

Analysis

Power Politics: Electricity Sector Reforms in Post-Soviet Russia

By Susanne Wengle, Berkeley

Abstract

While efforts to exert greater state control over a number of sectors of the Russian economy have made headlines, the government is currently also proceeding with efforts to privatize large parts of the electricity sector. Since the beginning of attempts to liberalize, effective opposition to these measures has changed: while in the 1990s, a variety of actors who reflected public concerns could negotiate the terms of reform, today influence is limited to a narrow elite of powerful insiders. Crucially, since about 2002 electricity sector liberalization has had the backing of President Putin and far-reaching reforms have been implemented. Nevertheless, it remains to be seen who emerges as the new owners of valuable power plants and if the plans to liberalize wholesale prices by 2011 will be realized in a post-Putin era.

“Power Politics” and the Political Economy of Electricity Sector Reform

The Soviet-era state-controlled electricity monopoly “Unified Electricity System” (UES), whose origins lie in Lenin’s initiative to electrify the newly-founded Soviet Union, is currently being broken up and privatized. Russians old enough to remember the Soviet period are aware of the extraordinary economic, political and symbolic importance of the electricity sector. The liberalization and privatization process has been marked from its onset by conflicts over the immensely valuable assets as well as over the future of electricity provision more generally. Struggles over property rights and resources are never simply battles between reformers and resisters, with one side pushing for change and the other blocking it. The stakes are high for a variety of actors: politicians at different levels of government, household and industrial consumers paying their bills and petitioning for subsidies, utilities negotiating their monopoly position in a changing regulatory environment, reformers with visions of more efficiency and lower prices – to name just a few. Multiple and shifting fault lines shape the conflicts over electricity sector reforms.

In what follows, I will sketch changing patterns of the political economy of electricity sector reform. The utility sector provides an interesting lens for understanding the post-Soviet period for several reasons. First, electricity is an important sector in a country with cold winters and energy inefficient industries; the electricity sector crisis and the proposed reforms have held public attention and generated stormy headlines for years. Second, Russia’s ongoing process of utility sector liberalization is at odds with accounts that portray the country as moving “backward” towards more statism. It also contrasts with widely publicized news

in other energy sectors – the “re-nationalization” of Yukos and the ouster of foreign oil companies from key oil and gas fields. An analysis of the patterns of conflict in the electricity sector illustrates that the dynamics of liberalization and privatization in the Russian economy vary across sectors. Finally, “power politics” mirrors some of the larger dynamics of post-Soviet political economy. The effective opposition to reform has narrowed over time and become less representative: in the 1990s Duma deputies, regional governors, regionally-based industrialists and mayors of important cities influenced the trajectory of the sector; today the terms of reform are negotiated among select elites close to the Putin administration.

The Aims of the Reforms: Unbundle, Restructure and Create Markets

The guiding principle of the electricity sector reforms, in Russia and elsewhere, has been to force utilities to operate more efficiently and reduce prices for end users through the introduction of market forces. In order to create markets and competition, electricity sectors are being fundamentally restructured. For much of the 20th century, vertically-integrated state-owned monopolies produced and distributed electricity throughout the world. While the global wave of electricity sector liberalization has taken shape in various ways in different countries beginning in the 1980s, restructuring typically involves undoing the vertically-integrated monopolies, isolating competitive segments from those that are considered natural monopolies. The unbundling of the different parts of the production chain restructures the sector into four segments: generation, transmission, distribution and retail. In generation and retail, reformers hope to introduce competition between independent companies. In transmission and

distribution, non-discriminatory access to grids is to be secured by a strong and independent regulator. The privatization of the generation and retail segments of the sector tends to be a later step in the reforms – although in Russia, privatization of electricity assets started before the restructuring of the sector.

