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**Briefing
PRIVATIZATION
Building Russia's Creative Capital**

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2011

The Government of the Russian Federation is considering privatization and a reduction in its management of commercial organizations as one of the possible instruments for structural economic reforms, improvements in the competitive environment and attracting additional investment.

The federal property privatization programme for 2011–2013 is a continuation of the policy aimed at reducing the government's presence in the economy and promotes the transition to innovative development.

Moderator:

Alexandra Levitskaya, Deputy Minister of Economic Development of the Russian Federation

Panelists:

Ruben Aganbegyan, President, MICEX

Vladimir Mau, Rector, Russian Presidential Academy of National Economy and Public Administration

Dmitry Pankin, Head, Federal Financial Markets Service

Igor Shuvalov, First Deputy Prime Minister of the Russian Federation

Alberto Verme, Chief Executive Officer, Citi (EMEA)

Vladimir Yakunin, President, Russian Railways

A. Levitskaya:

When we were preparing for this event, we knew that privatization was a high priority. We have always based our work on the premise that it is one of the government's key tasks. We billed this event as a discussion titled "Effective privatization, effective conditions for privatization". I think despite the fact that we were late in announcing it, the fact that we have so many interested people here today means that this is an important and interesting subject. After we had the opportunity to listen to the strategic address of Russian President Dmitry Medvedev earlier today, this subject has become even more relevant. That is why our discussion today, I think, should help us prepare for the steps we must take to achieve the goals we have set for ourselves.

First of all, I would like to quickly say that we are expecting First Deputy Prime Minister Igor Shuvalov. We have received confirmation that he will be joining us in a little while. But we have the go-ahead to begin the session. I will make a very brief announcement in order to focus your attention on the situation in which we find ourselves today, and to remind you of certain steps that have already been taken.

For example, in November 2010, the government adopted a three-year privatization programme, the first of its kind. This sets extremely far-reaching goals. In terms of the privatization of corporations, 50% of the share portfolio owned by the federal government has been earmarked for privatization. We have carefully studied plans from the regions. We were tasked with closely examining the plans of our major Russian companies, such as Russian Railways and the Russian Technologies Corporation. The managements of these companies are working with us on this project. I hope they will also say a few words about the situation.

We have a certain understanding of the vision Moscow has for privatization, and we will be fine-tuning these plans. As of 2011, total assets earmarked for privatization add up to around RUB 500 billion. This is a substantial amount. The

government and state-owned companies are planning to raise this amount by late 2011 or early 2012.

This is a very ambitious goal, so it will take considerable effort on our part to achieve it, especially if we look at certain factors related with the capital drain we are currently experiencing. Today, I would like to focus on this in more detail.

In addition, we would like to discuss in this situation what kind of additional conditions are required to ensure that privatization is effective. And I think that none of us present here expects this privatization campaign to be cheap. Nobody plans to have cheap privatization. And that means we are facing a large-scale issue. Considering that we have quite a few people who will want to say a few words, I propose that we adhere to the schedule. Also, I want to respect the wishes of some of our participants who need to be able to move on to other sections of the programme. Mr Shuvalov, would you like to say a few words?

I. Shuvalov:

Thank you, Ms Levitskaya. Good afternoon, ladies and gentlemen. On my way here, I met a great many journalists. They all asked me the same question: “What did President Medvedev mean by what he said? Did he mean more companies or more shares?” He meant both more companies and more shares. That is the simple answer.

We had several conferences late last year, several meetings with the Prime Minister. We were deciding which plans we can afford. We – I am disclosing this information in order to make things clear – were not guided by what we want to sell, but by what we want to keep. In making this decision, we were not guided by this at all. We asked consultants for their advice and realized that we must carefully prepare companies and blocks of shares for sale. We must conduct privatization with deliberation and transparency; we must attract quality investors; and if possible, we must sell the shares at the highest possible price. The price is not the main factor in this case – but if we do manage to sell a block of shares on

a healthy market in the process, then that is exactly what we are aiming for. I listed the main points we discussed during our meeting with the Prime Minister. The experts have told us that we can sell, for example, 25% of shares to a certain company. Or if we take Sberbank, this year we are selling a little under 8%. Meanwhile, we have already sold 10% of VTB shares. We do not pull these numbers out of thin air: we carefully calculate all this data. You can ask VTB employees and the people who organized the sale of VTB shares whether we could sell, say, 25% all at once. We could, if we tried really hard. But should we? And we do not know how much we could get for these shares. We were told that the ideal size of a block of shares is 10%, and that is precisely the block size we should sell. So it is not as though we are holding shares back to keep them for ourselves, and trying to hide this from the public; and it is not as though we do not want to privatize. Everything has limits and motives. Our motives are absolutely transparent. I have explained them to you. By order of the President, as was only recently formally submitted to the Parliament, we began to re-examine our privatization plans in order to broaden them. It was literally two weeks ago. Am I correct, Ms Levitskaya?

A. Levitskaya:

Two weeks.

