

# Big business in the Russian economy and politics under Putin's rule

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## Theses

1. The pace of ownership transfer in the Russian economy has speeded up considerably over the last year. There has been a significant rise in the number of acquisitions of whole enterprises, and large blocks of shares in individual firms and plants. Similarly the number of mergers, bankruptcies and take-overs of failing firms by their strongest competitors has grown.

The ongoing consolidation of individual industrial-financial groups in Russia, the expansionism inside a specific sector, and the expansion of activities into other sectors all have their own special processes and consequences, both economic and political. One common feature of these processes is a trend towards monopolisation of certain sectors of the economy.

2. As these industrial-financial groups have appeared and transformed themselves, their operational strategy has differed from that of the mid-1990s oligarchic conglomerates. The policy of these groupings and holdings has an ever more expedient character, aimed at unifying firms and enterprises into a specific technological cycle, i.e. a process of vertical integration. These holdings now more rarely demand the tax breaks, privileges and state guarantees which were so popular in the 1990s, and now try more frequently to influence the structural changes in the economy which the government has proposed. At present, their lobbying is focused on conditions for conducting business in Russia – custom, currency and tax legislation, financial and tariff policy, and reform of the natural monopolies.

3. After Boris Yeltsin's departure, the Russian business elite was stripped of its former political status; while the phenomenon of oligarchy has almost passed away at the federal level. Vladimir Putin's slogan of 'an equal distance between the oligarchs and the government', as well as the very definite steps taken against some of them, proved that even the most influential 'sharks' in Russian business, Vladimir Gusinsky and Boris Berezovsky, are not immune from this process. However, many examples indicate that among those oligarchs who are 'equally distant' from the Kremlin, some are "more equal than others". One symbol of the new privilege is Roman Abramovich, the owner of the Sibneft oil company, and a co-owner of the Russian aluminium industry.

4. The most important changes in the relationship between business and the government are taking place at the local level.

A process is taking place whereby the financial groups are 'regionalising' their interests. At present, the business 'sharks' are moving ever closer to those regions where their most important enterprises operate, with the aim of 'distancing' themselves from the Kremlin. In some cases, they have not only been 'hoarding' successive plants and branches of industry, but have also assumed political authority in these regions. As yet, this process of 'absorption' of entire territories by certain oligarchic groups has only covered the periphery of the Russian Federation – Chukotka, Yakutia, the Taimyr and Evenkia.

5. In spite of the great autonomy which private business enjoys, the state has maintained instruments which allow it to control and regulate economic processes. This especially concerns its capability to control the most profitable export sectors. Apart from a few exceptions, the government has generally tried to avoid conflict with big business, and is broadening its dialogue with the most important businessmen.

6. The re-grouping and excessive expansion of the vertically integrated holdings and conglomerates may lead to the creation of monopolies in entire branches of industry, which will be able to limit competition and fix prices. Analysts warn that Korean-type chaebol may appear in Russia, and that these businesses will be able to dictate terms to the state. Any further limitation of market competition may be a fundamental problem, which could lead to greater barriers for firms to develop in new directions, higher prices for consumers, and a lack of stimulus for Russian companies to increase their international competitiveness.

This paper aims at presenting some of the current trends in the Russian economy, and to examine their influence on the relationship between the government and business under Vladimir Putin's presidency. In this work we have focused on political problems, and will not analyse more widely the influence any changes in the structure of business might have on prospects for Russia's economic growth; for this reason, we will not evaluate the current changes from that point of view. Neither will we deal with the functioning of Russian anti-monopoly legislation, nor its implementation by the respective state organs<sup>1</sup>.

Private business is the exclusive object of our analysis. The natural monopolies, which are state-controlled and subordinated to its requirements – those concerning energy (the Unified Energy

Systems of Russia company), gas (Gazprom) and the state railway (MPS) – have been deliberately omitted. The natural monopolies have not yet been reformed, and have been subjected to the changes in the Russian market to a relatively small degree. To illustrate the processes which the economy is undergoing, the four biggest groups in the Russian Federation have been chosen to serve as examples of the different organisational structures which are transforming their industrial divisions: the Grand Coalition mega-holding of Roman Abramovich, Oleg Deripaska, Aleksandr Mamut and Iskander Makhmudov (which deals in crude oil, aluminium industry, mining, iron works, motor & air transport, etc.); the oil concern LUKoil, Vladimir Potanin's holding Interros (non-ferrous metal industry, chemical industry, electro-mechanical, mining, insurance, etc.), and the Alfa Group conglomerate of Mikhail Fridman (oil, chemical and agricultural sectors, commerce, banks, insurance, etc.). These are not the only such groups active on the Russian market, but the scale and range of the capital they command best illustrate the changes taking place in the Russian economy.

## Stages of consolidation in the Russian economy

The great private financial-industrial-media groups were formed in Russia during the period of privatisation between 1992 and 1997. The state financed and facilitated their creation in different ways. Many of these groups established conglomerates consisting of firms, plants and enterprises which were acquired at random and in an accidental fashion from different sectors, banks and so on; at that time, most of them were acquired practically for free<sup>2</sup>. This kind of group particularly developed during the so-called 'deposit bids' period between 1995 and 1996, when private banks took over blocks of state enterprise shares as 'deposits' for making loans to these enterprises. Nevertheless, many of these loans were sponsored by the state<sup>3</sup>. The process of distributing federal property after Boris Yeltsin's re-election<sup>4</sup> did not motivate most of the new owners, who were interested in fast and easy profit, to invest in the development of the enterprises they had so cheaply obtained. Only the financial crash in Russia (August 1998) brought about a change in attitude; this caused some commercial banks to go bankrupt, and some industrial private holdings grew both in importance and, gradually, in

independence, ultimately winning their freedom from the state's financial and political backing.

