop the road network should involve public consultations, primarily with road users themselves.

# VIII. DEVELOPMENT OF COMPETITION IN TELECOMMUNICATIONS

Ostankino Tower is owned by the Moscow branch of the Russian Television and Radio Broadcasting Network (RTRS). Photo: Natalia Garnelis / TASS.

The telecommunications industry in Russia is relatively competitive. However, even here negative tendencies of preserving and strengthening the state monopoly in certain market segments (primarily in television and radio broadcasting) are still being observed. Among other drawbacks, the government uses regulatory leverage to bolster the positions of the monopolistic companies close to the state, to complicate working conditions for independent private businesses, and to squeeze out independent media from the market.

## Negative consequences of telecommunications monopolization

State monopolism in the telecommunications industry manifests itself most visibly in the sphere of television and radio broadcasting, where the government retains complete monopoly on satellite broadcasting and controls radio and television transmitting centers in the regions. Frequency allocation is implemented by the State Radio Frequency Commission, and the allocation procedure is not transparent. All of these circumstances stand in the way of independent actors, preventing them from entering the electronic media market.

Russia's state telecom giant Rostelecom continuously builds up its influence in the telecommunications industry. It's the largest telecom company in Russia in terms of revenue; it also controls a number of the market segments. Other state companies hold dominating positions in specific segments of the telecom market, primarily in landline communications. The Russian government constantly increases its presence in the market by introducing new regulations (oftentimes pursuing political goals) that complicate the work of independent market players.

## Focal areas for demonopolization of telecommunications

Below is a list of much-needed solutions that will allow Russia to resolve the issues outlined above and help to make the telecom market more transparent, competitive, and independent from the state and state-affiliated companies.

**Demonopolization of television and radio broadcasting**

In terms of access to independent electronic media, the key problem for the Russian people is an overly tough state monopoly in television and radio signal transmission systems, which limits the ways independent views can be circulated around the country. This monopoly inflates the costs of and obstructs the development of independent private providers of signal transmission.

The key problems in this sector are:

- Federal State Unitary Enterprises—Satellite Communications (Russian Satellite Communications Company, RSCC) and Gazprom Space Systems (Gazcom)—fully dominate in the segment of satellite communications in the FSS and BSS networks. These two companies control about 90 percent of the satellite leasing market.
- The conditions for foreign satellites broadcasting on the Russian territory are about to become even tougher. In 2016, Russia's Ministry of Communications and Mass Media came up with an initiative to force the companies that use foreign satellite services to switch to national communication systems. This initiative is very likely to be implemented. Given the state monopoly and limited access to foreign satellite services, Russia has already developed an acute deficit in satellite capacity, leading to overpricing of the services offered by the national monopolists.
- In 2001, Vladimir Putin issued a decree creating the Russian Television and Radio Broadcasting Network (RTRS), a monopolist operator of the country's television and radio transmission system. It was a crucial step toward monopolization of the Russian electronic media. RTRS is now actively used as a tool to put political pressure on the media outlets.
- The network of independent cable providers in Russia is under increasing regulatory and legislative pressure as a result of constantly introduced amendments to various federal laws ("On Advertising," "On Communications," "On Mass Media").
- An overwhelming majority of new subscribers to IP-television (one of the fastest-growing segments of subscription-based television) are assigned through state-owned Rostelecom, directly resulting from its domination on the broadband internet market.
- The system of radio frequency allocation in Russia is not transparent; it is controlled by the State Radio Frequency Commission, which is not an independent authority. That fact, along with the RTRS monopoly, squeezes out of the market independent radio stations pursuing independent editorial policies.
- Up until now, a significant portion of radio frequencies in Russia is still being used by the military, thus creating a major roadblock when it comes to allocating frequencies at open auction and developing a competitive market environment. This status quo is the key reason television and radio broadcasting in Russia is entirely state controlled.