I. Shuvalov:

Yes, I have already conducted a meeting with the government on this subject. We do realize that we need more companies. As for the blocks that have already been allotted, we need to consider what we will do with them, and how we will sell them. My friends, I am completely serious when I say that if you think we are trying to hold something back rather than sell it, you are mistaken. I see we have representatives from the Ministry of Transport and from Morgan Stanley with us today. I had a meeting with them very recently and consulted with them regarding

the sale of Sovcomflot. We own 100% of it. Why can't we just sell the whole 100% right from the start? I guess we can, but nobody would advise us to do something like that. Of course we could go on the market right now and say, "Buy our 100% of Sovcomflot, name your price". But we agreed to use the help of qualified specialists. We have consultants, and we are ready to pay them to work with potential investors. They must ensure that the company rebuilds its equity structure so that it can grow. So it is not that simple. We hold 100% of shares, and we are ready to sell them. But should we? I do not know. That is why, on the one hand, the President's decree in regard to the growing number of companies and blocks of shares comes down to this: we must simply focus more on selling! We must sell better – but we do not know how to sell well. We have a great example in the form of the expertly prepared and conducted VTB deal, though I have heard some people critique it. You can critique it all you want, but the transaction was a success. I believe the transaction was a success. Compared to other measures, the sale of VTB was a successful project. We need to make sure other projects are also successful.

This does not mean we have to push for the sale of every object. Imagine that we reach a certain point in our Sovcomflot and Sberbank projects, only to hear, "There is no market", or "You will be interfering with each other's operations", or something in that vein. We will not be entering the market. We will make a decision to put things on hold. Hence the President has now ordered to make these plans more ambitious. We must present these plans to the President in the form of a coordinated government position by August 1. We will meet this deadline. These days, people try to press-gang me in the hallway and cook up some scheme on this basis. What does the government think about this? What does Putin think about this? You know, we do not have to look for any schemes. Vladimir Putin is also an advocate for privatization, just like Dmitry Medvedev. And we, their colleagues, are doing everything in our power to foster privatization. At one point in the 90s, Herman Gref and I worked in the area of

privatization along with our colleagues. I began working in the civil service right in the middle of the privatization process. We must not continue to privatize assets in the way we did back then! We must have no free lunches, no immediate interests, no hint that the procedure is not transparent. We currently have a great many questions related to this that we need to ask our privatization agency. Rosimushchestvo is not working as it should. And I say this both privately and publicly. I am not satisfied with the work of this department. I think we have a great many problems because the department is so unprofessional. Since the President tells us we must work better, all Rosimushchestvo employees should update their qualifications so that they are capable of helping us to privatize in better ways.

I see Gleb sitting before me. I am not criticizing you. You did great work, including your work on the VTB project. But we do need to have a team of like-minded professionals. Why did the VTB project go so smoothly? Kostin personally dedicated his respected position and his time to the project. He was sure this was necessary for the project. He had a professional team, and they found the right consultants who embarked on this journey with us. Levitskaya, Nabiullina, Kudrin – we all pulled together and did everything in our power to complete this project successfully and achieve specific results. And that is how we need to treat any other transaction, large or small. Of course we will not have the time for small blocks of shares and minor companies. For that, we need Rosimushchestvo to serve as an agent which operates successfully and professionally on behalf of the government. These days, when we hear complaints that a certain transaction was conducted without transparency, that is completely unacceptable! Maybe that is how things were done in the 90s and early 2000s. Then we went through a very long period when the government received no complaints at all about this. So I think the fact that we are talking about it again and receiving complaints about me is completely unacceptable and must be changed!

I addressed several questions that I would consider to be of utmost importance. To sum up: there is no scheming and no disagreement between the government and the President regarding the scale of privatization. Today, the President's privatization orders mean more companies and more blocks of shares. And most importantly, we must learn to operate on this scale, and to do so professionally. Because if we present this issue unprofessionally, nobody will forgive us our blunder or our lack of success. We do not need to sell for the sake of selling!

A. Levitskaya:

Thank you, Mr Shuvalov. I just want to offer additional information – I think it never hurts to remind you again – that our team, which was tasked by the government to handle privatization deals, includes 23 investment banks. The Ministry worked with the banks, and today, our information (we processed data from 1,300 corporations) shows that investment banks have shown interest in about 300 corporations. This means that the banks are ready to begin selling them. Some corporations either already qualify as blue chip companies, or aspire to reach this level. We have intense competition among banks, which reaches 19 or 20 out of the 23 banks competing for one place. But we consider certain corporations to be major companies. We expect them to inject good profits into the budget. But unfortunately, these corporations do not interact well with the market and with the investment community. These are the problems we have solved and will continue to solve. In part, we will impose certain additional requirements on the management of these corporations, and now also on their Boards of Directors. Decisions to replace members of Boards of Directors and Chairs of Boards of Directors will simply mean that if these companies are included in the privatization programme or are preparing to join it, the new leadership will have to work three times harder. In other words, I want to say that the people who have agreed to undertake this work must clearly understand that now they will be responsible for this, just like Aleksei Kudrin, or the Ministry, or

Rosimushchestvo, because the task of effective privatization will be on their shoulders.

From the audience:

Could I say a few more words? I saw the Governor and the Deputy Governor at this forum. Privatization, as we imagine it, must be focused on large projects, including assets owned by the Russian Federation. We have a specific plan for Moscow. I hope Yekaterinburg has a similar plan. But in the regions, anything to do with local energy supply, public services – everything that creates a certain social environment or atmosphere for comfortable living – often belongs either to municipal or provincial authorities.

Now is the time to begin projects aimed at attracting capital. These programs probably do not have to be focused on injecting money into the treasury by selling off these assets. But at minimum, we must have a programme for opening these assets to private investors who will bring their capital. Then these services can develop on the regional markets. This is a very large independent programme that we will have to implement. And of course the federal agent dealing with privatization must act in tandem with the federal government.