After the ownership' transfers, the big enterprises in most sectors of Russian industry were generally independent until 2000, with the exception of the fuel and energy sectors; if they entered into any larger groups, it was on the principle of mutual autonomy. 2001 saw the beginning of their active amalgamation into large interregional companies covering many sectors of industry. The companies, holdings and conglomerates created have diverse structures and natures. Some are integrated vertically, others focus on different kinds of enterprise; some are subordinated to a common managerial centre, and others form a loose coalition of holdings which follow a mutually agreed financial policy.

The operational strategies of the emerging and transforming industrial-financial groups differ from that of the oligarchic conglomerates of the mid-1990s, which accumulated assets of different types almost at random. The holdings and groups operate an ever more expedient policy, which is aimed at unifying firms and enterprises into a specific technological cycle, i.e. a process of vertical integration. The process of consolidating the private industrial-financial groups' assets differs from case to case, but expansion is always the ultimate goal – either within the confines of a specific sector of the economy, or with the aim of expanding activity into other sectors. The trend to monopolising individual branches of the economy was common practice for those groups which are consolidating themselves and those which are broadening the scope of their activities. This is an on-going process, and the structure of both the holdings and the individual sectors of the Russian economy may yet undergo many more changes.

## The biggest private companies

### 1. Mega-holdings – the Grand Coalition (Abramovich & Deripaska)

Among the great industrial-financial Russian groups, the Grand Coalition is exceptional in both its scale and the range of its expansion. The Coalition is a group of enterprises, firms, holdings and companies controlled by several capital groups. Within a relatively short time, its heads and co-owners have managed to take control of a considerable part of various important sectors of the Russian economy. This most expansive of the Russian mega-

holdings began to form in spring 2000, when the so-called Sibneft shareholders (Boris Berezovsky and Roman Abramovich) took over the British Trans World Group's shares in the Russian aluminium industry). Then they arranged a merger with Oleg Deripaska's Sibirsky Aluminium holding, as a result of which the Russian Aluminium (RusAl) holding emerged. At present, after the affiliation of Aleksandr Mamut's banking-industrial group MDM and Iskander Makhmudov's copper holding to the Abramovich-Deripaska tandem, the Grand Coalition's expansion has widened into the fields of the copper and iron industry, coal, transport, heavy machines, aircraft, energy, the banking sector and more. The Grand Coalition, which in Russia is exceeded only by Gazprom and LUKoil in terms of the scope of its business interests, consists of dozens of companies, each of which has a clearly defined profile of production, its own management, banks and insurance companies. They are linked by the Coalition empire's common ownership of the individual segments, and by an agreed policy of funding the firms' and plants' most important technological purchases.

The bedrock of the most profitable 'aluminium' part of the group (which exports over 80% of its production to European and American states) is Russian Aluminium (RusAl), which is controlled by Oleg Deripaska. This company manufactures around 75% of the aluminium produced in Russia, and is the world's second biggest aluminium producer after the international corporation Alcoa. Russian Aluminium has absorbed the biggest plants in this sector in the Russian Federation (the aluminium works in Krasnoyarsk, Bratsk, Sayansk and Novokuznetsk), as well as the main plants for fabricating (which is the aluminium industry's basic raw material) in Russia and the CIS states<sup>5</sup>. The holding's foreign activity has stimulated a bauxite deficit in the Russian Federation. RusAl imports some of the raw material from Guinea (where it has bought up considerable shares in the bauxite mines), and from Australia. RusAl is also a shareholder in the biggest hydroelectric power plants in the Russian Federation, in Irkutsk (around 30%) and Bratsk (around 70%), as well as smaller groups of other Siberian power plants stations. As of now (2002), RusAl is completing the formation of the Eurosibenergo energy holding, which will directly or indirectly control 50% of the energy generated in the region of eastern Siberia. Six firms registered on the Virgin Islands are RusAl's formal owners.

The 'petroleum' part of the group is the Siberian Oil Company (Sibneft), which is the seventh largest Russian oil group in terms of extraction (around 18m tonnes a year in 2000). The company is vertically integrated, and comprises extraction enterprises and refineries. The company also owns shares in several petrochemical plants. Sibneft's nominal owners are numerous firms registered in Cyprus, the Virgin Islands, Gibraltar and so on. After absorbing the Eastern Siberian Oil Company in 1997, Sibneft has been fairly passive in increasing its share of the oil sector in comparison with other Russian groups; however, we should consider the recent purchase (December 2001) from LUKoil of a package of 35% of the shares in the Russian Federation's most modern refinery in Moscow<sup>6</sup>. However, this passivity is merely superficial. In accordance with the principle of his former partner Boris Berezovsky, the company's present owner Roman Abramovich will not waste money on buying something he can have for free. For example, thanks to his lobbying skills, Abramovich took control over the export and finances of the state company Slavneft towards the end of 2000<sup>7</sup>, and has been efficiently delaying the government's plan for its privatisation for three years.

The representative of the coalition's 'copper' part is Iskander Makhmudov. His branch consists of two holdings: the Ural Mining-Metallurgy Company (UKGM; iron ore, copper and iron production) and Eurazholding (iron production, coal mining). As in the cases of the Russian Aluminium and Sibneft holdings, the main shareholders are anonymous off-shore firms. The UKGM mines, the iron-ore enrichment plants and smelting works control over 40% of ore mining in the Russian Federation. They are also responsible for around 30% of the copper produced in the Russian Federation.

