Market reforms in Russian telecommunications: A 'vanished' power, Svyazinvest and state consolidation, 1991–2002

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The advanced telecommunications sector is one of the most important industries in a modern society. Without it, decentralized and dynamic market economy doesn't work effectively. At the beginning of the 1990s, the Russian government showed that it realized this when they began to reform the outdated telecom sector. From the Soviet times, it had inherited the technological backwardness of this sector and its weak capacity to work in a new economic environment. In the 1980s, there were some attempts to modernize the sector, but without success. As some scholars noted, these reforms only promoted the degradation of the strong Soviet state's power in this sector (Campbell, 1995a).How did new the Russian federal structures recover the 'vanished' control over the sector? What changes took place on the telecom market after USSR's disintegration? How far has the Russian state come in dealing with the market transformation of the telecom sector?

The purpose of this paper is to answer these questions. The main research object is the Russian telecommunications sector and its development in the post–Soviet period. I will describe the main stages in the 'market reform' policy and its implementation in the sector during 1991–2002. The sector development and transformation are represented as a history of the largest Russian telecom company – Svyazinvest.

The theoretical point of this paper is 'state consolidation' in post–Soviet Russia. I see the Russian market transformation as the history of 'state formation' or 'its economic power formation'.[1] It was a period where the state lost control and only gradually restored it in the economy – the 'state consolidation' process, which includes various social actors in different political arenas.[2]

This theoretical assumption determines my choice of analytical technique – a 'historical' description of market reforms in Russian telecom. The basic idea is to analyze the reform implementation from the point of how the Russian state developed its capacities to regulate the telecom market.[3] Research data includes (1) 800 publications in Russian mass media 1991–2002 – analytical reports about telecom development; interviews with Russian policy makers; (2) 30 Russian legal documents (federal laws, presidential decrees, government decrees, and decrees from the Ministry of Communications);[4] and finally (3) five interviews with representatives of a local telephone operator.[5]

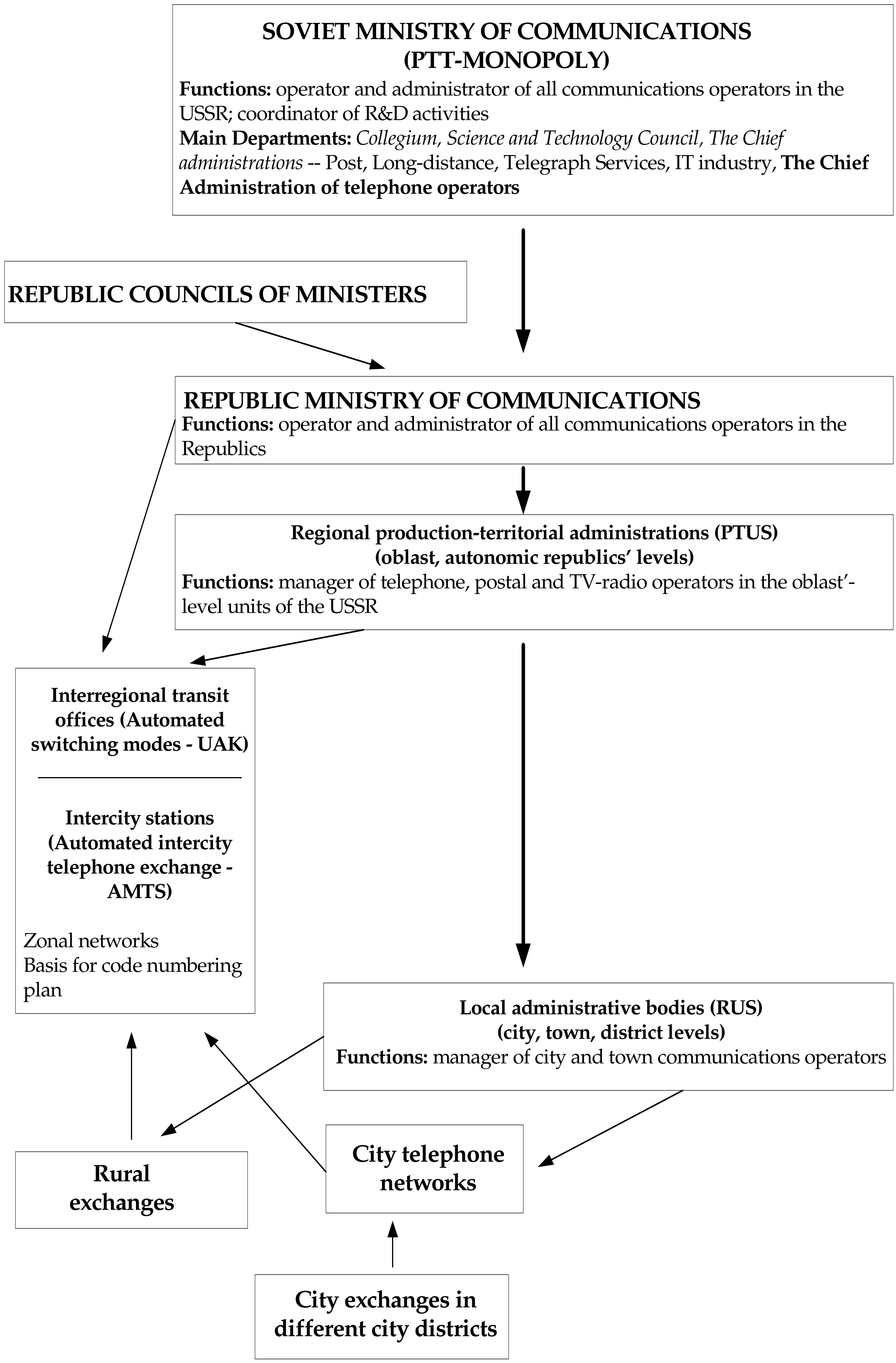
'Market reform' policy in the Russian telecom sector: Government, local operators and Svyazinvest

In the Soviet period, the sector was operated as a PTT type monopoly by the Soviet Ministry of Communications and Republican Ministries, which directed the activities of local operators. The local communications administrations (RUS) and technological administrations (PTUS) managed telephone, postal and TV–radio operations at the regional levels. The sector was constructed as a vertical integration structure, which connected local communications operators directly only with the capitals in the republics and Moscow (see Figure 1).After the USSR disintegrated, the new Russian state considered sector reorganization as an administrative rather than a political problem. The reform policy for the sector was only a byproduct of the changes made during privatization and liberalization in other industries. As a result, the clear statement of the state policy can be found only in academic literature. For example, Robert Campbell (1995b) suggested the following model of reforms in the sector. The aim of the reform policy was to create a management structure, which would combine operator autonomy, free prices, open access to various market segments, and a small degree of state regulation. For these purposes, the Russian government decided to: (a) privatize telephone operators and transform them into independent companies with real owners; (b) replace direct state intervention with indirect regulation.

The Russian policy makers (who formulated or implemented reform policy in the sector) assumed that implementing a 'market transformation' program would be a rather simple step. There were two basic ideas in a 'virtual' government project for the sector.