A. Levitskaya:

Mr Shuvalov, I would like to clarify one aspect of this. By order of the President, we examined the plan for the privatization of objects owned by Subjects of the Federation. Only 30 regions currently have concrete plans. And of course Moscow is one of these regions. But even these sizable plans (and we did a comparison of the share in these objects owned by the regional authorities) cover around 12% of state-owned assets in the regions.

A. Levitskaya:

Vladimir Yakunin. Today, we heard a lot of questions about the privatization of subsidiaries of Russian Railways. Mr Yakunin, could you tell us more about it?

V. Yakunin:

I will begin with what you already know. This is for the audience's benefit, because it would be simply inappropriate for me to repeat all this to you after what I have already told you. In compliance with the government's plan, in 2011-2012 we are preparing to privatize or offer for privatization shares of subsidiary companies alone amounting to RUB 200 billion. We expect that in 2011, we can and must bring in RUB 100 billion by selling companies earmarked for privatization. We already conducted a quite successful allocation campaign, after which we took the company public (I am talking about TransContainer). And this year, we are planning to sell off the blocking stake in TransContainer. The total is RUB 11-12 billion. Hence we expect to liquidate between RUB 10 and RUB 13 billion during this period. We successfully sold assets in the form of 63,000 vehicles that exceeded their planned lifespan and are in need of repairs. That was around RUB 13 billion. From this point of view, I believe we are moving along in the implementation of the plans signed by the government, and I do not think we are falling behind. I think in terms of privatization, it is very important to ask whether foreign and Russian investors want to take part in this privatization campaign. It is a crucial question, mentioned repeatedly by Ms Levitskaya. Since the capital drain we are facing today is considerably higher than the influx of capital into the country, this is another issue we should probably seriously consider.

I am not trying to scare anyone. In addition, let me tell you that our foreign colleagues also do not scare easily. I can tell you that I recently had two meetings: one with JPMorgan, and the other with Morgan Stanley. The prevailing opinion in the West is that Russia has a terrible investment climate. For example, the President of the World Bank went so far as to compare our investment

climate with that of North Korea. This happened on May 11-13 of this year. No expert can hear this without feeling at least a pang of bitterness. On the contrary, investors want to work with us, want to get involved – with Russia as a whole and with Russian Railways in particular.

As far as plans to privatize part of the Russian Railways Holding, based on the approved programme, we estimate that it will happen after 2013. By then, the Russian economy is expected to return to its pre-crisis condition. The company employs a very professional team. At least we have not received any complaints from the authorities – from government financial and economic bodies. In conclusion, I can say that we have just completed the floatation of the second tranche of our stocks in British Pounds, and we are grateful to our partners and foreign banks for their help. Mr Shuvalov, our results exceeded those of the first sales campaign. We floated the assets for 20 years at an annual interest rate of 7.049%. This means investors are definitely interested in our assets.

A. Levitskaya:

Thank you, Mr Yakunin. I would like to give the floor to Sergey Chemezov, head of the Russian Technologies Corporation. Mr Chemezov, we at the Ministry were studying your programme literally two days ago. Could you say a few words about your plans?

S. Chemezov:

Our plan is to create a product that would capture the interest of investors in terms of its investment potential. In order to do this, we distributed all the companies we selected (and we were already handed 592 companies) into holdings. Of course there are a great deal of companies which are not really functioning anymore. We have to get rid of them, meaning we have to purge them and get them back into order. Naturally, most of the Federal State Unitary Enterprises we have today must be floated. This requires time. To achieve this,

we were given a transition period until March 2013, and I hope we will have enough time to meet our objectives. And only after that will we be entering the market and offering blocks of shares for sale. Of course when it comes to defence companies, it will be up to the government to decide what part of it to sell and what part to keep. But civilian assets must definitely be sold off.

But here, we found ourselves in an interesting situation. Take, for example AvtoVAZ. We currently own 29% of AvtoVAZ shares. We decided to sell part of our shares. Our partner, the Renault-Nissan Alliance, headed by Mr Ghosn, contacted our Prime Minister, asking that the state corporation not sell the blocking stake, but instead retain it in order to allow us to be their 'parachute'. That is why we say that even though we should sell off all shares owned by the government, not all partners support this position. They want to have the presence of a state-owned company after all, because they see a state corporation as a certain guarantee of their success here in Russia.

Maybe the situation will somehow change. Currently, we have already pretty much prepared Russian Helicopters. We planned to begin privatizing it this year, but we decided to postpone privatization until next year. VSMPO-AVISMA will most likely be next. After that, I think we will begin preparing the Helicopter Holding – or, rather, the United Engine Corporation. And gradually, we will sell off all companies. And of course the AvtoVAZ assets, up to 25%. And whenever an additional emission of shares creates some additional small percentages, we will naturally sell them off as well. We currently own a large share of KAMAZ. And by the way, Daimler has also contacted us with a request to keep a certain amount of shares and to co-own KAMAZ. So not everyone wants to get the government completely out of company ownership. Thank you.

A. Levitskaya:

Thank you, Mr Chemezov. The government, as all my colleagues know, has created a task force that determines strategic directions for economic

development. Vladimir Mau is Co-Chairman of this task force. Mr Mau, I give you the floor to talk about privatization. Please.