In the Soviet Union, the “Unified Electricity System” was run by the Ministry of Energy and Electricity, a hierarchically-organized bureaucracy directed from Moscow. The current reform process rests on a set of laws that were passed in 2002/2003. Earlier efforts to restructure the sector, starting in 1997, were largely futile. The first important step of the ongoing liberalization was the unbundling of the regional vertically-integrated electricity companies, known as the “Energos” in 2004/2005. Reforms mandate the privatization of the bulk of generation assets by 2008, although the government always planned that hydro-electric generation would remain partly state-owned and nuclear power generation would remain fully state-owned. Prices are in the process of being liberalized, with full liberalization of wholesale prices planned for 2011. Transmission networks will remain state controlled, to be overseen by regulatory institutions that guarantee open and non-discriminatory access to the grid for all generators. Given that Russia had no experience with a privately-owned and marketized electricity sector, legal and regulatory institutions that underpin the sector had to be built from scratch.

The Key Drivers of Structural Change: A Monopoly Orchestrates Its Own Demise

UES itself has been the main driver of the current reforms in Russia. UES and its subsidiaries produce about 70 percent of Russia’s electricity, making it by far the largest electricity producer in Russia. It inherited most of the Soviet-era infrastructure in the sector via a 1992 presidential decree, including most power plants, transmission and distribution networks, and many other related functions – repair and maintenance companies, research institutes, etc. Under the leadership of Anatoly Chubais, a highly skilled, though controversial, politician strongly committed to the introduction of market forces, the monopoly provider UES has been orchestrating its own demise.

While UES has been providing the impetus and many of the blueprints for reform proposals, the Duma, Presidential Administration and two key ministries have also been involved in power sector reforms. Victor Khristenko’s Ministry of Industry and Energy has been charged with the somewhat vague mandate of the “overall oversight of reforms.” German Gref’s Ministry of Economic Development and Trade monitors the macro-economic and social impact of reforms, such as the effect of tariff increases on living standards

and inflation rates. At several points the Duma has played an active role in trying to shape the reform outcome. During the planning phase of the current reforms a Duma commission – led by Tomsk Oblast governor Viktor Kress – worked out a competing program to the UES plans, which involved less radical unbundling and allowed the state to maintain control of more generation assets. Nevertheless, the legislation that led to electricity-sector reforms was ultimately based on plans favored by UES, but the legislation ultimately adopted included hundreds of amendments to the law initially proposed by Chubais.

Without the support of the president, the current reforms would not have been possible. Putin reversed his position on utility reform after coming to office. In early 2000, then Prime Minister Putin sharply criticized Chubais for wanting to hike electricity tariffs and joined efforts to remove him from the chairmanship of UES. By the end of 2002, however, Putin had sided with the reformers and by 2003 signed the legislative package that came to serve as the basis for reform. Since then electricity has been grouped with other infrastructure sectors, such as railways, telecoms and financial services that have been liberalizing over the last few years. The faction of liberal reformers among Putin-era elites, including Gref, Kudrin and Chubais, prevailed over opponents of reforms. They justified the need for reform with the logic that liberalization and privatization are prerequisites to attract capital for infrastructure investment, which in turn they present as a necessary condition to reach Putin’s 2004 growth target of doubling GDP by 2010.

Who Opposes Liberalization? Narrowing Circles of “Relevant” Opponents

Changing coalitions of various social and economic groups have opposed structural changes in the electricity sector. The most threatening opposition to Chubais’ vision of a liberalized electricity market has narrowed over time, and, arguably, become less representative of public opinion. In the 1990s, the most vocal and powerful opponents included Duma deputies, the regional governors and regionally-based industrialists, often the incumbent beneficiaries of the UES empire. In contrast, in recent years the relevant opponents are concentrated closer to the president.

A comparison of the two reform attempts – one in 1997 that largely failed and one after 2003 that has so far succeeded – reveals how much the actors and the contours of the conflicts in the sector have shifted. UES tried to liberalize and restructure the electricity sector for the first time in 1997. At that time, the fragmentation of bureaucratic authority and the economic crisis inherited from the late 1980s and early 1990s set the context for reforms. The central government

in Moscow was struggling to assert political authority and many regional governors managed to control assets and tariff-setting institutions in the electricity sector in the early and mid-1990s. Governors were keeping electricity tariffs low to subsidize regional industrial elites, gain legitimacy among constituencies and assert their independence from the central government. Subsidy arrangements for industrial users varied across regions, depending, for example, on the dominant industry and its relations with the regional governments. In many regions, UES' reform attempts in the late 1990s were thus unwelcome: the reformist vision of what should happen with the sector – unbundling the regional, vertically-integrated monopoly, creating wholesale markets for electricity and other liberalization measures – threatened the basis of the subsidy arrangement among the troika of regional governors, regional Energos and regional industrialists.