The first idea was to change the direct role of the federal state structures. It was decided to pass the law, which redefined the ministry's functions and transformed it into a regulator. In that way, the state would be 'expelled' from sector activities. The second idea was to transform the local operators into market actors. It was expected that as soon as the market started its work (after passing decrees about privatization and liberalization), the sector would become an industry with huge investments. Local operators would be allowed to set their own prices, which should force them to focus on market development and refrain from 'rent–seeking' behavior. The state structures would neutrally observe their activities and act as a judge in distributive conflicts. That would be the start of the profitable and advanced telecom market in Russia.

Figure 1. Governance model for telecom sector in the USSR.



The assumption about the market's 'self–appearance' was a very prominent idea among Russian policy makers in the early 1990s. As a result, they passed very few laws or decrees about sector development in that period, deciding to await 'market formation'. At the same time, local telephone operators independently formulated and implemented their own separate decisions. They negotiated prices with regional administrations, bought new (mainly foreign) telecom equipment and tried to attract foreign investments.

Svyazinvest – a telecom company created in 1994 and intended to join Russian local operators – only served to widen the gap between the state's visions of 'market self–appearance' and the practices of local operators. For a long time, policy makers regarded Svyazinvest as a major actor in the telecom market and as the representative of all telephone operators. Indeed, to them, this company was the whole market, and, as a rule, they tailored their decisions specifically to Svyazinvest. Local operators considered Svyazinvest as a state company that had different goals than they did.

This value conflict was not discovered until late 1995 when, according to official documents, Svyazinvest was one year old. It appeared that the company actually did not represent anybody and had no power over its companies. The Russian government was faced with the problem of confirming this power and converting its 'virtual' ownership rights into real ones. Obviously, it would take more than decrees to solve this problem. Let's see how far the Russian state has come in reconstructing its power in the telecom sector. 'Virtual company': Russian local telephone operators, their privatization and the creation of Svyazinvest (December 1992 – November 1994).

Local telephone operators and their privatization, 1992–1994

After the disintegration of the USSR, regional administrations were called GPSI – state enterprises of communications and information. They received federal property status under the jurisdiction of a special department in the Committee of State Property (GKI). Their position was determined by Federal Agreements, (1992).[6]

The Russian government issued a decree about telecom companies on 22 December 1992.[7] The first step was structural reorganization, i.e., dividing these joint communications companies into separate bodies – post services enterprises, electrical communications, or telecommunication companies, and TV–radio broadcasting. So, in Russia, 89 independent regional telecoms appeared. Long distance and international operations were integrated into one national state–owned operator – Rostelekom.

The second step was to corporatize these bodies[8] and give them operative independence. In 1994, regional telecoms were privatized in accordance with the first variant,[9] and after that, local telephone operators were referred to as AO Elektrosvyaz. The privatization of the Elektrosvyaz differed from the general pattern in Russian mass privatization program in that it included two stages – *political* and *public distribution* of the stock.

The first stage was the *political distribution* of the stock between the state and employees. "It was decided to retain 51 percent and 25.5 percent of the common shares in federal property for no more that three years" (Gov. Decree No. 1003; 2.6, 2.7). The main shareholder was the State Federal Property Foundation, GFFI. The appointees designated by the Ministry of Communications represent these shares on regional boards of directors.[10]

Next, 25 percent of the shares were handed over gratis to the employees.[11] They were nonvoting shares, which could convert to common shares on resale. The workers also had the right to buy an additional 10 percent of the common voting stock at a special 30 percent discount. Management of regional companies – Director, Vice–Directors, Chief Engineer and Financial Director – had the right to buy an additional 5 percent of the shares (with voting rights).

The state thus held the majority of the shares in local Elektrosvyaz , but employees and management did have some control over their company. I can suggest two main reasons for this political decision: The first reason is pressure from the Ministry of Communications, which preferred to keep outsiders from gaining a controlling interest. In the early 1990s, there were many statements by ministerial officials indicating the great importance of communications for state security and the necessity of reserving the property rights for the state and insiders. The second reason is pressure from the companies' employees. The preference for the insiders' variant of privatization was explained by the fact that the workers could not afford to buy their expansive companies. In the case of outsiders' privatization, new owners might decide to cut back and lay off many employees. So the workers could be the main defenders of the state and insiders' variant of privatization. Anyway, the result of this privatization policy was obvious: It reduced outsider participation in the sector to a minimum.

The second stage of the Russian telecom privatization was *the public distribution* of stock. The remaining 15–25 percent of the shares (with voting rights) were to be sold to the public by different methods: voucher or cash auctions, through the stock markets or strategic investors. According to the government decree, these shares had to be sold during 1993–1994.

The privatization was officially completed by mid–1994. 'Political' shares were redistributed between the state and employees, and most 'public shares' had been sold. Russian reformers sought to present these facts as evidence of changes in the sector's property rights. Ministerial officials stated that 80 percent of all regional telecoms were privatized and had new owners.[12] In fact the political distribution gave state and insiders control over the telecoms. But what happened with the 'public' shares?

There is no systematic data about these 15–25 percent of the shares.[13] Most of the public shares sold at regional voucher auctions have found their way into the hands of stock speculators. Time of sale or percent of shares were very different across regions. For example, 14.6 percent of the shares in Chelyabinsk's Elektrosvyaz – Svyazinform were sold in July 1994[14]; 7.1 percent in the summer of 1998.[15] 38 percent of the shares in Moscow's operator – Moscow City Telephone System (MTS) – were sold during 1994–1995.[16] 22 percent of the shares in Petrozavodsk's operator – Elektrosvyaz' Respubliki Kareliya – were sold in the spring of 1996.[17]

Market transformation of telephone companies was a drawn-out affair. Reorganization, legal registration, meetings with shareholders and board elections took two–three years. How did the telephone companies work until that time?

While the legal registration of the new joint–stock companies was going on, many sector activities were outside the control of federal structures. The local operators enjoyed full independence and, as some scholars indicate, started their 'free sailing' (Zhyl'sheva, 1996). First of all, state subsidies to the sector were reduced to a minimum. The size of the state investments differs across official documents, but the conclusion is the same: The telecom sector developed without state subsidies. According to some sources, state investments decreased from 16 percent in 1990 to 0.7 percent in 1996.[18]

Elektrosvyaz were allowed to independently attract investors and choose suppliers. They bought different kinds of equipment – different classes, systems and manufacturers.[19] At the end of 1995, at least twenty different types of telecom equipment were used on the Russian networks . Their technical incompatibility reduces the quality of services and dcaused breakdowns in some parts of the national network. Operators in large cities (Moscow, St. Petersburg, Novosibirsk and Ekaterinburg) led the way in the purchase of foreign equipment because they could easily attract investments. All along, further redistribution of shares went on. In many cases, public shares were bought by foreign, not Russian, investors. The original position in the Ministry of Communications was that it would be a mistake to let foreigners buy local telecom shares. But since there were no laws or rules for foreign participation in Russian voucher auctions, many foreign investors moved in and bought most of the public shares. Likewise, shares sold by employees in the emerging regional stock markets have been bought by foreign investors. All in all, foreign participation in the telecoms increased from 6 percent to 42 percent between 1992–1996.[20] For example, foreign investors own 13.4 percent of the shares in Ulyanovsk's operator,[21] 19.3 percent in Vladivostok's operator,[22] 25 percent in Nizhnii Novgorod's operator,[23] 13.5 percent in Novosibirsk's operator,[24] and 13.8 percent in Chelyabinsk's operator.[25]