Eurazholding emerged after taking over the Kuznetsk Metallurgical Combine, as well as shares in the Western Siberian and Nizhnyetagski metal combines<sup>8</sup>, from its competitors. In February 2002 Eurazholding absorbed another 'acquisition', the Nowolipetsk Metallurgical Combine, which has been renamed Russian Steel. The formation of both holdings was accompanied by well-publicised scandals. An insignificant proportion of the plants and firms which it currently includes has been bought up; most of it was acquired either by forced bankruptcy or by force with the use of local courts, the police and special services, and was aided by disinformation campaigns in the press.

The banking part of the coalition, whose backbone is MDM-Bank, is controlled by Aleksandr Mamut, head of the MDM financial-industrial group; during Yeltsin's second term he gained the nickname of the 'family's banker'<sup>9</sup>. After this period, MDM-Bank inherited full financial control of the Russian Federation's state atomic industry, among other interests. MDM's branches – the Techsnabeksport bank<sup>10</sup> and the official state bank of the atomic enterprise Konversbank (both of which are administered by MDM managers) – are the media for all settlement of accounts in this sector. The MDM group also owns shares in many Russian insurance companies, including a controlling share in one of Russia's biggest companies, RESO-Garantiya (RG). The majority of RG's accounts have been transferred to MDM-Bank.

MDM-Bank not only participates actively in the Coalition's joint ventures, by co-funding or making loans to profitable ventures, but has also been creating its own industrial base. In 2000 the group began to stockpile shares in plants producing ball-bearings, using various means (purchasing, bankruptcy, exchange for other shares or introducing its own people into management boards). A year later, it created the European Bearings Corporation holding, which controls over 50% of the Russian ball-bearing market.

Apart from the above-mentioned domains, the Coalition has been actively expanding its activity in other sectors of the economy. Abramovich and Deripaska jointly own a 26% share in the airline Aeroflot. The group's aerial sector will soon increase its shares in the Domodedovskie airline by 50%. The Coalition has already announced that it will participate in the privatisation of this enterprise, which is scheduled for 2002<sup>11</sup>. As for its newest acquisitions, the group is currently co-opting the Ruspromavto motor holding, which was created towards the end of 1999; it produces private and delivery vehicles, buses, road-works and construction machines, engines and car parts at the GAZ Gorkovsk Auto Factory, one of the biggest in Russia. During 2001, the Coalition also began to create an airline holding (Aviaresursholding) its aim being to deal with the production and repair of aircraft equipment, and the production of aircraft fuel, lubrication & air-pressure systems. Furthermore, the Grand Coalition's structure includes also a multi-sector conglomerate, SoyuzMetallResurs, which produces universal containers, railroad cars & platforms, copper and molybdenum concentrates and coal mines), a timber holding, food processing plants (including Omski Bekon) and more.

## 2. Centralised holdings – the Interros group (Vladimir Potanin)

The Interros financial-industrial group is substantially different from the Grand Coalition regarding its centralised administrative structures, and the fact that it has been subordinated to one person – Vladimir Potanin.

Interros' concerns are industrial activity, investment and foreign cooperation in such sectors as energy, mining and processing non-ferrous metal, the chemical and electromechanical industries, insurance, and most recently even agriculture and the food industry. Potanin's group is also a shareholder in several mass-media organisations, including the newspapers *Izvestia*, *Sovietski Sport* and *Komsomolskaya Pravda*, the weekly magazine *Ekspert*, the information agency Prajm TASS and the radio stations Europe-Plus and Novosti On-Line.

The centres of the financial group are Rosbank<sup>12</sup> and the Renaissance MFK international financial corporation. At the moment Rosbank is being strengthened on the Russian market. Interros representatives have even suggested that in the short term the holding's two main banks Rosbank & MFK could merge, which would help to boost the investment group's potential.

The holding's basis in the industrial market sector is Norilsk Nickel Joint Stock Company, which is essentially the monopolist on the Russian nickel and platinum market. Norilsk Nickel is responsible for 50% of world platinoid production and 20% of nickel production; it exports over half of its production of nickel and copper. This nickel-mining and metallurgy combine contains enterprises which cover the whole production cycle, from scientific research institutes through to extracting and processing the ore. Owing to its strategic partnership<sup>13</sup> with Norilsk Gazprom, NN is assured of stable power supplies for its production, and thanks to its own harbours, river and sea fleet<sup>14</sup> it has its own transport network at its disposal.

Norilsk Nickel is also actively involved on the international market. In June 2000, it began creating its own overseas sales network by buying up shares in two non-ferrous metal companies, British Norimet and Almaz of the USA. It has been simultaneously negotiating the purchase of shares in a New Caledonia nickel mine.

Interros is also an active participant in the electromechanical market. In mid-2001, by subordinating the Elektrosila enterprise, which is part of the Power Machines (Silovye Mashiny) consortium, it ended a three-year battle for all-out control of all the enterprises concentrated in this holding. Furthermore, Interros is a shareholder in the Pierskiye Motory company (PM), and also in enterprises of the Perm machine industry which PM administers.

In 2001 Potanin's group expanded its activity into the agricultural sector. In mid-October of the same year Interros registered a new enterprise, the Agros Agro-Industrial Complex. This company will deal both with the cultivation of plants and the breeding of animals as a processor of farm products.

## 3. Vertically integrated groups – LUKoil

The process of vertical integration was begun in Russia by those companies which succeeded in accumulating the most money, namely the oil companies. Since their establishment, the strongest of them have been buying up, absorbing, bankrupting and taking over smaller companies, mining enterprises, refineries, licences and so on. The leader of the Russian 'nieftianka' (the oil sector) is LUKoil, the biggest oil company in Russia in every way – by amount extracted (it is responsible for over 20% of all oil extracted in the Russian Federation), by stocks, amount refined and exported, local and foreign investment. It is the world's sixth largest company by amount of daily extraction<sup>15</sup>. Its most recent acquisitions were the oil companies KomiTEK in 1999, and NORSI-oil in October 2001.