V. Mau:

Thank you very much. I will not be speaking on behalf of the task force, since Mr Shuvalov presented a report on the results of its work just days ago. The task force has a long list of measures that it is working to implement, and our Ministry colleagues are actively working in this area. I do want to say a few words about the privatization campaign of the 90s, since when we talk about the current wave of privatization, hardly anyone, including Mr Shuvalov, can avoid mentioning the 90s. How does the campaign of the 90s compare with what we are facing today?

I think the fundamental task right now is to define the objectives of privatization: what results we are expecting from it. Depending on the evaluation of privatization of the 90s, we can evaluate and track success and failure criteria. I personally belong to a very small group of people who consider the privatization of the 90s to be a success, since as an insider who participated in the process, I can clearly see and understand the goals of that campaign. Actually, no matter where and when it happens, privatization always has the same three objectives: political – to consolidate the foundation of the political system; fiscal – to replenish the budget; and economic – to attract strategic investors. Depending on which objective we identify as primary, sometimes these objectives overlap. But mostly, one of them rises to the top of the list of priorities. The objective we identify as primary determines how we evaluate the success of privatization.

Of course we knew that the privatization programme of the 90s, which was implemented in conditions of triple-digit inflation and complete political uncertainty, could not possibly serve as a factor in attracting strategic investors or replenishing the budget: there was no sense in expecting that. There is one major difference: today, we do not have to worry about political and fiscal objectives. The privatization campaign of the 90s achieved its goal brilliantly: it

created the basis for a market economy, however shaky it might be; and it prevented the country from returning to the traditional Communist system, with all its problems and atrocities. By this measure, the campaign was a great success. Therefore it is pointless to talk about attracting strategic investors, because no strategic investor – no sane person – wants to deal with conditions when the political regime can change in the space of a few months, and inflation hovers in triple-digits. This just leaves profiteers and people who will continue to protect these assets.

Today, of course, we are facing a completely different situation. And if we consider history again, this situation is more in line with Margaret Thatcher's vision of privatization in the early 80s: creating effective proprietors and attracting strategic investors. By the way, unlike the past experience of Britain and the current experience of Greece, our objectives are not fiscal. Because naturally, we have to sell for the best possible price – but not because we have to plug a hole in the budget, but rather because a higher sale price attracts more serious proprietors who are ready to invest their money. I repeat: considering the current situation, I believe our primary objective is to attract strategic investors, including investors from abroad. This objective is also related to providing social reinforcement for mid-sized and large business and stimulating structural modernization. Because without privatization in general, and specifically without privatization focused on attracting strategic investors, we cannot modernize.

We have two parallel goals which were not a factor when developed countries were undergoing privatization. We must develop a modern financial market – and it would be good if we could link privatization solutions on the macro level with the development of an international financial centre. We cannot solve all problems at the same time, when we all publicly trade in London while at the same time building international financial centres. We must look at this as two sides of the same investment issue. Our situation is unique in another way: unlike classic examples of Western privatization, we are not trying to lighten the

budgetary burden. As Sergey fairly noted, we are rather laying the groundwork for privatization, making it more attractive. We do not remove companies which are detrimental to budgetary income or which are receiving subsidies from our accounts. On the contrary, we improve them and then sell them. These are two very important distinctions which we must keep in mind.

To my mind, the key issue Mr Yakunin mentioned so ambiguously is privatization against a backdrop of capital drain. We can argue endlessly over how massive it is. But there is no doubt that increasing outflow of capital points to a decreased confidence in the investment climate. And this, of course, necessitates that we solve conflicting problems.

While we are meeting the challenges of privatization, we must also work towards improving the investment climate. This is one of the things the President mentioned today. And this is not an issue of economics alone. The visa problem, for example, is obvious, and simplification of the visa system is a nice gesture, but it is not enough. As I understand it, it is also a question of macroeconomics. If we now consider privatization from the macroeconomic perspective, the solution will depend on lowering inflation and bringing down interest rates. I do not mean inflation for the sake of inflation: I mean that lower inflation means lower interest rates. Since we are attracting strategic investors and hoping that they will operate on our market and borrow from our banks, and since we want them to get involved in the financial centre, we must ensure that our interest rates can compete with the interest rates of Western markets. It follows that the issue of economic stability, the issue of lowering inflation and interest rates, is also, I believe, a highly critical component of an effective privatization solution.

I want to stress one last thing: it is very dangerous to expect that privatization will yield immediate, visible improvements. We cannot avoid complaints that we have privatized everything, and yet life has not improved. Life will still not get better. We must be prepared for this. In other words, it takes a generation for privatization to take effect. Perhaps a decade.

In conclusion, I want to remind you that in reality, the privatization movement of the 90s was a significant factor in the economic growth of the 2000s. The privatization campaign of the 90s attracted substantial investments into the economic growth of the 2000s, when a new property system was formed, and new political and macroeconomic stability was established. And, in my opinion, it was not just a political, but also an economic success. But waiting for this process to have effect will take patience. Thank you.

A. Levitskaya:

Thank you, Mr Mau.

V. Yakunin:

Ms Levitskaya, please forgive me, I cannot keep silent, please forgive me. But I cannot, as a political scientist, leave this without a comment. We all know the two main types of minorities. And now, before our very eyes, the third type was born: those who think the privatization campaign of the 90s was hugely successful. Mr Mau said so himself.

V. Mau:

I never tried to hide this from anyone.