The opponents of reforms thus outnumbered supporters by far. When Chubais took the chairmanship of UES in 1998, a broad coalition of opponents rallied against electricity sector reforms, which included Duma deputies, and influential political actors like Moscow mayor Yuri Luzhkov and Boris Berezovsky, who controlled Russia's most important television network at the time. A coalition of Duma deputies tried to stop UES' plans by removing Chubais: over 60 motions seeking to remove him from the leadership of UES came to a vote between 1998 and 2004 (when the Duma became dominated by United Russia). Communist deputies, opposed to the sale of state property, were joined by other opponents of reforms and those who opposed Chubais personally, such as the Yabloko party.

During the Putin-era centralization of power, the opposition by regional elites, the Energos, the governors and industrialists was broken or co-opted. Since 2004, the Duma has been dominated by United Russia deputies, who have loyally followed the Kremlin's position on infrastructure reforms. The most threatening opponents to Chubais' plans to fully liberalize the electricity sector are now positioned not in the regions or in the legislature, but close to the presidential apparatus. Some key members of the Presidential Administration envisage something like a Gazprom-led energy empire and are not in favor of selling UES' assets to a broader investor base that includes foreign strategic and portfolio investors.

Reforms in the electricity sector are thus still contested, but the fault lines of the conflict are no longer aligned with the opponents and proponents of privatization (although Chubais tends to frame the conflict in this way – calling his opponents supporters of “Goskapitalism”). Instead, the debate centers on the question of whether electricity should be classified

as a “strategic sector,” which would provide a rationale to exclude foreigners and give a larger role to Russian companies, including Gazprom. Gazprom has been trying to buy electricity sector assets. It is not yet clear to what extent the enormously powerful gas monopoly will be able to control the sector. (Gazprom presents itself as a profit-oriented private company, but most observers think of it as basically an arm of the government.) State support for vertically-integrated “national champions” that can compete internationally is clearly on the agenda in a number of other sectors. Electricity, so far, is considered an infrastructure sector, where competition and foreign investment are ultimately needed to support the growth of the Russian economy as a whole. Even if Gazprom can secure assets, unlike previous rounds of privatization, it will probably have to offer a high-enough price to outbid other interested parties. Yet, the classification of utilities as a “non-strategic” industry may be short-lived. Opponents to the involvement of foreign investors have successfully used the argument that electricity *is* strategic to keep the St. Petersburg generation company reserved for Russian investors.

Does public opinion matter for the progress of reforms? Following price increases and frequent electricity black outs in some regions, Russia saw a wave of protests against electricity reforms around 2001. Ordinary Russians are clearly vulnerable to changes in the sector: over half (57%) of the respondents to a recent survey by the Public Opinion Foundation (FOM) said that the increase in utility prices has greatly affected their lives, and about a third (33%) said they will have to adapt spending patterns or find additional income sources. Currently, in the run-up to presidential elections, the government is committed to not letting electricity prices increase too quickly; gradual price increases up to full liberalization in 2011 are planned. A gradual approach is to a large extent motivated by a concern about the inflationary effect of price liberalization, though it is probably also partly the result of fears of a popular backlash against sharp price hikes. It remains to be seen if any of the parties in the Duma will articulate opposition to price hikes in the future. Representation under Putin is in many ways deeply flawed: at a time when opposition to increasing utility prices and the hatred of Chubais and his schemes is at a high, the circle of actors able to shape the reforms in the sector has narrowed to a small group of elites in Moscow.

Prospects for Reforms: Two Open Questions – Who Will Be the New Owners and How Will Price Liberalization Progress?