LUKoil is also one of the few genuinely transnational Russian corporations. It participates in international oil groups in the Caspian region, Iraq, Iran and Africa. The group owns refineries, petrochemical plants and sales enterprises in the CIS states, the Baltic republics and the Balkans, as well as filling stations in Russia and abroad, including the USA and Canada. Overseas refinery and petrochemical plants owned by LUKoil, including in Bulgaria and Romania, create over 25% of the oil products produced by the company. In the near future, LUKoil intends to increase this figure to 40% since, as LUKoil chief Vagit Alekperov has stated, the reprocessing of oil and marketing oil products abroad is more profitable for Russian companies than exporting raw materials. In connection with this, the company's plans include the acquisition of new processing plants and the expansion of its filling stations'

network in central and western Europe. The purchase of a share package in the Austrian firm Avanti GmbH (a filling station network in western Europe) is presently under negotiation. LUKoil also declared that it will bid for a 23-percent share in the Greek petroleum company Hellenic Petroleum. The company's operations in Europe are coordinated by LUKoil Europe, a company created in January 2001 and registered in London. LUKoil offices will be located in most oil-producing states.

The first Russian oil concern is the backbone of the financial group, which until recently consisted of fifteen regional and three national banks<sup>16</sup>, and the East-West United Bank (USA, 49%). LUKoil's banking sector ended this process of agglomeration in November 2001. At present, the company's main bank and coordinator of its financial transactions is Petrokommertzbank, which also owns fourteen regional bank branches. During the course of final negotiations, in February 2002 a controlling share was purchased of the Kiev bank Aviatek and its branch in Odessa; this latter could serve the Odessa Refineries belonging to the Russian concern. A separate part of the concern's financial group consists of funds and investment companies (LUKoil-Fond & LUKoil-Reserve-Invest), retirement funds (LUKoil-Garant & Nikoil) and actuarial agencies (LUKoil-Miedved and others).

LUKoil furthermore owns an extensive transport section, founded on two firms: LUKoil-Trans, which coordinates rail transportation of the concern's cargoes and administers the wagon, container and tanker parks it owns; and LUKoil-Flot, which administers the concern's fleet, which presently numbers 54 units of different classes (including several tankers and three ice-breakers)<sup>17</sup>. Shipyards in Saint Petersburg and Germany are currently building a further 10 tankers ordered by LUKoil.

The concern's transport section will soon include a trans-shipping base built near Murmansk by LUKoil. Petroleum will be transported in high-displacement tankers to Rotterdam and the USA from this first private terminal in Russia. In 2001, while testing the equipment so far installed at the base, the company dispatched its first 7 tankers (each with a displacement of around 15,000 tonnes).

#### 4. Conglomerates – Alfa Group

Alfa is one of the biggest private financial-industrial groups in Russia. The firms which formed this consortium emerged in the early 1990s. The Alfa Group, which from its inception has been led by Mikhail Fridman, expanded in the first years of Russian privatisation. Then in 1997 it received a bonus for its financial involvement in Boris Yeltsin's electoral campaign, in the form of shares in the Tyumen Oil Company TNK<sup>18</sup>. Presently the Alfa Group deals with industrial activity not only in petroleum, but also in the chemical and agricultural sectors. It sells its products mainly through its own sales network, both wholesale and retail. The consortium is also a strong presence in the Russian banking and actuarial sectors. The Alfa Group is active in the markets in Russia and the CIS states (principally in Kazakhstan and Ukraine). Since the moment of its creation in 1996, the group's corporate centre has been the CTF holding, which manages the assets of the whole group.

The consortium's financial-investment centre is Alfa-Bank, one of the biggest private banks in Russia<sup>19</sup>, as well as several smaller banks, such as Alfa-Bank Bashkörtöstan (Bashkiria).

Since October 2001, several insurance companies (VESTA, Alfa-Garantii, Ostra-Kiev) have come together under one common name AlfaInsurance (Alfa-Strakhovanie); these companies were either formed earlier or bought up by the group. AlfaInsurance is now one of the five biggest underwriters of voluntary insurance on the Russian market.

The industrial sector is primarily represented in the group by the vertically integrated oil concern TNK<sup>20</sup>. TNK deals with both extracting and processing oil, as well as the sale of crude oil and oil products. 97% of its shares are presently in the hands of two off-shore Cypriot firms, TNK Novy Investment and Novy Petroleum Finance. Both firms represent the interests of the Alfa Group and ZAO Renova, 50% each).

The process by which TNK took over its branches (extraction companies) ended in December 2001. As a result of the conversion of the shares, the participation of minority shareholders in these firms has been considerably limited.

In September 2000 Alfa won a bid for an 85% share in the ONAKO Oil Company, whereas in mid-2001 TNK additionally bought up 44% of the shares of another oil company, SIDANKO, from Interros. TNK also owns shares in Ural Oil Company (51%), and in the Russian-Belarusian oil company Slavneft (12.58%).

Sales of crude oil and oil products for the Alfa Group are dealt with by two firms registered in London, Crown Resources AG<sup>21</sup> and Alfa-Eko. The latter is also an important importer of sugar and tea in Russia.

The consortium also owns cement factories, distilleries, chemical enterprises, the Perekriostok network of Moscow supermarkets, and the United Food Company, which makes food and agricultural products (mainly sugar and cereals), and intends ultimately to form an agricultural-industrial enterprise covering the whole production cycle.