A. Levitskaya:

Colleagues, I move we return to our topic. Mr Mau brought up the issue of the financial market and the Moscow International Financial Centre (MIFC). We welcome Moscow's Deputy Mayor Andrei Sharonov. Please tell us your thoughts on this subject: what concrete plans do you have for Moscow? And maybe a few words about your privatization plans.

A. Sharonov:

So, in keeping with the agenda, I am going to limit my remarks to privatization. In reality, from the perspective of privatization, Moscow shares a lot of problems with the Federation and with other regions. But it has a few specific challenges as well. First of all, Moscow has a great many new assets. In other words, the Federation and the regions mainly sell assets created during the Soviet era, while we are facing the need to sell off assets created within the past decade, or even within the past five years. I was surprised to discover that in the past five years, we have acquired a great number of assets: for example, a metal works, a large number of agricultural companies and the like, which were paid for from the municipal budget. I will not go into why this happened. In some cases, it seemed a reasonable thing to do; in other cases, it did not. But in any event, we are facing the need to sell new assets created in recent years using the municipal budget.

How do we approach this challenge? First, we consider the sector in which a particular company operates. The overwhelming majority of these municipally owned companies are structured either as State Unitary Enterprises or as corporations partly owned by the city, and operate within the market sector. This is the main reason for privatizing these assets.

Next, we will examine the fulfilment of state and private functions. The overwhelming majority of companies have nothing to do with state functions – or if they do, they are usually quasi-state functions connected with providing services. As a rule, they have a monopoly on these services – for example, public utilities and transportation – which, strictly speaking, is not the function of the state. But the state, and primarily the city, carries the responsibility for these services, including political responsibility. This is a sensitive, but far from restricted, sector. We also think this sector has privatization potential – but primarily from the perspective of attracting investments into these companies. Igor Shuvalov has already spoken about this.

Moving on to the issue of share block size. A huge number of assets consists of tiny blocks which fall short of the 25% mark – they might make up 1%, 0.5%, and so forth. This will most likely be a simple accounting operation, since there is not much to sell. We look at each company's books, since we are not worried about how we can sell the company and whether or not it is profitable. We are guided by different logic. We often get bogged down in what you might call "additional investment". We are told, "This is our company. Yes, we built it using public funds; but if you could invest just a little bit more, we will turn it into a morsel we can easily sell". And regardless of what Mr Mau said, everyone will be happy. In my opinion, this is a very serious mistake that usually points to dishonesty, because if the company has value, private investors will recognize this value without any additional investments, and will act better, more effectively, and faster than the municipal authorities would. And more often than not, it is an attempt to continue the robbery (I will not mince my words) that was started by the company's management in the absence of oversight on the part of the city. Therefore, 90% of the time, attempts to find additional investments in order to raise the value of these supposed assets and then sell them off prove to be a dangerous mistake.

In conclusion, I would like to say that despite everything I've said so far, this year we managed to sell two major assets and turn a nice profit for the budget: a share in the Bank of Moscow and a share in an oil company. To put this in perspective, I will tell you that the Bank of Moscow made the city RUB 103 billion, even though we had estimated that in 2011, the entire privatization would pull in RUB 20 billion. These are huge numbers, though the fiscal goal was not our main motivator. Do not misunderstand me: we are not looking to sell everything off for pennies. But we think that it is very important for us to pull out of a competitive sector: stop crowding it, stop skewing the competitive field, and prevent company managements from engaging in dishonest activities in the name of the city. And as far as strategic and quasi-strategic assets are concerned, we also see

opportunities for privatization that would leave the majority interest in the hands of the city, at least in the medium term. This includes involvement from strategic investors that would, first and foremost, bring their knowledge and money to the table. But again, this is not a fiscal, but a structural objective. I think I will end my speech here. Thank you.

A. Levitskaya:

Thank you, Mr Sharonov. I do want to touch upon the subject of the MIFC in the context of privatization, because this subject is being voiced and discussed on the expert level. Go ahead, Ruben.

R. Aganbegyan:

Thank you very much. First of all, I would like to note the very positive approach to privatization we have seen today. Regardless of which road we will choose and how privatization will be conducted, the very fact of a position shared by the government, regional administrations and state-controlled corporations is very encouraging. The second very important and, I think, positive fact is that, when we are talking about market sales, strategic sales doubtless make a lot of sense in the case of certain assets. Nevertheless, the fact that so much importance and attention is given to developing the Russian asset market, no matter where these assets are located, is doubtless also a good sign.

Many of you know my long-held position to which I have consistently adhered. It is based on two goals. The first goal is the importance of promoting Moscow as an international financial centre. And the second goal, which I am also working hard to reach, is to link privatization plans with the first goal. I think the government took a giant step forward in developing the MIFC when it breathed post-crisis new life into this issue and began planning for the future, working for the long term, before we even recovered from the crisis. Second, the government demonstrated its political influence and put together an efficient team. We are

already seeing concrete results in the form of legislation, both proposed and signed laws – for example, the law on clearing. This is also a very encouraging fact, and investors are taking note of it. The third factor is the fact that the opinions of investors are being considered; privatization is moving forward; and we are actively working on developing a central depository law. At this time, it means that we are listening to investors, because it is important that they know what our next step will be in terms of developing infrastructure. Our work in this respect has been very successful. From the point of view of privatization and the MIFC, I would like to note that our stated position that money is not the most important factor in privatization allows us to consider the government's other important goals and explore rational connections between these goals. In this regard, from the point of view of creating the MIFC, I think this privatization provides a powerful incentive. It is a good idea to link privatization to legislative reforms in order to grow our market and provide a platform for these transactions. This means that we must fully provide all investors with complete access to our market. In effect, the point of the legislative changes we are trying to introduce consists of expanding access to our market for investors who currently do not have this access for one reason or another.