The structural change in the power sector over the last five years has been substantial: vertically-integrated

regional monopolies have been broken up, generation companies are in the process of being privatized, a wholesale market for power has been created with a non-profit organization that administers trading, and lastly, the regulatory institutions of the electricity sector have been re-organized to deal with the marketization of the sector. Finally, since the culmination of Chubais' plan is the abolition of vertically-integrated monopolies, the UES reform plan seeks to liquidate all UES assets by 2008.

It is highly unlikely that the restructuring of the vertically-integrated monopolies into horizontal holding companies will be reversed. And it is probable that the government stake in generation assets will be significantly reduced, which will mean a *de facto* privatization of generation. This is currently happening through the public issue of equity stakes, which are intended to raise capital for future investments, but simultaneously reduce UES' stake – and therefore state ownership – in generation companies. It is also likely that the share of liberalized transactions and contracts on the wholesale markets will gradually increase over the next few years. It is *not* clear at this point, however, who will be allowed to acquire the shares of generation companies – domestic or foreign, industrial or energy interests – and how much competition will be created.

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Suggested readings:

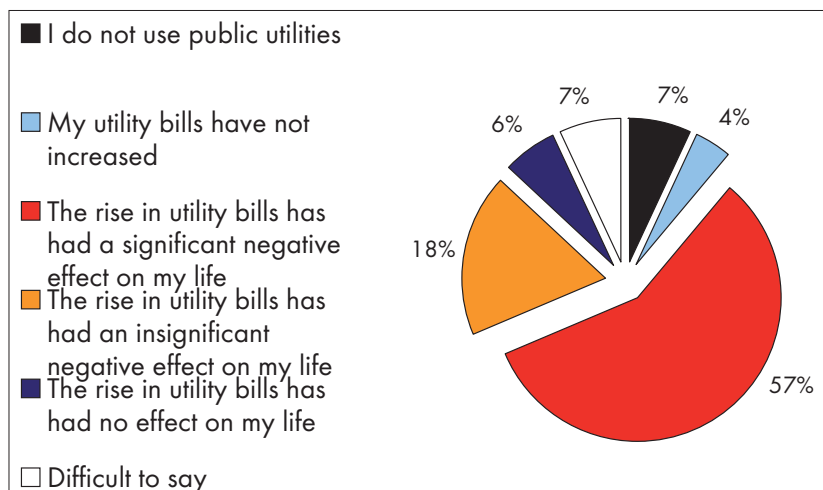
- Peter Rutland, "Power Struggle: Reforming the Electricity Industry," *The Dynamics of Russian Politics II*. Peter Reddaway and Robert Ortung (eds.), Rowman and Littlefield, 2005.
- William Tompson, *Restructuring Russia's Electricity Sector: Towards Effective Competition or Faux Liberalization*. OECD Economics Department Working Paper No. 403. Paris, OECD, 2004.
- Public Opinion research on utility reforms, see <http://www.fom.ru/>.

Nor is it clear if the government will stick to its current commitment to fully liberalize wholesale electricity markets by 2011.

Conclusion: Who Determines the Price of Power in the Future?

