

Forbes, issue 05 (158) 2017, pages 2016-2019

CHARCOAL DRAWING

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Coal industry restructuring is a rare example of a successful structural reform in Russia

Today, very few people remember that there were the miners' strikes, which caused the collapse of the Soviet Union. Of course, the reasons of the demise of socialist system were much deeper; yet, the situation in the coal industry indicated a serious economic crisis in the country, which then became a political one. In the end of 1980's, the closely-knit class of numerous miners became a very serious political power. On July 12, 1989, there was the first strike on the Shevyakov's mine in Mezhdurechensk, which quickly spread all over the country. The miners demonstrated full support for separatist, as it was called at that time, policy of the Russian Federation government and Boris Yeltsin personally. Moreover, all coal companies started coming under the jurisdiction of the Russian Federation and paying taxes to the Russian budget.

28 years later barely anyone in the country other than people directly working in that industry can tell anything about the situation with the miners. The industry completely disappeared from the political stage; it became private and profitable. Restructuring of coal industry became one of the most vivid economic pages in the history of new Russia. No doubt, this experience may be used during further structural changes in our economy.

The systemic crisis in the coal industry started as early as in the 1970's. It was expressed in ageing of the active part of the main funds. At that time, more than a half of mines were more than forty years old. It is an equivalent of oldness for human. It takes about ten years to learn the design capacity, then it is followed by the stage of active operation, then a mine deteriorates and dies. In addition, more than a half of the coal companies worked in difficult mining and geological conditions, on non-standard low-power layers, for which modern world technology is not suitable at all – none of the developed countries in the world develops such coal deposits. In early 1990's, these circumstances were completed with an aggravating macroeconomic situation, in particular – decline of industrial production, hyperinflation, and reduction of coal consumption on the Russian market.

In the late 1980's, I was the head of economics in "Lisichanskugol", Ukraine. I saw a miners' strike over there. Our company produced 3.620 million ton of coal per year; there were 36000 employees in our company, we had eight mines, two coal-enriched plants, mine construction department, mine-penetrating department, department for assembling and disassembling of mining equipment, truck fleet – we had everything. I should mention that this colossal industry only produced only 3.620 million tons of coal per year, because we worked on layers that were 70-80 cm. In fact, it was slave labor at the depth of 800 meters at 36-37°C. Miners worked almost naked. Now this company is closed. In contrast, in our today's company – Belovskaya Mine, one of our soil lots – Karakanskiy-Zapadny open pit – produces 4.200 million tons of coal, and only 630 employees work there. 36000 vs. 630, who produce more than the whole "Lisichanskugol" enterprise. Such growth of labor efficiency would have been impossible without full scale restructuring of coal industry, however, it took some time before the government dared doing it.

In 1991, prices were deregulated for all types of industrial products except coal products. This is a very important thing. Traditionally, coal in our economy has a closing position in the energy resources chain. It means that when there is a shortage of gas, crude oil, fuel oil, petroleum derivatives in economy, then we turns to coal. The government was afraid of releasing prices of coal, because it could result in seventeen-fold growth of prices for the inter-industrial model.

Therefore, they thought that it was dangerous to do it, and if it was dangerous then it was necessary to keep the prices. It resulted in drastic increase of governmental grants as commodities, electric energy were going up in price, everything was rising in price around us, so expenses of governmental grants for coal industry grew up as well. The industry remained a wild island amidst developing market economy. This situation could not last long. In 1992-1993, governmental grants counted to USD 5-6 billion. It was not only counter-productive but also impossible to keep financing the coal industry out of the state budget, because in 1993 a barrel of oil was USD17 and oil prices kept going down.

At that time, I already was the first vice president of Rosugol Group and I was in charge of the financial and economic sector. Finally, from July 1, 1993, coal prices became deregulated, but not at once. When we started looking into the situation in energy-deficient regions of the Far East and Eastern Siberia, we realized that prices had to be increased seventeen-fold; this is how far behind the new economy our industry was. It would have caused a collapse in the energy system, therefore we decided to go step by step, and started by initial increase of prices six-fold in average. In order to prevent a collapse, we developed a mechanism for companies' adaptation to market conditions. Depending on mining and geological conditions, coal quality, level of market prices, mines could count on a flexible system of governmental support. Before that, all of the coal industry companies were supported, but now we decided to find out to what extent price covers the necessary costs and how it created conditions for self-sufficiency. It turned out that only 6.3% of the total number of companies were making profit. The second group consisted of perspective enterprises that needed governmental support for financing of capital investments. That was about 6.6%. Enterprises that needed governmental support for financing of capital investments and implementation of tariff agreement amounted to 26.8%. Tariff agreements are employer's (in this case government's) obligations to the miners. The fourth group and the largest one (60.3%) consisted of the enterprises, which needed governmental support, literally, for all types of activities; those were the "dummy weights" of the industry's economy.

The word "restructuring" appeared together with our advisors from the World Bank and the International Monetary Fund. We quickly adapted it to the Russian language, and although it sounded very substantial, the meaning was simple: the companies that were not ready to live in a competitive economic environment had to be closed. The perspective viable companies, producing highly demanded types of coal (coking or energy ones) but yet experiencing temporary economic difficulties, had to be restored to a healthy state and prepared for participation on the market. At the beginning of the restructuring, more than a half of coal reserves, involved in development, did not correspond to the international conditions of quality, power efficiency, and modes of occurrence. The Soviet model required producing the maximum of possible amount of coal. The economy was very energy demanding, and coal was required anyway at any price. By the time restructuring commenced, we came to understanding that it was not the case. Firstly, it was impossible to state this price; secondly, we did not need such volumes of coal; and, thirdly, only those mines should work, which could survive in the situation of self-sufficiency and self-financing. Only 10-15% of Russian mines were close to Western European standards in their technical and economic level. More than a half of mining and transport equipment simply outlived itself. Level of fatal injuries was high. Every year we used to lose one person per 700 000 tons of produced materials. At the same time, crisis in the industry affected the social situation in miners' towns and settlements. Usually, those towns were single-industry. Delays in salary affected life of doctors, teachers, and municipal sectors as well. The crisis began forming in 31 such single-industry town. Major expenses born by the industry started affecting municipal life.