The Alfa Group is also active on the telecommunication market. In April 2001 it took over a 43.8% share in Golden Telecom, which owns a controlling share in the biggest internet providers in Russia, Rossija-online and Cityline, and a 50% share of the phone network operator Sovintel. At the end of May 2001, the group also took over a blocking share in VimpelCom, a cellular network operator.

## Change in the industrial groups' methods of operation

In the USSR, the management of individual enterprises proceeded outside their gates; such matters as the reason for a company's existence, its specialisation, admissible costs, profits and so on, were in general decided at the central level. One result of the creation of the great capital-industrial groups and companies during the Russian privatisation period in the 1990s was the decentralisation of management. The newly emerged groups initially decided the economic strategy of the individual companies which they incorporated; they consolidated their finances and administered them by using 'administrative stocks' thanks to their links with the government. The banks which formed the core of such financial groups then bought up dirt-cheap or absorbed everything, from mines and refineries to bakeries. Their structures were not integrated, and their managers were largely incompetent, looking to make immediate, large profits without any expenditure.

After overcoming the results of the 1998 crisis, those who survived continued to stockpile assets, but towards the end of 1999 their purchases or sale of shares or even whole enterprises began to take on a more purposeful character. The holdings accumulated firms and enterprises which in effect created a defined technological cycle, for example from mining the raw material to the

production and sale of the final product. At the same time, the groups' powers have been increasingly limited to managing their capital (by strategic alliances, searching for foreign investors and so on). The taking of economic decisions and the direction of the production processes now take place at the level of the company.

The holdings are increasingly uninterested in obtaining the same tax breaks, privileges and state guarantees which were so popular in the 1990s; they are increasingly focused on influencing the structural changes to the economy which the government has proposed. Their lobbying is aimed at changing the current conditions under which business in Russia is conducted: this concerns legislation regarding tax, customs, currency, financial and tariff policy, and reforming the natural monopolies.

The ability of the capital groups and integrated companies to bring about such changes is exemplified by the fact that the reform of the energy monopoly RAO-UES, whose holdings are decidedly opposed to it, has been delayed by a year; also, many important changes have been introduced to the text of the already approved plan, which will hinder the radical restructuring of the sector.

So far, the main source of revenue for the Russian industrial empires has been export. If Russian commodities can really be called competitive, then this is principally because their prices are lower than those in the rest of the world. As Boris Grozovsky writes (*Polit.ru*, 25 June 2001), Russian producers do not so much export steel or nitrogen fertiliser as they do cheap electric power and almost free gas. This is why the holdings have reacted so sensitively to the state's tariff policy. The considerable rises in the prices of electricity, gas and rail transport – which are essential elements in reforming the natural monopolies – could seriously shake the foundations of many Russian industrial empires.

## Relations between government and business

The history of the current relationship between business and government in Russia can be conventionally divided into three periods. Before 1996 (Yeltsin's election), the Russian financial elite were assured of the existence and development subsistence by their close links with the central government. The sponsor's role in this system fell to the state structures, which in various ways – including a system of discounts and privileges for selected 'clients' – financed and stimulated the creation of the financial-

-industrial groups. In the next stage (1996–1998), the role played by the already formed private business elites in Boris Yeltsin's electoral victory was reversed; the financial groups ceased to be manageable clients of the state administration, and began dictating their own terms. The so-called 'mixed-interest' groups also appeared at this time, which unified influential representatives of state structures and the 'sharks' of Russian business<sup>22</sup>. The financial crash in Russia (1998) negatively verified both the stability of this relationship and the economic strength of the industrial empires, and especially their financial segments, as many private commercial banks went bankrupt. Between 1998–2000, the powerful Russian capital groups lost some of their political influence<sup>23</sup>; however, many of them have survived and have maintained their links with the government elites.

Vladimir Putin's accession to the presidency in March 2000 saw the start of the next period in government-business relations. The state's notably greater independence is an important change in this relationship, in comparison with the previous periods. Presidential authority has been reinforced; the Kremlin, which felt no pre-electoral obligations to big business, has succeeded in taking the initiative. The oligarchs have been stripped of their former political status, and at the same time the phenomenon of oligarchy has almost completely passed away at the federal level. Vladimir Putin's slogan of 'an equal distance between the oligarchs and the government', as well as the very definite steps taken against some of them, (for example Vladimir Gusinsky and his Most media empire), have demonstrated that not even the most influential potentates have immunity. The Kremlin's anti-oligarchic campaign was in principle directed only against two representatives of this class, namely Gusinsky and Boris Berezovsky, the Yeltsin 'court's *Éminence grise*. However, its result has been to deprive the whole group of its influence on the most important media<sup>24</sup>.

At the same time however, a considerable part of the financial elite has not only maintained its place in the Russian economy, but has gained even greater independence and considerably strengthened its position. It seems that the central government is still searching for a model of relations with business which will be adequate to Russian reality. At present, an important condition (if not the principal one) deciding the prosperity (or failure) of individual private capital groups is the degree of their loyalty to the Kremlin. The concept of loyalty has at any rate a fairly broad definition in the Kremlin; as the recent well-publicised case of the

SIBUR chemical holding has proved, President Putin also considers both the attempt and the fact of transferring state assets to private firms as political disloyalty<sup>25</sup>. However, the government's generally positive attitude to loyal businesses is demonstrated by Putin's declaration that there will be no revision of the results of privatisation<sup>26</sup>.

Despite the great autonomy which private business enjoys, the state has kept certain instruments of control which allow it to regulate economic processes. This especially concerns its ability to control the most profitable export sectors. Apart from the general world-wide mechanisms which regulate local export and economy (tax policy, granting licenses and so on), the Russian Federation also employs specifically Russian ways of regulation (the top-down establishment of rates and export duties, the legal and fiscal mechanisms which ensure the supply of cheap energy on the internal market, and so on). The state's monopoly on establishing energy and transport prices is also an important instrument of control<sup>27</sup>. The government is attempting to take advantage of its position by obliging private or partially private business to sponsor the state's requirements (such as loans in the form of cheap supplies of oil products for agriculture, partially free supplies of electric power and gas for state-run institutions, and so on).