In accordance with the neo–liberal market program, state participation in the telecom sector was reduced to a minimum.[26] However, the institutional basis for such a 'deregulation' was very weak. It was unclear whether the Ministry of Communications could control local operators or not and, if so, which rights and responsibilities it had. Until 1992, ministerial activities were regulated by the Soviet Law about Communications (1971). The new decree, 'Regulations of activities of the Russian Ministry of Communications, Information and Space' was passed in July 1992.[27] It was supposed to be a temporary, but the sector operated under it for a couple of years. As Robert Campbell notes, it seems that this decree was created by ministerial officials and signed by Boris Yelt'zin "without a lot of thought about the long–run complexities involved in shifting from direct administration to more indirect control via regulation" (Campbell, 1995a, 207). At the same time, there were great management problems for the Federal Ministry in Russia's ethnic republics, which insisted on their ownership rights in the sector. According to two agreements between the Russian federal structures and Republic Governments in Tatarstan and Bashkortostan (1994), Russia transferred its power over the sector to these Republic Governments.[28] Unlike the telephone operators in other Russian regions, which were 'federal property', republic telephone companies have a special 'joint property' status. In the early 1990s, the Russian telecom sector was a diverse entity of isolated telephone companies, sometimes with unknown owners (because their shares circulated endlessly among stock speculators). Their financial and technical activities were beyond state attention or any coordinated regulation. At the same time, the federal structures decided to play the ' judge' role in telecom market 'games' and declared a 'liberal' reform policy in the sector. This political choice can be explained not so much by their ideological preferences as by their incapacity to create one 'game' with clear 'rules' for all market agents.

Integration of local telephone operators

At the end of 1994, the government policy shifted to one of selling the state's shares in local telephone companies – 38 percent of the stock (or 75 percent of all common shares). This privatization decision had one explicit goal – to raise revenue for the state budget. Selling telecom shares separately through the stock market was rejected because of the duration of the process and concerns about 'state security' and 'state control' over the national network. Another government plan was to integrate local telephone companies and create a new structure, from which shares could be sold through cash auctions. The government considered two variants: integrating local companies into twelve regional organizations or into one holding (Campbell, 1995b).

The Ministry actively lobbied for the second variant : Creating a uniform holding would make it possible to centralize sector activities, attract money for modernization and preserve its power over the sector (to the extent the Russian federal structures believe that they had still this power). The Ministry hypothesized that the creation of a holding would generate money for technical updates and allow centralization of investment flows. There were many investments in the Russian telecom sector, but only in some market segments: foreign companies preferred to invest in long–distance and international communications (in the national long–distance operator, Rostelecom), cellular communications (Vympelcom Bi–Line or Moscow cellular communications) or special communications (Comstar, Golden–Line or Sovintel).[29] Since, at the same time, it was impossible to attract money for the local telephone operators, it was assumed that one holding for all local operators would make it easier for foreign participants to invest money in local services. Besides, the holding would allow final implementation of the 'liberal' reform program in the sector: (a) change the old Soviet governance policy; (b) demonopolize the state monopoly; and (c) increase competitiveness in the sector. The new company would have the management power over local telephone operators, and the Ministry of Communications would be a regulator.[30]

These ideas found their implementation in the decision to create a new Russian telecom company – Svyazinvest.[31] It consolidates the state's stock holdings in the 88 regional telecom companies: 76 regional Elektrosvyaz', eight special city telephone companies (like Moscow City Telephone Company, Petersburg Telephone Services or Petersburg long–distance and international communications), and four telegraph companies. 100 percent of the stock in Svyazinvest remained in state ownership and were delegated to GKI. A three–year sale moratorium on 51 percent of the shares was established – they were in 'federal property' till 1996.

Local operators' responses to their integration

There were two common reactions to Svyazinvest's integration:

1) 'Exit'. Some regional operators refused to join Svyazinvest namely the operators in Tatarstan, Bashkortostan, Yakutiya, Tuva, Ingushetiya and Chechnya. Despite the Federal Agreements of 1992 (which stipulated that local governments have little power over property in the sector), the Russian government preferred to allow this separation. In mid-1995, the Russian government signed the new Agreements with the Republics about delegation of state power over telecommunications.[32]

2) 'Ignorance'. The 'exit' reaction was a less dangerous strategy than the one chosen by the majority of local operators. They accepted the situation and did not react to the creation of Svyazinvest. It is hard to believe that integration was not alarming to them, but at the time it looked so abstract and distinct from real practice.[33] The Elektrosvyaz were solving their own problems such as bureaucratic obstacles to become registered as joint–stock companies, technological modernization, etc.

Moreover, there were new problems with tariff policies. Officially, the Elektrosvyaz were independent in the tariff–setting process at the local level, but in practice regional administrations intervened frequently in these decisions. The Federal Law on Communications (20 January 1995) legitimized this opportunity for local power.[34] The Law defined the tariff–setting process as follows: The Federal Regulation Agency determines the price of services in each region. It has special local departments in the regional administrations and should be funded by resources from the regional budget. The government also passed a special decree, which fixed the local administrations' rights to participate in tariff–setting process.[35] Contrary to expectations, this decision resulted in uncertain price-settings, which depended on strong or weak relations between regional administrations and telephone operators at the local level.[36]

So, when some Elektrosvyaz chose to 'ignore' Svyazinvest, it was more than natural. Besides, Svyazinvest itself showed no activity at all. It consisted of three persons: the Director, his secretary and the Financial Director,[37] who couldn't represent their company in regional boards of directors in more that seventy companies – let alone manage their activities. Svyazinvest was a 'virtual' company and existed only for the government and ministerial policy makers.

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In the mid–1990s, the Russian telecom sector was a disconnected entity of isolated local operators with independent and separate financial and technological policies. Their 'free sailing' had at least two consequences: First, a gradual loss of state control over property rights in the sector. The telephone operators' shares were sold and resold endlessly; sometimes it was impossible to find out who owned them. Second, 'free sailing' led to technological problems in the development of the national network (which was based on rigid vertical integration of local operators and unified technologies). Since the early 1990s, the Elektrosvyaz were allowed to buy different types of telecom equipment, which had a negative effect on the quality of services.