The World Bank and the International Monetary Fund played critical role in reformation. At first, we saw a sort of a trick in their initiative. We thought that the West wanted to de-energize Russia, shut down coal enterprises and leave the country alone with its problems. Of course, it was a fallacy, yet conservative standards of thinking were mostly dictated by the existing

practice of coal industry management. More coal meant higher development. Motherland has always demanded more coal. What was the vision of the World Bank and the International Monetary Fund? I think first of all they strived to ensure stability of the political system; they realized that miners are the power that could destroy any political regime and had already proved it in 1989-1991. Secondly, they had to balance budget's revenues and expenses. After all, every year they had to pay miners USD 5 billion, near ca.1.4% GDP. Financial resources had to be concentrated for a short period in order to implement the restructuring. There was a shortage of time. In France, for example, it took 25 years to restructure coal industry, which produced only 50 million tons of coal. We absolutely did not have that much time. Miners "ochlocracy" kept pressing the government. They used to receive money from Moscow; so their discontent was also aimed at Moscow. Therefore, the reform had to decentralize this discontent, bring it down to the local level, increase miners' and company management's involvement and responsibility for the product. That is enough to bang hardhats on the humpback bridges; work at home. When they received 80 coins more per ruble of commercial product price, regardless of the performance, local managers were not motivated to show any growth.

Of course, we faced powerful opposition. It was a very convenient model for the general directors, when all money used to come from Moscow. There is an image of enemy, there is "Rosugol" – go there. They often readdress miners' frustration to the Kalinin Prospectus. The World Bank and the International Monetary Fund suggested eliminating "Rosugol", which was done later. There should not be a singular managing center of all coal companies; all companies had to be reincorporated as joint-stock companies and transferred to a private sector. However, first of all, we had to get rid of money-losing sector of coal mining as quick as possible, ensuring at the same time social support of discharged employees. Governmental support had to be focused on investment programs of the industry.

188 mines and 15 coal pits were closed (production dropped down by 100 million tons), therefore, costs of coal production were reduced, the labor efficiency was provided and there was a decline of occupational injuries; all companies were reincorporated as joint-stock companies. At the second stage, in 1998-2004, large-scale privatization of self-financing mines and pits took place. At the final third stage of structural changes, in 2005-2015, a balanced territorial-sectoral social-corporate policy with elements of government control was implemented. The Russian Independent Trade Union of Coalminers provided active professional, political and organizational support during industry restructuring.

What have we received? Fully private, 100 %, market-oriented, financially and socially stable industry competitive at the global market. The industry became safer – fatal injuries rate reduced 9-fold. During restructuring with full social support, up to 730 000 people were discharged from the industry, including 230 000 people directly involved in coal production. Prior to reforms commencement, up to one million people worked in the industry; today, we have 146 000 people. From 1998 through 2016, salaries and wages of the remaining employees grew up 25-fold. From 1994 through 2016, production increased by 42%. Yet, the most important thing is that the upgraded industry was fully focused on coal export, which grew up 8-fold. Russia is the third largest coal exporter in the world after Australia and Indonesia. Labor efficiency increased 5-fold. The industry became profitable, consolidated profitable. Regardless of all crises, coal production has been growing sustainably by 3-4% per year and already achieved peak rates of the late USSR era – 380-390 million tons per year. In 2016, the Kuznetsk Basin produced 227.4 million ton of coal, which is more than the expected production level for 2020, as forecasted by the Long-Term Program of Russian Coal Industry Development for the period up to 2030.

In the years 1999-2016, contributions to budgets of all levels amounted to 15.6 billion US Dollars. By comparison, the government spent 13.2 billion dollars for the complete restructuring of the industry. At the same time, coal companies, which already became privately owned, allocated 24.5 billion dollars investments in the fixed assets, and today we have received new production facilities. Coal companies have invested significant amounts of money into

infrastructure development projects; they participate in railways construction, building of coal port terminals Ust-Luga, Vostochny, Vanino. “Mechel” invested 75 billion rubles in construction of Ulak-Elga branch railway line.

Coal production is the basis for life of 1.5 million residents of single-industry towns. As for the railway, the industry ensures 40% of cargo turnover and 17% of Russian Railways revenues. Coal is irreplaceable for electric energy supply to Siberia and Far East. The industry successfully sails through crises. If in 2015 losses were amounted to 71 billion rubles, then in 2016 income before taxation, by our estimation, will amount to 95 billion rubles. Not to exaggerate, I would say that Russian coal industry restructuring is the economic phenomenon that should be studied in the profile universities. You should not talk about structural reorganization – you should do it. We started restructuring of coal industry, when oil price was not 57 or 55 USD per barrel, but 15.8; the treasury was empty and the society was churning. It was a challenge, and we accepted this challenge. The headquarters worked continuously, we worked day and night under constant pressure of mass media, miners’ strikes, observers from the World Bank and the International Monetary Fund, Russian Government, and law enforcement agencies. And I’m not just ranting. More than 20 years have passed, and the industry has been functioning without subsidies and protectionism. “Practice is the sole criterion of testing truth”, classics teach us. The newest history of Russia now knows its own example of economic success, that has no analogs unparalleled anywhere in the world. We did it, and I am so proud!