At the same time, the Kremlin has tried (with a few exceptions) to avoid conflicts with big business, and its dialogue with the biggest businessmen is expanding. The government has elevated the Russian Association of Industrialists and Businessmen (RSPP), which represents the private enterprise elite, to the rank of an institutional intermediary in its relations with business. This, together with this body's direct contact with the Kremlin and the government<sup>28</sup>, is one element of the new model of the government's relationship to loyal businesses. Consultations regarding concrete matters of economic policy between the state's representatives and business are even more frequent than under Yeltsin's government. The state's policy towards the big industrial groups is often based on a search for a compromise regarding taxes and access to export<sup>29</sup>; however, the state always has the final word in these matters. The government has not given up its attempts to pressurise those concerns who are inclined to manage their resources more effectively (for example, by withdrawing unused licenses), making their finances more transparent, and transactions linked with transfers of ownership.

Many examples prove that, among those oligarchs who are 'equally distant' from the Kremlin, some are more equal than others.



One symbol of the new privileges (and the lightning rise in fortunes of the Russian businesses linked to them) is the governor general of Chukotka, Roman Abramovich – one of the creators of the Grand Coalition<sup>30</sup>. However, it is as yet difficult to define which criteria the government employs in choosing the ‘leaders’ of this environment.

## The ‘regionalisation’ of the oligarchs’ interests

Recently the most important changes in the relationship between government and business have been taking place at the local level. Analysts have called attention to a relatively new phenomenon in this relationship – the ongoing process of ‘regionalisation’ which these financial groups are undergoing<sup>31</sup>. Most of the oligarchic conglomerates which took shape in the early 1990s treated as colonies those areas where they swallowed up the industrial enterprises. The new owners’ interests were concentrated in Moscow, on which the success of their ventures depended. At present, as part of the process of ‘distancing’ themselves from the Kremlin, the business ‘sharks’ have been moving ever closer to the regions where their most important enterprises operate. In some cases, the groups have not only been heaping up more plants and industrial sectors in these regions, but have also taken over political authority there. As yet, this process has only covered the periphery of the Russian Federation; the Grand Coalition has absorbed Chukotka, the oil company Yukos runs the Evenki autonomous okrug, and Norilsk Nickel runs the Taimyr<sup>32</sup>. The most spectacular acts of dividing up Russia into regional zones of influence – the acceptance of direct gubernatorial rule by big business representatives and local potentates<sup>33</sup> – is merely a part of this process. With the aim of strengthening their position in the regions, the oligarchs have been exerting ever greater influence on the results of gubernatorial elections in the bigger territorial units, and within the personnel of local organs of legislative and executive government. Another visible effect of the common oligarch-gubernatorial staffing policy is the composition of the Federation Council, which has the reputation of being a lobbyist’s club<sup>34</sup>. Almost one-third of the regional representatives in the upper chamber of the Russian parliament are managers of private enterprises; they are delegated to local parliaments or administrations, and only then to the Federation Council. Likewise in the Duma, several inter-party lobbying groups operate, among whom

the most numerous and influential is the ‘Russia’s Energy’ group, which represents the interests of the fuel and energy complex<sup>35</sup>.

## Possible consequences of structural changes to the Russian economy

The growth in the number and significance of the interregional companies in most branches of the so-called ‘real sector’, and the decrease in the number and significance of independent enterprises, is one of the most important processes presently taking place in Russian big business. The aggregation and excessive expansion of vertically integrated holdings and conglomerates may result in the emergence of monopolies which cover whole branches of industry, ultimately eliminating all competition and deciding all prices<sup>36</sup>.

Moscow is attempting to maintain political and economic control over the economy, but at the same time much indicates that it does not want total subordination of local business. Its constant policy, as mentioned above, consists of a system of consultation between the highest organs of state authority and representative organisations of the industrial circles. Increasingly frequently, the Kremlin and government are playing the role of arbiter in conflicts between interest groups.

After dealing with the political autonomy of the media empires of Vladimir Gusinsky and Boris Berezovsky in 2000–2001, the Kremlin has supported the expansionism of capital groups in the regions. Those of the former oligarchs who have been able to accommodate the demands of the new relationship between government and business as proposed by Putin, and who have surrendered all their excessive political ambitions, can count on the government’s support. An example of this is the president’s promise of ‘indulgence’ in the matter of controversial privatisation transactions, and his tolerance of violations of anti-monopoly legislation. The Kremlin has also supported foreign expansion by the ‘sharks’ of Russian business. Representatives of Russia’s financial elites almost always accompany Vladimir Putin on his foreign visits. On such occasions President Putin, as well as prime minister Mikhail Kasyanov, often address their audiences as if they were spokesmen for local private companies.

As a result of the creation of the large interregional companies, the greatest changes in government-business relations can be seen at the local level. For independent enterprises, the authorities of individual Federal areas where the enterprises operate are serious partners, irrespective of whether they own shares in them or not. The amalgamation of companies into groups which are not linked to specific regions alters their relations with the federal authorities. On one hand, this reduces the influence regional directors have on the companies' policies, which by extension deprives the governors of some of their economic authority. On the other hand, the process taking place in the Russian Federation whereby representatives of Russian business take control of the regions important to them, either by direct or indirect participation in creating local organs of authority, subordinates regional political elites ever more to the private corporations. As yet, the Kremlin has not interfered in this process, and in specific cases has limited itself to a mediating role. In the meantime, the large interregional companies associated with the federal government are able to counteract separatist tendencies in the regions. But they can also exacerbate them, as recent events in the Krasnoyarsk area would seem to confirm; this was linked to the financial 'secession' of the Taimyr<sup>37</sup>, which proved that the interests of the economic capital groups are moving political events in the regions. Analysts warn<sup>38</sup> that the ever greater concentration and monopolisation of the Russian economy, together with the 'annexation' of whole regions, may lead to the appearance in Russia of Korean-style chaebol. This could lead to situations in which the state will have to give way to the interests of big business.