I would like to bring up another very important point. I will give you a figure: last year, the total MICEX and RTS circulation volume reached RUB 200 trillion. This is a huge number. It gives you an idea of the size of our domestic market. Though this number includes not just shares, but all financial instruments. The second point: we have a massive over-the-counter securities market. It is 50% larger than the stock exchange. That is why we have a very big financial market. The fact that we have the tenth largest GDP in the world means that Russia is one of the countries that can lay claim to having an absolutely massive domestic market. Both the government and investors have the opportunity to benefit from this fact.

In conclusion, I would like to bring up one more crucial point. Vladimir Mau told us about long-term objectives of privatization, and specifically said that if performed correctly, privatization will set a certain tone for the next decade, creating powerful economic incentives. I know that our main subject is the “national IPO”. I would like to note that this tool has shown great results in those countries which find ways of sharing the results of their economic success with their citizens, not just through average per-capita GDP, but also through property endowments. If we examine the current situation, we will see that our export-oriented economy involves very large streams of cash, most of which is distributed among citizens. What do they do with this money? The majority of this money is doubtless deposited into banks, and huge amounts are spent on real estate. One of the largest commercial real estate retailers sells 15% of apartments using mortgage financing, and 85% for upfront payment in full. That is how people build their assets. Therefore another crucial financial market reform would create tools that allow citizens to make competent decisions regarding share accounts, futures, and other instruments. It might even make sense to give the government an opportunity to invite citizens to participate in privatization, thus avoiding, in my opinion, the mistakes we have made in the past – in other words, by creating tools for making competent investments into our assets and turning our population into active participants in the country’s economic success. I think I will end my speech here. Thank you.

A. Levitskaya:

Please welcome Dmitry Pankin, the new head of the Federal Financial Market Service. If you do not mind, I will give you the floor. How do you see the development of the stock exchange, and how is it related to privatization?

D. Pankin:

Thank you, Ms Levitskaya. I think the observation that this mass privatization can and must provide a major stimulus for the growth of our domestic financial market was correct. And the proposal regarding certain changes to the general regulations for releasing Russian securities on the international market (within the framework of current limitations) is, to my mind, very interesting. How does the issue present itself today? Where does the problem lie? If we sell our securities abroad, we naturally have access to a larger pool of investors, and we can sell the securities at a higher price. And if we try to limit sales and only offer the securities domestically, our pool of investors becomes much smaller. Naturally, we will make less money. That is the dilemma.

What are we doing to solve it? We have a regulation that imposes this limitation: if a company wants to sell its shares abroad, it can only sell 25% of its shares on the international market. Statistics give us a picture of what is actually happening. In reality, despite this limitation, the majority of capital comes from abroad. Furthermore, the trend in recent years shows that even the prescribed 25% is not being used. In addition, companies have a way of getting around this limitation by simply declaring the shares, offering them on the domestic market, but not actually putting them up for sale inside the country – in fact, the offer goes directly to the foreign markets. That is how companies get around this. Furthermore, a way of registering a special legal body with Russian assets located outside the Russian Federation is increasing in popularity. More than 70% of capital is already being handled this way. This company outside the country is already releasing shares and attracting corresponding capital, while Russia's domestic financial system is completely broken. Here, I think the President's remark earlier today that we should probably move towards removing these ineffective limitations was completely justified. The intentions are good – to attract capital into our market – but it is not working. We must move in another direction: to create optimal conditions for investors, while examining our infrastructure. This is a question of the Central Depository; of nominal share

ownership; of permitting foreign depositaries to hold a nominal number of shares – in other words, we are facing many technical questions. And we are facing another technical question related to privatization: where will we be placing the shares? Abroad, or on the domestic market? In my opinion, the proposal that deserves serious consideration is to place these shares and make a legislative decision to place them on the domestic market. Yes, we will miss out on some of the money; yes, we will attract smaller investments; and maybe we will have access to a smaller pool of investors. But regardless, I think this will be a very powerful driving force for the development of our domestic market and for attracting investors to Russia. And in the long run, I think we will benefit. Thank you.

A. Levitskaya:

Thank you, Mr Pankin. As I understand, our next topic is the MIFC? Or do we have more time?

I. Shuvalov:

It is true that the privatization wave of the 90s had completely different objectives – and those objectives have been met. But can we rest easy with the results? Of course we had to deal with the President we had at the time; we had to deal with the state we had at the time; and to uphold it required that particular kind of privatization. The programme did meet its objectives – and here we are, still doing well after all these years! We cannot rest easy, though. We think that even using this shareholder structure of major companies... Imagine what is going on at Norilsk Nickel. Imagine how many family fortunes were made. But was this really the right thing to do in the long term? In the short term, in order to tackle immediate challenges, including the 1996 elections and so forth, this was probably the right step. I guess you cannot have one without the other. It is clear

that otherwise, we would not be sitting here and talking about this, because if the Communists had won in 1996, we do not know what would have happened.