It is necessary to note that the creation of one holding company – Svyazinvest – looks like a very wise political decision based on a neo–liberal considerations. The arguments about reducing 'transaction' and 'investment' costs were very good tools to legitimize the creation of a new vertical integration structure for the Russian telecom sector. But in addition to this argument used by Russian policy makers, there is the opposite argument about the 'self–appearance' of such integration – it should be a voluntary integration of economic actors who realize the market necessity to create it (Williamson, 1971). In other cases – with weak government capacities and weak power over financial and technological policies, integration 'from above' leads only to the creation of a 'virtual' company.[38]

In the mid–1990s, the main problem in Russian telecom policy was the weak state control over local operators. But in 1994–1995, Russian policy makers still had not noticed it, and their only concern was the sale of Svyazinvest shares. Let's see how the Russian government managed to sell a 'non–existing' company.

'Selling a virtual company': the first privatization of Svyazinvest (December 1995)

In the mid–1990s, the Russian Center of Privatization (RCP, Director – Maxim Boiko) and Vice–Premier, Anatolii Chubais, formulated and implemented a privatization policy in the telecom sector. They decided to sell 25 percent of the shares to foreign investors at the end of 1995 and later the remaining 24 percent to Russian investors. 2.9 billion rubles (or $1.4 billion) were the initial price for 'foreign' shares. On November 30, 1995, it was officially announced that the Italian telecom company, STET, had won the auction.[39]

However, the final agreement with STET was not signed. In an official statement (23 December 1995), RCP declared: "The Russian government and the company STET could not agree on payment for these shares. It was a very important question for both of us. Despite the Russian government's desire to find a compromise, STET insisted on a payment method that was illegal in a Russian privatization program. We have decided to sell these shares in 1996."

There are two possible explanations for this government decision:

1) The Russian government couldn't fulfill STET's requirements.[40] After the 1995 auction, STET offers to place money in an escrow account until the Russian government fulfills STET's special requirements. The Russian government knows about the requirements and decides not to discuss the question before the auction. This leads to a conflict after STET's victory. The Russian government insists on real and fast 'money now', and offers an additional guarantee from the Russian Ministry of Finance: If the government does not fulfill its obligations, it promises to give STET its money back. STET rejects this offer.

On the one hand, we can explain the Russian government's behavior with legal reasons. One of the main rules of the auction was that "payment for the shares shall be made at the end of the agreement." The agreement expired on 22 December 1995, and STET's payment had to be made before that date. The escrow account meant that the Russian government would only get the money after fulfilling STET's requirements – as many experts noted, within 3–12 months. Thus, if the agreement was made on STET's conditions, it would be considered illegal.[41] However, it seems that such considerations have never been a main concern for the Russian government. As many privatization cases in other large Russian companies show, such contracts were seldom regarded as illegal.

On the other hand, we can explain the failure of the agreement between STET and the Russian government with the 'virtual' nature of Svyazinvest. What did the Russian state actually sell at this auction? Russian policy makers r tried to represent Svyazinvest as a real company that managed and controlled the majority of Russian local operators. The Italian investors asked about the reality of this picture. STET insisted on the escrow payment and required proof of Svyazinvest's power – licenses from each local operator where Svyazinvest's rights should be determined; control over price–settings in regions; Svyazinvest's control over equipment purchases, etc. The preceding description of sector development in the early 1990s shows that the Russian federal structures couldn't fulfill any of these requirements: "Let's take license registrations for all Svyazinvest companies. Obviously, we can't physically make 85 licenses before 22 December".[42]

2) The Ministry of Communications was against that agreement.[43] The Ministry did not show its negative or positive attitude towards a new owner of Svyazinvest during the auction. Asked for a comment, Minister of Communications, Vladimir Bulgak, answered: "The Ministry has no comments. This agreement concerns the state shares, which are under GKI's and RCP's power. We are not involved in the Svyazinvest sale."[44]

What possible motives could the Ministry have? If GKI's main goal was to get 'cash' for the state budget, the Ministry's aim was quite the opposite. After STET's victory, the Ministry would have to work together with the new investor. STET would be a 'strategic investor' for the local operators and have all rights to participate in policy formulation for the Russian telecom sector. The Ministry of Communications probably did its best to keep STET out and decided to lobby the Government. Later, Vladimir Bylgak stated the Ministry's true attitude towards the 1995 sale: "The government has searched for a foreign company which would modernize telecom sector. We would be forced to buy only Italian equipment for some years. We would not even be allowed to check the quality."[45]

Although the first attempt to privatize Svyazinvest failed, it had at least one implication for the evolution of state power in the telecom sector. During the 'cash auction' period in Russian privatization policy, GKI and the Ministry of Communications assumed they could sell their 'virtual' company without problems. Of course, they recognized that Svyazinvest actually wasn't a 'real' company: "We should be realistic. Svyazinvest represents only an uncertain potential opportunity."[46] However, there were no concerns about the reality of such 'potentiality' and (more important) the divergence between the government's ideas and local operators' visions of Svyazinvest. During the 1995 auction, some interesting and unexpected details of Svyazinvest activities appeared: The auction's organizers were not even able to define its exact price. There was no proof of Svyazinvest's existence or its shares in the books of some local operators. The 1995 Svyazinvest auction taught the Russian government two lessons: (a) it is impossible to attract real investments for a 'virtual' company; (b) it is impossible to implement market transformation without the state's participation and its strong regulation of the economy. The auction also poses the following questions: Is the Government capable of transforming its 'paper' property rights into 'real' ones; is it capable of defining and formulating new regulation and new financial and technical policies for the telecom sector?[47]

From 'virtual' to 'real' company: the first steps towards organizational consolidation in the telecom sector (1996–1999)

The 1995 auction was a crucial moment for the Russian state and its economic power evolution in the telecom sector. It was the starting point of the consolidation of state economic power and the creation of borders between 'state' and 'market agents' (the Ministry of Communications, Svyazinvest and the Elektrosvyaz). My analysis indicates that there were three major methods of state consolidation in the telecom sector: (1) organizational changes; (2) economic and financial changes; (3) political changes.

Organizational changes: Svyazinvest and its companies

The main problem revealed by the 1995 auction was Svyazinvest's inability to manage and coordinate all local telephone operators. As mentioned, the local operators of six ethnic republics (Tatarstan, Bashkortostan, Yakutiya, Tuva, Ingushetiya and Chechnya) refused to participate in Svyazinvest activities, and even its companies regularly tried to separate from it (for example, the Elektrosvyaz in Nizhnii Novgorod and Ekaterinburg). In 1996, ministerial officials debated with these operators and tried to explain to them that it would be very dangerous to build local networks independently of the national ones.[48]

Svyazinvest had to get real power over its companies . What actions did Russian policy makers take for that purpose?

A) Svyazinvest representatives in each local operator. First of all, Svyazinvest increased its staff (originally only three persons). Its managers changed their vision of the company's position and goals.[49] All local telephone companies held shareholders' meetings during March–May 1996 – it was the first meeting for many of them. The program for the meetings was prepared by Svyazinvest two months in advance; it delegated its representatives in each Elektrosvyaz up to the middle of March. When Svyazinvest representatives were included into all regional boards of directors by the end of 1996,[50] the gradual transfer of technological control to Svyazinvest began. Through participation in the regional boards' activities, its representatives could actively influence the Elektrosvyaz' technological policy, for example, control and restrict equipment purchases.