*Ewa Paszyc, Iwona Wiśniewska*

<sup>1</sup> The themes discussed in this work were also the subject of research and analyses emphasising the economic aspects of the question. Mention should be made at this point of 'Russian Economy 2000', 'Trends and Outlooks' (issue 22), the Institute for the Economy in Transition, June 2001 ([www.iet.ru](http://www.iet.ru)). It is possible to find a discussion (along with a selected bibliography) of various research works by the World Bank connected with this theme in the article 'Competition and Business Entry in Russia' in *Finance Development*, the quarterly journal of the IMF (Vol. 38, No. 2, June 2001).

<sup>2</sup> For example, the Uralmash plants (34,000 employees) were sold for US\$3.7m; the steelworks in Chelyabinsk (35,000 employees) for US\$3.7m; the Chelyabinsk Tractor Factory (54,300 employees) for US\$2.2m, and so on. The money for these purchases was received by the future owners in the form of interest-free loans in Russian state banks. Data from a report by Vladimir Lisichkin, Duma deputy 1992–96, and member of the committee for analysing the results of privatisation (*Trud*, 15 October 1998).

<sup>3</sup> For example, in April 1995 the Central Bank of Russia lent the MENATEP private bank a sum of US\$500m as an interest-free loan to repay its debts in investment tenders, at the request of the government's commission for monetary loan policy (*Trud*, *ibid.*).

<sup>4</sup> Boris Yeltsin won the presidential election of 1996 thanks to financial and media backing from the owners of the seven biggest private financial groups. Yeltsin's second term was sometimes seen as a pay-off (with the state's assets) of the 'debt of gratitude' which it had thus incurred with big Russian business.

<sup>5</sup> Including the Mykolaiv Alumina Plant in Ukraine, and Azerbaijan Aluminium (Azierbajdzhansky Alumini), which includes an alumina factory, the bid for whose management was won by Russian Aluminium. The Coalition also plans to take control over the Pavlodar Alumina Combine in Kazakhstan.

<sup>6</sup> Along with this package, Sibneft has acquired around 20% of the shares in Mosnefteprodukt, the owner of most filling stations in Moscow and the surrounding region. The Moscow oil company is the main shareholder of the Moskevskie and Mosnefteprodukt refineries.

<sup>7</sup> Roman Abramovich managed to insert 'his' candidate Mikhail Gutseriev as head of Slavneft, while all of this state concern's export transactions pass through Runicom, a company which Abramovich owns. Plans to privatise the state's part of Slavneft (75% of the total) have been deferred since 1999 under different pretexts.

<sup>8</sup> After being bankrupted, these combines were incorporated into Mikhail Zhivilo's Mikom group. In September 2001, the former owner lodged a summons in an American court against Makhmudov, who he accuses of corruption, racketeering and arranging murder.

<sup>9</sup> The 'family' consisted of the persons closest to Boris Yeltsin; this included some oligarchs, owners of the biggest capital-industrial groups, who financially supported Yeltsin's electoral campaign in 1996.

<sup>10</sup> In October 2000, the Tekhnabeksport bank was given the status of a state agent for export and enrichment of nuclear materials. At the same time, the head of the state-owned Konversbank was dismissed, and his place was taken by the board chairman of MDM-Bank Andrei Mielnichenko.

<sup>11</sup> Domodedovskie Airlines, the airline which is the fourth largest national carrier by numbers of passengers transported, and second largest in terms of freight transportation in Russia, also has flights in the CIS area.

<sup>12</sup> Rosbank emerged at the end of 1998, and in November 2000 it absorbed ONEKSIMbank, which previously was a branch of Interros. On 1 September 2001 Rosbank was seventh among Russian banks by ownership capital, and eighth by size of assets. MFK ranked 21st and 42nd respectively.

<sup>13</sup> RAO Norilsk Nickel and OAO Norilsk Gazprom are the two biggest enterprises in the region, and work closely together, including at the Pelatkin condensate gas fields. The resources in this area will provide security in the Norilsk Industrial Region's energy field for thirty to forty years.

<sup>14</sup> In October last year NN strengthened its river fleet by buying a 48.5% share in the Yenisei Maritime Company JSC.

<sup>15</sup> After Exxon Mobil, RD Shell, BP-Amoco, Chevron-Texaco and TotalFinaElf.

<sup>16</sup> NIKoil (100% of shares), Petrokommertzbank (82% of shares), Imperial (controlling share). LUKoil owned between 25 and 51% of the shares in the regional banks (data from the 2000 report at [www.lukoil.ru](http://www.lukoil.ru)).

<sup>17</sup> In May 2001, LUKoil took majority ownership of the Northern Maritime Company (Archangelsk) enterprise, which specialises in freight transportation in the Arctic region. The company's boats are to be used for transporting supplies needed for work on the Timano-Pechora. In addition LUKoil owns a fleet of tankers and controls 51% of the Murmansk Maritime Company.

<sup>18</sup> Alfa-Bank, along with other oligarchic groups, funded Boris Yeltsin's presidential campaign in 1996.

<sup>19</sup> The fourth largest in Russia by capital, and fifth by assets (as of 1 September 2001).