Of course this is all conjecture. But do you know why we consider all this a mistake? Because we cannot accept this state of affairs. And in the future, when we are selling off companies, we do not want family clans to use these companies to make multibillion-dollar fortunes after having invested just a few hundred million. If these few hundred million are borrowed from the same state-owned banks, this is a situation we cannot accept. And our society will not accept this situation. We will not be able to survive another round of this. And of course both the privatization that is being carried out at the moment and that planned on a large scale in future is not privatization. I really like Ruben Vardanyan's idea. A way of being able to safeguard savings in the form of stocks while not tying them up. This is a great idea – we just have to learn how to do it. The privatization wave of the 90s is the reason we cannot achieve anything now. It is our duty to learn how to do this, because people's savings should not be held in deposit accounts, but primarily in pension funds, share accounts, and so forth. But the main part is still joint stocks: people holding a portfolio of stocks or other securities. And of course we have to learn how to do this. I completely agree that such large-scale privatization must be combined with our international financial centre project. One has to support the other. In fact, we will actually be attending the MIFC roundtable. Thank you.

A. Levitskaya:

Colleagues, we still have the opportunity to partially split up our MIFC events, but we still have a number of questions we need to discuss. Still, as I understand, the rate of departure has increased. Privatization and the quality of management in our companies are doubtless our most important questions, and I think we probably have a lot of work ahead of us. I would like to invite Alexander Brayms to speak on this subject. You actually work within the MIFC. As I understand, you

have a task force. We always said that general corporate governance rules must be applied to state-owned companies.

A. Brayms:

Thank you. Yes, this is a truly important subject. I would like to begin by saying that overall, in the past few years, from the investor perspective, we see first of all that many state-owned companies have quite considerably improved not only the quality of corporate governance, but also the quality of management as a whole. Some examples of these improvements are VTB, Sberbank, Rosneft and other oil companies. Of course it is comforting to see that state-owned companies occupy such a large share of the stock exchange. In other words, when the quality of corporate governance declines or improves, this has a very important effect on Russia's overall investment appeal. In our portfolio – and we manage approximately USD 5 billion in Russian stocks – shares of state-owned companies account for approximately 20%. This is quite high for us. But I think this share is even higher for many other investors. In other words, it is very important for investors in general, for the investment community, how Russian state-owned companies are governed. In this regard, privatization undoubtedly provides the government with a very effective incentive to improve corporate governance in state-owned companies. Even if the fiscal goal is not the main focus, these shares will still increase in price if the companies have higher-quality governance and comply better with international standards. In this regard, I think it is important to make sure the measures to improve corporate governance (we already see such measures in action, including changes in the leadership of state-run companies) are applied not just to those companies that fall within the privatization programme, but to the state sector in general, because investors who can acquire assets as part of privatization will no doubt be thinking about the future and about the form corporate governance of these companies will take after the government fulfils its plans. This is why we must never, under any

circumstances, leave examples of bad corporate governance unaddressed, even if the government does not plan to sell shares in a particular company that has yet to achieve a respectable level.

I think it is a very good idea to invite additional independent members to join the Boards of Directors of state-owned companies. At the same time, we must make sure the independent directors who join these governing bodies are, first of all, truly independent – in other words, that they do not have any conflicts of interest, because we often see that not all candidates fulfil this criterion. And secondly, I think it is necessary, though it can sometimes be difficult, to give these directors considerable freedom to make decisions. Of course they must share the government's vision for these companies. But overall, it is a good idea to give them the authority to improve the governance of these companies: to make sure they are not mere enforcers of the government's orders, because otherwise, their presence in these governing bodies probably loses some of its purpose. Thank you.

A. Levitskaya:

Thank you, Alexander. I would like to give the floor to Mr Verme, Chief Executive Officer of Citigroup. If you could, I would ask you to touch upon the subject of the role of international financial organisations in the privatization process. Considering the goals we have set for ourselves, this is a very urgent question.

A. Verme:

Thank you. As an institution, we feel extremely encouraged by the developments in Russia. We have been an investor and will remain an investor, and we think the process that has been embarked upon, of privatization, is a very good one. Given the expertise in the audience about Russia itself, we feel it was more important for us to leave you with three messages, and to reflect on the experiences that we as an institution have had elsewhere.

The first message is that it is extremely important to have a comprehensive plan, and I would like to draw attention here to Israel.

Secondly, it is extremely important that we commit to each other, so that once that plan has been accepted, we keep the execution simple and transparent. And thirdly, let us make sure that as we have these debates, there is consensus on the objective of privatization, without which it would be impossible to have a plan, and execution of that plan will fail.

Back in the 1980s, international financial institutions used to advise governments on the design of the plans. One such government was Israel. The debate continued on natural resources, chemicals, telecommunications, avionics, refineries, utilities, and in six months an eight-volume report was presented to the Knesset. That programme started to be executed a year later. It was presented in 1987, it started to be executed in 1988, and it continues to be executed, which is another lesson. Plans of this nature take time, and for us to enjoy the benefits, we need the conviction that the plan has been accepted and execution will follow. Message number two: for all of us in the international financial community, execution is simple. It encompasses five different tasks: one is due diligence, the second one is evaluation, the third one is marketing, the fourth one is negotiations, and the fifth one is closing. When there is no political conviction about the plan, we spend a lot of time in due diligence and evaluation.