In television and radio broadcasting, the following changes need to be implemented:

- Create conditions for competitive development of telecommunication and satellite services; end the monopoly of RSCC and Gazcom. The non-military assets of these companies must be sold; Russian and foreign private providers of satellite services must be given access to satellite broadcasting.
- Largely simplify the normative framework that regulates frequency allocation, certification requirements, and the work of the oversight authorities; liberalize imports of radio-electronic equipment to Russia.
- Liquidate RTRS monopoly—this structure must be abolished. At the regional level: create a competitive environment for regional radio and television transmitting centers; take measures to facilitate the development of alternative channels for signal delivery, including via internet.
- Draw up an inventory of all the legislative and regulatory barriers hindering the work of the private cable networks; remove as many of these

barriers as possible.

- Clear the frequency usage from the military; demarcate frequencies by designation.
- Abolish the State Radio Frequency Commission and introduce in its place a transparent legal mechanism that would regulate frequency access through auctions.

**Liquidation of Rostelecom**

Rostelecom controls up to 40 percent of the broadband internet and about 15 percent of the cellular communications market in Russia. The government doesn't need its own telecom company. Rostelecom should be dismantled into independent commercial cellular operators (carriers) and an independent infrastructure company that will not be affiliated with any other market players. The newly created independent operators should be sold on the open market. The government has to make a full exit from the cellular communications market.

However, it makes sense to preserve the government's participation in certain market segments, such as development of broadband internet and construction of fiber optics communication systems in geographically remote areas—something that private investors may not be interested in.

**The government's exit from capital interest in telecommunication companies**

The fact that the Russian government has interest in a number of state companies is a big problem in the landline communications segment, where such companies withhold significant market shares. They are among Russia's top 30 telecommunication companies: Svyaztransneft and Telecomnefteproduct (subsidiaries of Transneft), Transtelecom (subsidiary of the Russian Railways), Moscow Telecommunications Center of Energy Systems (subsidiary of the Federal Grid Company for the United Energy Systems); Multiregional TransitTelecom (subsidiary of the VTB bank, with interest of the former communication minister Leonid Reyman). Government-affiliated assets of the telecom market have to be sold on the open market.

**Simplification of the regulatory rules of the telecommunications industry**

A number of measures need to be introduced with goals to lift the regulatory burden, stimulate competition, lower prices, facilitate the market penetration for various services, and improve quality of the service:

- Simplify regulations on frequency band exchange, shared usage of the radio-frequency spectrum, and shared construction of the mobile communication infrastructure;
- As already mentioned above, liquidate the State Radio Frequency Commission and establish a transparent mechanism to give access to frequency allocations through auctions;
- Transit to auction format to allocate new frequency bands, which will require developing new protection measures against speculative activities;
- Adopt uniform rules for landline and wireless operators to gain access to telecommunication infrastructure; introduce amendments to housing and urban planning legislations and to regulatory framework to reduce their propensity for corruption.

# CONCLUSION: POLITICAL MEANING OF THE ECONOMY DEMONOPOLIZATION PROGRAM


Thousands of people took to the streets to protest against vote rigging in the 2011 December parliamentary election and policies of the Russian government. Photo: Mitya Aleshkovsky / TASS.

As war is sometimes called "the continuation of politics by other means," domestic policies are in a sense the continuation of the country's economy. There is a strong and indissoluble connection between the monopolist structure of the Russian economy and the authoritarian structure of the Russian government. Reforming (democratizing) the former without reforming (demonopolizing) the latter is a utopic idea. At the same time, solving economic problems requires political will; therefore, demonopolization of the economy cannot be launched, let alone carried out, until tectonic shifts take place in politics—essentially creating a safe distance between the political decision-making process and the bureaucratic "power vertical" (or removing "power vertical" entirely from that process), as the latter is currently the main beneficiary of the monopolistic structure of the Russian economy.

The call for demonopolization of the economy is doomed to occupy a special place in political programs of any reformist party (in a broad sense of the word), as it is not just "one of the many" slogans, but the backbone of a new political agenda.

The site of wells cluster at the Bovanenkovo gas field. Photo: Stanislav Krasilnikov / TASS.