<sup>20</sup> The second largest in Russia by stocks of petroleum, and fourth in terms of extraction.

<sup>21</sup> This international business company emerged in July 2000 on the basis of Crown Trade and Finance Limited, founded in 1996 by the Alfa Group, and is registered in Gibraltar.

<sup>22</sup> One example of such asymbiosis was the 'Family' who, apart from members of the president's administration and members of Boris Yeltsin's family, also included leaders of the biggest Russian financial-industrial conglomerates, including Boris Berezovsky and later Roman Abramovich. Other influential interest groups also had undeniably close ties with high-ranking organs of state government (such as the ONEKSIM group, which at that time was linked with Anatoly Chubais, then head of the president's administration (1996–1997) and first vice-premier (1997).

<sup>23</sup> For example Yevgeny Primakov, after becoming prime minister in September 1998, deprived big business representatives of the entrance cards which entitled them to free access to government sessions. Previously, only those oligarchs who acted exclusively in the financial sphere (such as Aleksandr Smolensky of the SBS-AGRO group and Vladimir Vinogradov of Incombank) lost their privileged places in the symbiotic relationship between government and business.

<sup>24</sup> Vladimir Gusinski was among other things the owner of the popular TV station NTV; Berezovsky controlled the First Programme of Russian television ORT and the TV 6 station.

<sup>25</sup> It was precisely on these charges that the heads of the SIBUR chemical and petrochemical holding were arrested in January this year. The RSPP's representation to the president requesting their release ended in failure. Putin, substantiating the rejection, defined this kind of practice as political disloyalty.

<sup>26</sup> The Communist opposition, as well as other groups, has demanded this revision for a long time.

<sup>27</sup> The state's agent in its relations with oil concerns is presently the Transneft monopoly, which owns oil pipelines and oil terminals throughout the Russian Federation. Plans for reforming all three natural monopolies (Gazprom, the energy monopoly RAO-UES and the Russian rail transport) presage detaching the transport parts from their structures (gas pipelines, power and rail networks) and creating a monopoly under exclusive state control.

<sup>28</sup> Activity of the enterprise council in the government of the Russian Federation; periodic meetings between the president and representatives of the Russian Association of Industrialists and Businessmen, at which the most important current economic problems are discussed.

<sup>29</sup> A typical example of such practices is the constant consultation between the government and the biggest oil concerns on decisions regarding export rates on petroleum, limiting extraction and so on.

<sup>30</sup> After the merger with the Sibirsky Aluminium group and the creation of the Russian Aluminium holding, which concentrated three-quarters of the Russian Federation's aluminium industry, the check carried out at Putin's instigation by the Ministry for Anti-Monopoly Affairs (MAP) and the Chamber of Accounts detected 'no sign of monopoly practices' in this event (*Kommersant*, 8 August 2000). The MAP came to a similar conclusion after Russian Aluminium's purchase of the Gorkovsk Auto Factory (GAZ); the latter was then joined to the Ruspromavto motor holding, which currently controls over 70% of the Russian motor industry (*Vedomosti*, 28 June 2001).

<sup>31</sup> Including Rostislav Turovsky (of the Tsentralnaya politicheskikh tekhnologij foundation). 'Governors and oligarchs. A history of their relations', [www.politcom.ru](http://www.politcom.ru)

<sup>32</sup> Roman Abramovich, owner of Sibneft and co-owner of the Russian Aluminium holding, and governor of Chukotka since December 2000; Boris Zolotaryov, one of the directors of the Yukos oil concern, and governor of the Evenki autonomous okrug since April 2001; Aleksandr Khloponin, vice-chairman of the board and

director general of Norilsk Nickel, and governor of the Taimyr autonomous okrug since January 2001.

<sup>33</sup> Including Vyacheslav Shtirov, chairman of the ALROSA (Almazy Rossii Sakha) company, and president of the Sakha (Yakutia) republic since January 2002.

<sup>34</sup> This description is often encountered in the press (including *Kommersant*, 27 February 2002). The Federation Council includes two individual representatives for each area of the Russian Federation. One is sent by the governor general to the upper house of the Russian parliament, the other to the local Duma.

<sup>35</sup> The 'Russia's Energy' group numbers around 80 persons (out of 450 deputies in the Duma).

<sup>36</sup> For example Russian Aluminium, which today controls around 75% of the Russian aluminium industry; Ruspromavto, with around 70% of the motor industry in the Russian Federation; Norilsk Nickel, with 96% of Russian nickel production (and 20% of world production of this metal), 95% of cobalt production, 55% of copper production and so on.

<sup>37</sup> The conflict between the Taimyr Autonomous Okrug (TOA), where Norilsk Nickel is located, and the Krasnoyarsk Krai (KK) which includes the Taimyr, concerned the division of tax revenues (50% for the KK's budget and 25% for the TOA's budget), which the Taimyr government saw as inappropriate. Last year Norilsk Nickel, which supplies around 70% of the KK's budgetary revenues, delayed payments to Krasnoyarsk, and then started a campaign to transfer the city to the Taimyr Autonomous Okrug. (The TOA's governor is Aleksandr Khloponin, the former director-general of Norilsk Nickel.) After a struggle of several months between Khloponin and the Krai's governor Aleksandr Lebed, both parties reached an agreement in December 2001; Khloponin succeeded in changing the proportions to 60%–40% in the TOA's favour, but the conflict has not died down. In March this year, President Putin visited Krasnoyarsk and Norilsk in order to mediate in this dispute.

<sup>38</sup> Including Igor Bunin, 'Government and business. Stages on the long road ahead' ([www.politcom.ru](http://www.politcom.ru)).

## Appendix

### Big business in the Russian economy and politics under Putin's rule