This 'representative control' was also supported by legal methods. In early 1997, the Ministry of Communications passed a decree about state protection of domestic telecom manufacturers,[51] which recommended all local telephone operators to 'use mainly domestic telecom equipment, including equipment produced in the joint ventures'. Svyazinvest received the rights to control the purchase of this equipment and to distribute state budget money for that purpose. Before this order, Svyazinvest made contracts for $130 million with European manufacturers – Siemens, Alcatel and RFT – which supplied switching equipment for local operators in the Kurgan region, Murmansk, Stavropol' and Chita.[52] In addition, Svyazinvest signed a credit agreement with Ericsson, which supplied its products directly to the Elektrosvyaz in the early 1990s.[53]

B) Agreements with regional administrations. The second problem for Svyazinvest was the strong relations between the local telephone operators and the local administrations. It was necessary to determine rights and responsibilities of federal structures and regional administrations in the telecom policy. In 1996, the Russian government had signed a number of agreements with regional administrations,[54] which defined three levels of control in the telecom sector – federal, regional, and joint. The main rules for their interactions are:

a) Only federal structures can pass laws about the state policy in the sector, about its financial, tax and credit policy;

b) Both federal and regional structures must implement federal programs for sector development;

c) Directors of some local telephone companies must get approval from the Ministry of Communications in order to get this position;[55]

d) The regional administrations should only implement state policy in the sector. They are not allowed to have their own policies, especially if their goals contradict state policy.

These agreements made it possible to speed up organizational changes in the telecom sector. Svyazinvest now had the power to control technical policy in the Elektrosvyaz and no longer had to ask the regional administrations' opinion.

Economic and financial changes

The 'representative control' also allowed Svyazinvest to influence another crucial problem for the telecom sector – independent financial policies of local operators.

A) A single auditor and registrar. The problem was that Svyazinvest did not have exact information about its local companies and their shareholders. Russian policy makers then decided to estimate the approximate cost of all local operators and to collect data about their shareholders. One auditor company was appointed for all companies. During 1997–1998, Svyazinvest representatives lobbied regional companies on behalf of Audit–Svyaz' (a company it founded together with Price Waterhouse). During 1998–2000, this company collected information about the Elektrosvyaz and their balances, credit contracts and liabilities.[56]

Another problem for Svyazinvest was the lack of knowledge about shareholders in the local companies. According to the Ministry of Communications, in the mid–1990s, 21 percent of all regional operators managed their own shareholders' registration, 53 percent used the services of non-specialist registrar firms. As a result, it was difficult to determine the shareholders' names in each Elektrosvyaz. It was decided to create a uniform system of registrars, which would make it possible to control all shareholders in local operators. Svyazinvest created a special company – Registrator–Svyaz' – and again lobbied local operators on its behalf. During 1996–1998, this company became the registrar for the majority of the Elektrosvyaz .[57]

B) Centralization of investment flows and sale of shares. In 1996–1997, the share of separate investments in the Elektrosvyaz was reduced to 5–7 percent. Svyazinvest now controls the investment flows into local operators. Also, the 'representation control' opens the door to control over operations with shares in the local companies. Svyazinvest uses its veto right against additional emission of local operators' shares. In 1996–1997, many regional operators (Petersburg Telephone Services,[58] Tumen'telecom, Svyazinform (Nizhnii Novgorod), and Novosibirsk City Telephone System[59]) tried to lobby emission decisions during shareholders' meetings. But Svyazinvest was against these plans. Regional operators explained this by Svyazinvest's unwillingness to reduce its shares in the local companies and the money shortage to buy additional shares in emissions. After debates with Svyazinvest, many Elektrosvyaz decided to delay additional emissions of their shares at least until spring 1998.[60]

Political changes

The political changes include abolition of influential (politically or economically) sector structures or a reduction of its status. This method of state consolidation was implemented against the Ministry of Communications.

The history of Russian state consolidation in the telecom sector goes as follows: Through organizational and economic changes, the federal structures not only begin to restore e control over the financial and technical policies of the Elektrosvyaz , but also strengthen their capacities, especially administrative capacities.[61] It was the beginning of the real (instead of the 'virtual') existence for Svyazinvest and its control over local operators.

However, one fact in this history could affect the sector development in the future – Svyazinvest's dependence on the Ministry of Communications. If one looks at the real 'face' of this company rather than its appearance in legal documents, Svyazinvest was no more than a ministerial division. When it was decided to place Svyazinvest representatives in each local operator, the ministerial bureaucrats often filled these positions due to Svyazinvest's limited staff. Their participation in regional boards allowed the Ministry to control the major activities in the Elektrosvyaz .[62] Thus, the Ministry and its policy makers were the main actors in the state consolidation in the telecom sector. It was possible that at some moment the Ministry's positive role as the main 'consolidating actor' would turn into a negative one. It was necessary to remove the Ministry from the market and to transform it into a separate regulatory body. Another structure – Svyazinvest – would strengthen its power and control over local operators.

The Russian government chose the simplest way: to temporily eliminate the Ministry from the sector development. In March 1997, the President passed a decree to close the Ministry of Communications.[63] This political decision had at least three implications for the telecom sector:

1) It allowed a transition to a regulatory model in the sector. The Ministry of Communications was considered a symbol of the Soviet era, so its abolition can be regarded as an elimination of the Soviet practice – direct state intervention in sector activities.[64]

2) It reduced the bureaucratic status of the federal structure in the sector. The State Committee of Communications and Information replaced the Ministry, but in the bureaucratic state hierarchy, the Committee had lower status than the Ministry did.[65]

3) It improved Svyazinvest's status. The Russian mass media began to call Svyazinvest (initially just for fun, then seriously) 'the new commercial ministry'. As it was unclear at the time what rights the Committee would have (the government decree about its functions appeared only in July 1997),[66] it was impossible to say anything about its future power in the telecom sector. This implicitly strengthened Svyazinvest's power.

In 2000, the Ministry of Communications was restored.[67] However, the three–year period without it gave Svyazinvest a great opportunity to strengthen its control over local operators. The abolition of the Ministry in 1997 and its restoration in 2000 are interesting facts in the history of Russian state consolidation in the telecom sector. These political decisions (a) paved the way for a regulatory model for the Russian telecom market; (b) granted Svyazinvest time to legitimize its power in the regions; (c) allowed the Committee to learn its regulatory 'role' and then delegate it to the restored Ministry.

Conclusions: Preliminary results of market reforms in the Russian telecom sector (in the early 2000s)

In 1996–1998, the Russian government's actions were aimed at restoring the 'vanished' control over the telecom sector and at legitimizing Svyazinvest's power. The main methods were organizational, economic and political changes. On January 22 1997, the Minister of Communications declared the first results of state consolidation in the sector: "Svyazinvest now manages and controls its shares and local operator activities in all regions."[68]

The following questions may be asked: What happened then and was it a real restoration of 'vanished' state power? State consolidation is a very long process, and it only started in the mid–1990s, so it is too early to assess its final results. However, I will describe its major trends and the main results of the market transformation in the telecom sector (see New governance model in the sector management, Figure 2).

