Putin, the Oligarchs & the End of Political Liberalization

Marshall I. Goldman*

*Wellesley College, Harvard University
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Summary

President Putin’s reassertion of state control over more and more of the economy combined with his radical reversal of many of the country’s political reforms is ominous. Correcting for some of the political and economic excesses of the original reforms is all to the good, but unless he can do so without sowing the seeds of future recriminations and turmoil, Russia will find it difficult to establish the climate of stable property ownership, encourage long-term investment or spur the diversified economic growth, all of which are essential for political stability and legitimacy.

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*Marshall I. Goldman Davis Center for Russian and Eurasian Studies Harvard University 625 Massachusetts Ave. Cambridge, MA 02139
The news from Vladimir Putin’s Kremlin has always been murky; however, in the last few months it has become more enigmatic than ever. After insisting that he did not want to bankrupt Yukos — until now, Russia’s largest oil company — President Putin did just that. To collect taxes owed by Yukos, his Ministry of State Property auctioned off Yuganskneftegaz, the most valuable part of Yukos, for less than half of its appraised value to Baikal Finance, a company that almost no one had heard of before.

Some wishful investors insist that the Yukos affair and the arrest of its CEO, Mikhail Khodorkovsky, is a one-off affair. Given Mr. Khodorkovsky’s onetime net worth of $15 billion and the way he managed to manipulate votes and defeat attempts in the Duma to raise taxes on oil companies, it is easy to see why President Putin singled out Mr. Khodorkovsky as a special threat to the power and authority of his government.

The government’s attack on Yukos appears to be, however, the forerunner of an effort to redress at least some of the abuses resulting from the 1990s privatization of a number of Russia’s richest assets. In the course of this effort, President Putin has already begun to recentralize the Kremlin’s power over the economy. Several members of President Putin’s staff, particularly former comrades from the KGB or the so-called siloviki, are leading this effort. The siloviki are concerned that much of Russia’s wealth suddenly became the property of the newly rich like Mr. Khodorkovsky; they are reclaiming at least some of it for the state and, in some cases, for themselves. It is more than a coincidence that a growing number of state-owned companies (e.g., Rosneft, which probably will become the ultimate owner of Yuganskneftegaz) now have former KGBniks as their leaders, many of whom retain their day jobs as Kremlin officials. For instance, the newly appointed chairman of Rosneft, Igor Sechin is still a senior official in Putin’s Kremlin administration.

At a September 6 gathering in his suburban home that I attended, President Putin responded to my question about the state’s attack on Yukos by reiterating that he had no intention of forcing Yukos into bankruptcy. He went on to note that Rosneft was too small to take over some of Yukos’ most productive divisions. He emphasized, however, that Yukos like all Russian companies had to pay its taxes. By demanding the immediate payment of up to $10 billion in back taxes and by putting Mr. Khodorkovsky and two of his associates in jail, President Putin insisted that the government authorities were only doing their job. The president also stated that Yukos had more than enough net worth to sell some of its assets and pay its taxes without going bankrupt, implying that Yukos, not the government, was responsible for the position it was in.
To show that he supported an open market and wanted to encourage private enterprise and foreign investment, President Putin confided to us that he had given his blessing to ConocoPhillips in its effort to acquire the state’s shares of stock in privately-held Lukoil. However, this support was restricted in that ConocoPhillips’ equity cannot exceed 20 percent, which means that ConocoPhillips can never assume control. The President also noted that Lukoil had been paying its taxes, unlike Yukos.

Yet, this was only part of the story. Just a week after our meeting, President Putin announced that state-owned Rosneft would be merged into state-controlled Gazprom. With this new financial backing, Rosneft was able to find the financing to buy Yuganskneftegaz from Baikal Finance. Once the sale is completed, President Putin’s government will control at least 25 percent of the country’s energy output through the merger of Rosneft (the new owner of Yuganskneftegaz) and Gazprom — in effect, the former Soviet Ministry of Energy has been recreated.

Except for the green light for ConocoPhillips, there is not much in all this to reassure the business community. Given the flawed nature of the privatization process, the vast majority of Russians support the attack on Yukos and the efforts of the siloviki in the Kremlin to recapture assets from the oligarchs. Demanding the payment of billions of dollars in back taxes is one way to do it. What’s more, based on statements by Igor Shuvalov, one of Putin’s economic advisors, Yukos is just the first of the privately owned companies that will be forced to sell their assets.

Equally disappointing, President Putin and those around him have moved to tighten their political control. While many of his recent moves have been under discussion for some time, the tragedy at the schoolhouse in Beslan has provided a cover for those seeking to increase control at the center. As an example, Vladislav Surkov, one of President Putin’s closest aides in the Kremlin, attacked the emergence in Russia of what he insisted was a new “fifth column of … fake liberals and real Nazis … sponsored by foreigners, all of whom, as he put it, share a common hatred for Putin’s Russia and Russia itself.”

This display of paranoia was intended to justify Putin’s decision to override the constitution and appoint the country’s provincial governors who have heretofore been elected. Putin also decided that, henceforth, Russian voters would no longer be allowed to elect Duma representatives in their districts (in the past, half of the representatives were elected this way). Further, in a major setback for
President Putin’s reassertion of state control over more and more of the economy combined with his radical reversal of many of the country’s political reforms is ominous. Correcting some of the political and economic excesses of the original reforms is all to the good, but unless he can do so without sowing the seeds of future recriminations and turmoil, Russia will find it difficult to establish a climate of stable property ownership, encourage long-term investment, or spur diversified economic growth, all of which are essential for political stability and legitimacy.

Marshall I. Goldman is the Kathryn W. Davis Professor of Russian Economics, Emeritus, at Wellesley College and the Associate Director of the Davis Center for Russian and Eurasian Studies at Harvard University; his most recent book is The Privatization of Russia: Russian Reform Goes Awry.

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