In the 1990s, we spent a significant amount of time in Brazil. Every time I talk to you—and I talk about China, India, and Brazil—Brazil is the one that sparks excitement. So what actually happened in Brazil? We remember in 1991, 1992, and 1993 just spending thousands of man-hours with auditors and partners in the legal field trying to help the Brazilians privatize. It was only in 1998 when the debate continued, whether it was strategic or whether it was retail. The government decided to hire advisors, and they felt that within five months, the telecom monopoly could be privatized. That process was launched in February of that year and privatized in July. The proceeds were USD 20 billion.

The importance of this became clear 12 years later, last year. You probably read in the newspapers that Brazil had sold more shares of their oil company, amounting to more than USD 70 billion. That was a process that started with that monopoly being privatized in 1988, but it was not a plan, it was piecemeal.

The last lesson, and we say this with great humility: many of the benefits that Israel and Brazil are enjoying were not even thought about. The development of the local capital markets – it was value maximization, it was employment, it was capital, it was new technology. But Brazil in particular had the conviction that they needed to diversify the economy, and they needed to create more of a domestic savings pool. When we come to Russia, those are two very good objectives, in addition to everything else that privatization will bring to the table.

With that, as an institution that has participated in many of these privatization processes in your country, we feel very encouraged by the process. Let us make sure that the plan gets embraced, keep execution simple, and make sure we all understand the objectives. Thank you.

A. Levitskaya:

Thank you very much, Mr Verme. Colleagues, I would like to give the floor to the governor of one of our most prosperous regions, Natalya Komarova. I think this region has a comprehensive plan which was mentioned earlier during the privatization programme. Please.

N. Komarova:

Information about our privatization plans for the next three years and analysis of the overall investment climate in our Autonomous Area are included in the brochures we distributed earlier. I hope you will find them useful. Incidentally, I think that regional privatization programmes have a problem because potential investors do not have enough knowledge about our plans. Today, my Moscow colleague Andrey discussed one aspect. But while he was not working in the

Moscow administration, he spoke to me about privatization plans as one of the investors. The major 'morsels' of the privatization plan that were included in our package – I am talking about 41% of shares belonging to the Bank of Khanty-Mansiysk – were the Borov, Chelyabinsk, and Nizhnevartov poultry factories, all of which were very interesting; the Ugoria Insurance Company; and so on, and so forth. Each of these facilities, each block of shares, must be considered individually. But when this work is done by bureaucrats, we find ourselves in a situation that unavoidably leads to corruption. It is a good thing Andrey and I know each other very well and had no distrust in our negotiations. Neither of us thought our partner was unreliable. But these things happen all the time. That is why regional privatization programs, since, as a rule, the object is not sold on the stock exchange; so a lack of information creates an extremely bad situation. We need to seriously reflect upon how we can correct this state of affairs.

I want to focus on just one more aspect. Actually, I was expecting to have more time, but considering that each participant has very limited time, I will bring up just one more point: government organizations and their inability to participate in the privatization process, although as a rule, they carry out very marketable activities. Consider, for example, dental clinics.

If we decide to transfer these activities and all corresponding organisations into private ownership, we have to fire all employees and liquidate these organisations. In other words, we would have to close them down and cease all activities. This spells death for the business. It is much harder to revive it later than to allow it to continue by implementing procedures that it used while it was still state-owned. Instead of closing the business, we ought to reorganize and restructure it. It would be extremely useful to develop new privatization methods. I also want to say that in our Autonomous Area alone, government organizations operate RUB 185 billion worth of assets. This is a great impediment to effective use of these assets, and a burden on the budget. If we consider this sector alone, we could lower budgetary expenses by at least 10%. Thank you.

A. Levitskaya:

Thank you, Ms Komarova. Does anyone have a pressing desire to say a few words in the next minute? Please keep to one minute.

From the audience:

I want to mention three things.

First, privatization in and of itself is seen by the investment community as a positive process. But I think after what the President said today, after this session, I have reasons to believe that the investment community, including investors from abroad, will realize that the government plans to enter this new stage of privatization in an organised and appropriate manner. This will completely change the way people view privatization in our country – and that is a big plus.

Secondly, a quick comment about the MIFC, and in particular about Dmitry Pankin's speech. He said we should only float companies undergoing privatization on the Russian stock exchange. I have a feeling that this is not that much different from the prohibition against putting companies on the international market. That is why I think it is worth considering that we should do more than make a show of the fact that we are currently working on this. We should find a way to synchronize the creation of the MIFC with the privatization process. Rather than prohibiting it today, we can implement the plan to float these companies exclusively on the Russian stock market by 2013 or 2015.

And third, I want to mention what Sergey Chemezov said about whether investors want to have the government as a major co-investor. The question is, how far should we sell blocks of shares of state-owned companies? If we take multinational companies as a whole – and the majority of them are public companies – they do not have large shareholders. And if they do, especially if the major shareholder is the state, investors do not look very kindly on this. Statoil,

which is sold at a discount to international companies, is a perfect example of this. But our economy is slightly different, much like in other developing countries, and that is why the things Mr Chemezov mentioned are happening. They do not want to see state assets slip out of their control, even if this control has negative effects. This is probably a question about how the government governs. As Dmitry Medvedev was saying today, we are striving to move towards an economy that is not governed manually – and that includes state-owned companies that are not governed manually, but follow a system in which the government acts more like a regulatory organ rather than as a hands-on manager. I agree that companies should not move closer to the government. At this point, it is only a matter of time.

A. Levitskaya:

I want to thank all my colleagues. I think we had a very dynamic and interesting discussion. Our work is cut out for us. We all recognize each other, and we will work together. I wish you all the best!