In the early 2000s, the main results of market reforms in Russian telecom sector are:

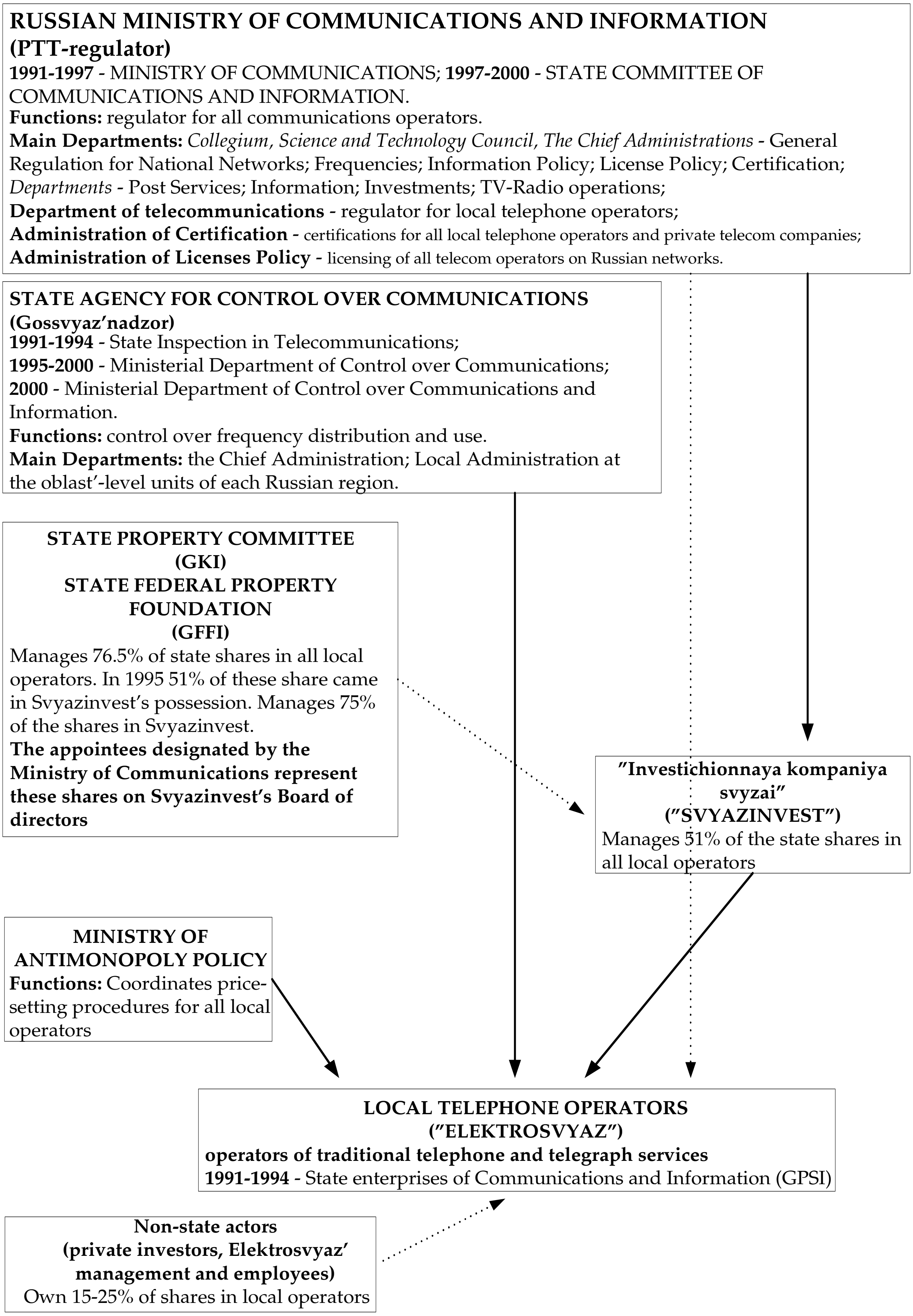
1) The Ministry of Communications as a regulator rather than an operator. Unlike in the Soviet period, the Ministry cannot interfere directly in local operators' activities. In contrast to the early 1990s, it was no longer a 'neutral and helpless' judge, but an active regulator.[69]

2) The formulation and enforcement of new rules for telecom market activities. Unlike in the Soviet period, the local operators do not have an automatic right to deliver local telephone services, but must confirm it by means of licenses and certification of their equipment. The Ministry now uses these mechanisms for regulation rather than for direct intervention.[70]

3) Managemental control of Svyazinvest As a result, the 'opportunistic' behavior of local operators is gone, like their chaotic equipment purchases or odd investment flows.[71]

Which indicators of sector development can verify these statements? First of all, the Russian government passed laws about basic telecom agents, certification and licenses policies. A clearer state position and state policy promoted the economic growth. As many experts note, in the early 2000s Russia has the developing telecom sector – with different firms (public or private) and advanced telecom services. This sector is one of the most advanced industries in the Russian economy, and it demonstrates the high level of development and investments (Rytsareva, 2001).

Figure 2. Governance model for the telecom sector in Post-Soviet Russia, 1992-2002.



These indicators verify the positive results of state consolidation in the sector. It begins to create a clear separation line between the state (the Ministry of Communications) and the market (the Elektrosvyaz). As a semi–state and semi–market structure, Svyazinvest plays the role of mediator between these agents. In sum, my analysis of the Russian telecom sector development shows that *in the 1990s, the major trend in the sector history was the beginning of state consolidation and formation of its effective regulatory capacities* (see Table 1).

Table 1. The main stages of Russian state consolidation in the telecom sector (1990-2002)

	PERIOD	MAIN TENDENCIES
1.	1990–1992	Separation from the Soviet Ministry of Communications; legal enforcement of property rights in telecom sector
2.	1992–1995	Local operators' corporatization and privatization; Creation of Svyazinvest and its first privatization
3.	1994–1996	Federal structures lost power and control over property in the sector, over its financial and technical activities
4.	1996–1998	Federal structures began to restore their power and control over local telephone operators
5.	1998–2002	Further measures to legitimize Svyazinvest power at the regional level

This conclusion allows some comments on a very popular theory in current political economy of transition – a theory about 'privatization' and 'state weakness' in post–Soviet Russia (McFaul, 1998; Solnik, 1999). According to this theory, the history of Russian market transformation was the story of unsuccessful attempts to redistribute the public resources – the story of weak government, which couldn't formulate and implement independent political decisions, and some strong social groups, which 'captured' this control and used it for their own benefits. My research shows that there is another possible analytical framework for Russian market reforms. It allows us to look at this process from the position of the 'consolidating' state and consider Russian market transformation as a formation of the 'strong state', which will be capable of regulating and cotrolling market organization in the future.