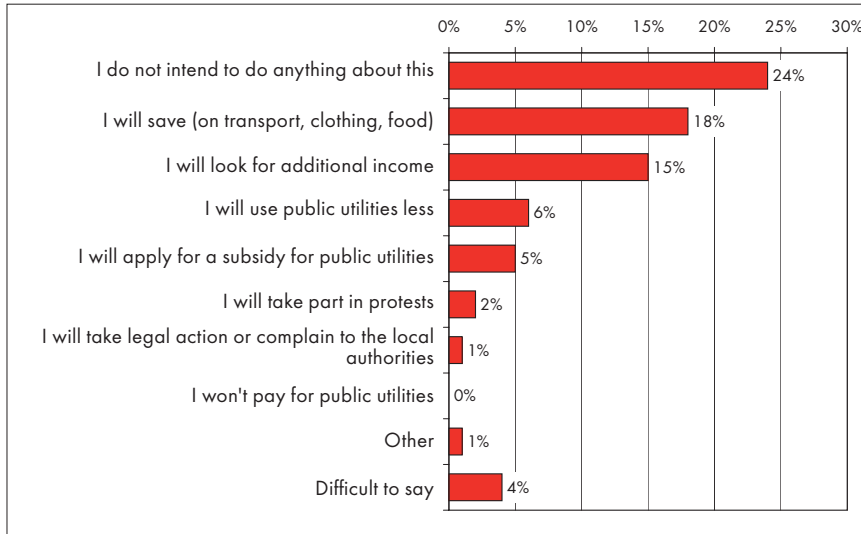
What does this analysis of the electricity sector tell us about the overall direction of reforms in the Russian economy? The circle of relevant opponents to liberalization has changed over time; more precisely, it has narrowed and arguably become less representative. In the 90s, actors who could shape reform policies included Duma deputies, regional governors and regional industrialists. Today, struggles about reform outcomes are mostly fought out among elite actors who either favor state control in the energy sectors or believe that market mechanisms can make energy production more efficient. The question of how the price of power will be determined in the future – by markets, technocrats, politicians or industrial consumers – remains open. It is clear, however, that the outcome of the current large-scale change in the sector will crucially affect the cost of living and the cost of producing and will thus be reflected in some way in every Russian's life.

“Have Your Utility Bills For 2006 Grown Compared To 2005? If So, Has The Rise in Utility Prices Had a Significant Or an Insignificant Negative Effect On Your Life?”



Source: FOM opinion survey conducted on December 16–17 2006, http://bd.fom.ru/report/map/projects/dominant/dominan2006/dom0650/domt0650_1/d065010

“What Do You Intend To Do About the Rise in Utility Prices?” (Only Those Who Answered that the Rise in Utility Prices Has Had a Significant Negative Effect On Their Lives)



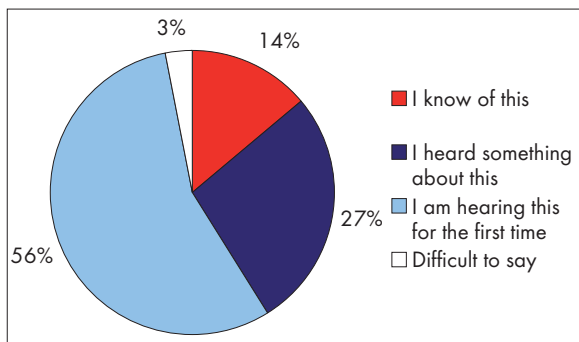
Source: FOM opinion survey conducted on December 16–17 2006, http://bd.fom.ru/report/map/projects/dominant/dominan2006/dom0650/domi0650_1/d065010

Opinion Survey

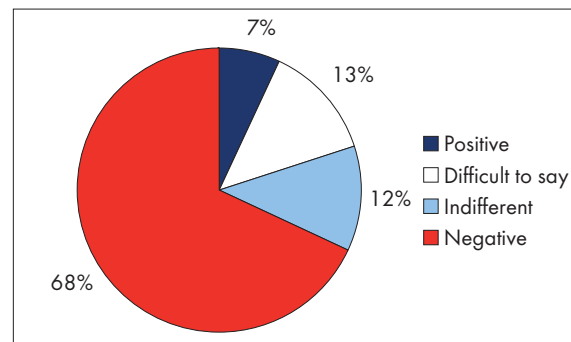
Russian Attitudes towards the Privatization of UES

Source: FOM opinion survey conducted on June 30 – July 1 2007, <http://bd.fom.ru/report/map/d072727>

UES is the Largest Russian Company Generating and Transmitting Electricity. Do You Know, Have You Heard, or Are You Hearing for the First Time that the Government is Planning to Reform UES?



UES is a System of Electric Power Stations, Transmission Grids, Distribution Networks and Dispatching Organizations. As Part of the Reforms it is Planned to Transfer Electric Power Stations to Independent Producers and Private Companies. What is Your Attitude towards this – Positive, Indifferent or Negative?



The Proposed Reform of UES will allow the Transfer of Electric Power Stations to Foreign Private Companies. What is Your Attitude towards this – Positive, Indifferent or Negative?