Notes

1. I base my assumption on the ideas of historical sociology (Tilly, 1981). On their applications for post–Soviet experiences, see Volkov (2000).
2. This argument is based on Karl Polanyi's work (Polanyi, 1944),. For applications of his ideas for post–Soviet Russia, see Woodruff, 1999. .
3. There are different analytical approaches (mainly economic) to market reforms in Russian telecom (Campbell, 1995b; Mil'chakova, 2001; Rytsareva, 2001; Zhyl'sheva, 1996).
4. I use the database of the Russian mass media (http://www.public.ru, http://www.securities.com.ru) and the database of Russian laws (GARANT, KONSYL'TANT+).
5. The interviews are numbered as follows: I1 – interview with the main assistant to the director of a local Russian telephone operator; I2 – interview with the financial director or a local Russian telephone operator. I conducted the interviews in August, 2000.
6. Federal Agreements, 31 March, 1992 – 'Agreement between Russian federal structures and autonomous republics', 'Agreement between Russian federal structures and regional administrations', 'Agreement between Russian federal structures and autonomous regions'.
7. Government Decree No. 1003, 22 December, 1992 'About privatization in the communications sector'.
8. Presidential Decree No. 721, 1 July, 1992 'About corporatization of state organizations'.
9. Presidential Decree No. 1392, 16 November, 1992 'Industrial policy and privatization'; Presidential Decree No. 1535, 22 July, 1994 'Privatization program after 1 July, 1994'.
10. Presidential Decree No. 341, 29 December, 1991 'Privatization'; Government Decree No. 96, 10 February 1994 'About delegation of Government rights'.
11. All local operators (except the operator in Perm' – Uralsvyaz'inform) were privatized in accordance with this variant. Employees of the Perm' operator chose the second variant of privatization. There were no cash auctions, so the main shareholders are Svyazinvest (51 percent), employees (29 percent) and management (12 percent) (Dmitrii Grishankov, Svetlana Lokotkova. NICHTO NE CHENIT'SYA TAK DOROGO, KAK OTKROVENNOST', *Expert* (Moscow), 2 November, 1996).
12. ITOGI I PERSPEKTIVY: V MINISTERSTVAH I VEDOMSTVAH, *Ekonomika i zhizn'* (partner), 6 February, 1995.
13. As a rule, telephone companies do not have this information. For example, the company Tomsktelekom reported the following information about its shares in late 1990s: Svyazinvest (51 percent), Russian public (10 percent), and no data about the remaining shares (PORTRET EMITENTA, *Delovoi Express* (Moscow), 9 June 1998).

14. VSEROSSIISKII KOORDINACHIONNYI CHENTR I CHELYABINSKII FONDOVYICHENTR SOOBSHAET, *Rossiiskaya gazeta* (Moscow), 29 April, 1994.
15. POSLEDNII GOSYDARSTVENNYI PAKET AKSHII 'CHELYABINSK-SVYAZINFORMA' BYDET PRODAN, *Delovoi Express* (Moscow), 17 June, 1998.
16. Alexandr Znatnov. TELEFON – NE SREDSTVO OBSHENIYA, A SREDSTVO SVYAZI, *Allo!* (Moscow), 1 December, 1997; GLAVNOE OB AKSHIYAH KRYPNEISHIH PREDPRIYATII, *Expert* (Moscow), 2 September, 1996.
17. DO VYHODA SLEDYUSHEGO NOMERA, *Kommersant'-Daily* (Moscow), 16 April, 1996.
18. Konstantin Baskaev. OTECHESTVENNYE SISTEMY SVYAZI PEREKLUCHAUTSYA NA MIROVYE STANDARTY, *Izvestiya* (Moscow), 14 May, 1996.
19. "At that time … we'd attracted many Western investments. We'd bought some digital local and long-distance switching exchanges … We'd bought the most expensive technologies – new optic cables … That's all that we could buy at that time" (**I1**).
20. Sergei Kashlev. TELEKOMMYNIKASHII MOGYT RAZVIVAT'SYA BYSTREE, *Nezavisimaya gazeta* (Moscow) 19 February, 1997.
21. Annual financial report, 1999. Company 'Elektrosvyaz'', Ulyanovsk region.
22. Oleg Klimenko. 'AMYRSVYAZ'' NE ZAHOTELA PRISOEDINYAT'SYA, A PRIDET'SYA, *Zolotoi Rog* (Vladivostok), 26 June, 2001.
23. Sergei Lygovoi. SVYAZINFORM GOTOVITSYA K PRYZHKY, *Birzha* (Nizhnii Novgorod), 23 May, 1997.
24. OAO 'ELEKTROSVYAZ'' NOVOSIBIRSKOI OBLASTI, *Expert* (Moscow), 09 February, 1998.
25. OAO 'SVYAZINFORM' CHELYABINSKOI OBLASTI, *Expert* (Moscow), 21 April, 1997.
26. See Interview with the Russian Minister of Communications, Vladimir Bylgak (Vladimir Sydakov. INVESTOR VYHODIT NA SVYAZ', *Delovoi Mir* (Moscow), 15 December, 1995).
27. Presidential Decree, 11 July 1992 (Rossiskie vesti, August 1992, No. 444). Federal Law 'About Communications' was passed only at the beginning of 1995 (No. 15, 16 February 1995).
28. 'Agreement between the Russian Federation and Tatarstan Republic about rights' delegation', 15 February, 1994; 'Agreement between the Russian Government and the Government of Bashkortostan Republic about state property', 25 May, 1994.
29. Sergei Kashlev. TELEKOMMYNIKASHII MOGYT RAZVIVAT'SYA BYSTREE, *Nezavisimaya gazeta* (Moscow), 19 February, 1997.
30. "After the creation of a holding the Ministry … will not be an operator and delegates its 'executive power' to this new structure. It will be the 'brain' of the Russian telecom sector and will formulate the state policy and develop develop-

ment strategies. It will focus mainly on state control and regulation – license and certification policies …" (Alexander Eroshenko. 'SVYAZINVEST ' PREDLAGAET BOL'SHIE PROEKTY I TAKIE ZHE PRIBYLI, *Interfax AiF* (Moscow), 16 October, 1995).

31. Presidential Decree No. 1989, 10 October, 1994 'About state governance in the telecom sector'; Government Decree No. 1297, 25, November 1994 'About the creation of the joint–stock company, Svyazinvest'.

32. For example, Agreement with Yakutiya ('Agreement No. 10 between the Russian Government and Sakha Republic Government about rights delegation in communications sector', 28, June 1995).

33. "There was a decree about Svyazinvest. You had to give the state 51 percent of your shares. What's the matter? Nothing, no problem. Anyway we continued to manage our own policies and activities" (**I1**).

34. Federal Law on Communications (No. 15–FL, 16 February, 1995), Ch. 4, Art. 29.

35. Government Decree No. 793, 7 August, 1995 'About state regulation on some services and their prices'.

36. "We, for example, have never countered the regional administration. Why, we live in one region?! So, we have to listen to their requests, opinions, and demands ... Then they can help us in the price–setting process, make a deal with the Ministry of Antimonopoly Policy … Or, let's suppose we have some problems with our taxes, the governor can help us. This policy is so flexible, you know, while it is unstable Russian policy" (**I1**).

37. Mikhail Ymarov. IZMENENIYA V STRYKTYRE 'SVYAZINVESTA', *Kommersant'-Daily* (Moscow), 1 March, 1996.

38. The creation of such a company can be also represented as a result of 'institutional traps' (Polterovich, 1999). Russia represents a specific institutional model – model of 'stationary transition'. Changing this model is impossible without changing the disciplinary mechanisms (Kapelushnikov, 2001). However, any attempts to introduce such mechanisms meet resistance from informal practices (Stark, 1996). As a result, reforms 'from above' fail and lead to 'non–traditional' market interactions – non–payment, barter, relations with regional administrations. They are the main obstacles to further market development, but refusing them is impossible since it would destroy the whole economic system. So, there is an endless self–reproducing 'institutional trap'.

39. Victor Konovalov. ITAL'YANSKAYA KOMPANIYA STET POBEDILA MEZHDYNARODNYI KONSORCHIYM, *Segodnya* (Moscow), 2 December, 1995.

40. See, for example, Natalya Kalinichenko, Alexandr Privalov. PLOHO V STRANE S KONKYRENCHIEI – ZATO S KONSORCHIYMAMI HOROSHO, *Expert* (Moscow), 30 June, 1997.

41. Interview with Maxim Boiko (STET OTKAZALSYA OT POKYPKI ‘SVYAZ-INVESTA’. MNENIYA SVYAZISTOV OB ITOGAH SDELKI, *Kommersant'-Daily* (Moscow), 26 December, 1995.
42. Ibid.
43. See, for example, Alexei Kompaneech. KON’UNKTURA/ TELEKOMMYNI-KABEL’NOST’, *Kommersant’–Weekly* (Moscow), 10 December, 1996.
44. Ibid.
45. *Russian TV, VESTI*, 29 July, 1997, 20:00.
46. Interview with the Director of Svyazinvest, Alexandr Lipatov (Alexandr Malutin, Roman Prokolov, Mikhail Ymarov. SITYACHIYA VOKRYG TENDERA AO ‘SVYAZINVEST’, *Kommersant’–Weekly* (Moscow), 25 November, 1995).
47. ”Well, the first attempt was unsuccessful ... But this auction had very good results for us – see these documents – we will use them in the future. We didn’t have such contracts early, right? We only learned to do them” (*Expert’s* interview with Anatolii Chubais (see Chubais' website – www.chubais.ru).
48. Elena Starostenkova. PRIVATIZAZHIYA ‘SVYAZINVESTA’ PRODOLZHAET BYDORAZHIT’ YMY CHINOVNIKOV, *Finansovye izvestiya* (Moscow), 10 July, 1997.
49. ”We had the wrong vision of Svyazinvest. This project and this company are more than only a few people …. And, of course, it is more than only the object for sale …” Interview with the Director of Svyazinvest, Alexandr Lipatov (Mikhail Ymarov. ROSSIISKIE SVYAZISTY SITYASHIU NE DRAMATIZIRYUT, *Kommersant’–Weekly* (Moscow), 14 March, 1996).
50. Alexei Ionov, Ivan Cheberko. SVYAZISTY POGOVORILI TRI DNYA O PYATYAH I PERSPEKTIVAH, *Kommersant’–Weekly* (Moscow), 31 May, 1997.
51. Ministerial Decree No. 8, 14 January, 1997 ‘About protection of domestic telecom equipment manufacturers’.
52. Mikhail Ymarov. NE VIDIT OKO, I ZYB NEIMET, *Kommersant’–Weekly* (Moscow), 27 September, 1996.
53. Maxim Kashylinskii. ERICSSON STAVIT NA Svyazinvest 145 MLN. DOLLAROV, *Segodnya* (Moscow), 29 November, 1996.
54. See, for example, ‘Agreement No. 2 between Russian Government and Irkytsk’ regional administration’, 27 May, 1996; ‘Agreement No. 3 between Russian Government and Rostov’s regional administration’, 29 May, 1996.
55. For example, ‘Agreement No. 8 between Russian Government Khabarovsk’s administration’, 24 July, 1996.
56. Vasilii Dydin. SVYAZINVEST: OTKAZAVSHIHSYA NE BYDET, *Finansovaya Rossiya* (Moscow), 3 July, 1997.
57. Ivan Cheberko. SKOL’KO STOIT SVYAZINVEST, *Kommersant’–Weekly* (Moscow), 23 July, 1997.

58. ‘PETERSBURGSKAYA TELEFONNAYA SET', *Delovoi Express* (Moscow), 30 April, 1996.
59. NOVOSTI EMITENTOV, *Delovoi Express* (Moscow), 27 August, 1996; 9 September, 1996; 24 September, 1996; 27 October, 1996; 12 November, 1996.
60. VYPYSK AKSHII KOMPANII SVYAZI OTLOZHEN DO VESNY, *Rysskii telegraph* (Moscow), 18 December, 1997.
61. About difference between ‘administrative’ and ‘political’ state capacities, see Chaudhry, 1993.
62. Miroslav Byzhkevich. SVYAZ’ – ETO NERV STRANY. I ON NATYANYT, *Delovoi Mir* (Moscow), 29 July, 1995.
63. Presidential Decree No. 249, 17 March, 1997 ‘About federal structures in Russian Federation’.
64. See interview with Alexandr Krypnov, the Chair of the State Committee of Communications and Information (Mikhail Ymarov. ALEXANDR KRYPNOV: V 2003 GODY V ROSSII BYDET 40–45 MLN. TELEPHONOV, *Kommersant’–Weekly* (Moscow), 17 May, 1997).
65. ”Well … the Minister and the Chair of Committee – they have so different status and position … the Minister reported directly to President, and the Chair only to the Vice Prime–Minister…” (**I1**).
66. Government Decree No. 883, 14 July, 1997 ‘About creation of the State Committee of Communications and Information’.
67. Government Decree No. 265, 28 March, 2000 ‘About restoration of the Russian Ministry of Communications and Information’.
68. Denis Babich. MINISTERSTVO SVYAZI DOVOL’NO RYNKOM, *Nezavisimaya gazeta* (Moscow), 27 Januar, 1997.
69. ”There are regional companies, the Ministry of Communications (which is responsible for licenses and certification) and Svyazinvest, which manages our activities. The Ministry can’t interfere in Svyazinvest’s area” (**I2**).
70. ”For example, we don’t have the right to certain services in our license, Ministerial officials can come and state: ‘This is an illegal activity. You should apply for permission for these services’… They have very strong tool – Svyaz’nadzor (*special Communications Regulation Agency. – OB*) that checks our activities. We cannot avoid it, this very strong state regulation tool” (**I2**).
71. ”We are an independent company, which has its own rights and responsibilities. Well … then, we have the great restrictions on our activities. Svyazinvest manages our development and attracts investments” (**I1**).

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