

Senior Service College

**A HISTORY OF PRESIDENT
PUTIN'S CAMPAIGN TO
RE-NATIONALIZE INDUSTRY
AND THE IMPLICATIONS FOR
RUSSIAN REFORM AND
FOREIGN POLICY**

BY

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A HISTORY OF PRESIDENT PUTIN'S CAMPAIGN TO RE-NATIONALIZE INDUSTRY AND THE IMPLICATIONS FOR RUSSIAN REFORM AND FOREIGN POLICY

Introduction

A major shift in the tone of Russian foreign policy has occurred over the last several years. Russia under Boris Yeltsin was economically depressed, militarily enfeebled, and dependent on Western assistance, giving the impression of being pliant and often subservient. While Russian foreign policy has been turning from a pro-Western orientation over the entire Putin administration, the seminal event announcing Russia's new stance was President Putin's speech at the 43rd Munich Conference on Security Policy in February 2007. Putin openly attacked the United States and its hegemonic position in a unipolar world, "One state and, of course, first and foremost the United States, has overstepped its national borders in every way. This is visible in the economic, political, cultural and educational policies it imposes on other nations. Well, who likes this? Who is happy about this?"¹ He also stated Russia's objections to the Conventional Forces Europe (CFE) Treaty, the stationing of U.S. missile defense systems in Europe, and its perception of the Organization for Security and Cooperation in Europe (OSCE) as an organization that meddles in its internal affairs. The speech served as a public declaration that the Russian Federation was prepared to undertake a very independent foreign policy as well as telegraphing many of its actions for the year, including the suspension of the CFE treaty, placing obstacles to the OSCE's monitoring of the Russian parliamentary elections in December, and constant objections to US plans for a missile defense system in Czech Republic and Poland. These, along with Russian objections in the UN Security Council to sanctions on Iran and insistence that

a Kosovo settlement must be agreeable to Belgrade, all added up to a year in which the Russian Federation made its voice heard loud and clear in international politics.

One of the primary objectives of the Foreign Policy Conception of the Russian Federation from 2000 (the only formal doctrinal statement of Russia's foreign policy under Putin) is that "Russia will promote a multi-polar system of international relations that will genuinely reflect the diversity of the contemporary world and its great variety of interests." This concept also states the major obstacle to a more constructive and legal international order: "new challenges and threats to the national interests of Russia are emerging in international affairs. There is a growing trend towards the establishment of a unipolar world order, with economic and power domination by the United States."² Although more than seven years have transpired since this document was published, it reflects the *realpolitik* framework that Russia still uses. The dramatic change in tone and the difference in the level of assuredness are also readily apparent. While the document is cloaked in the language of neoliberalism, declaring support for the precedence of law, free markets, and the democratization of international affairs, its implementation under Putin has been based on balance of power politics - gathering partners primarily to counterbalance the global power of the U.S., but also against other perceived threats such as an expanding NATO and European Union. Though claiming a support for a "stable, just, and democratic world order,"³ the actual implementation of foreign policy of the Russian Federation is now almost completely devoid of any ideological basis. Unlike its Soviet predecessor which tended to adhere to doctrine, many of Russia's current partnerships are merely for convenience, lacking almost any

similarity in world view. Venezuela, Iran, and Greece all share in having very good relations with Russia, but virtually nothing in common with one another.

Many analysts attribute this resurgence in Russia's assertiveness on the international stage to a dramatic improvement in the domestic economic situation spurred by increasing hydrocarbon prices. As the world's top producer of natural gas and second for oil,⁴ much of the Russian economy's recent success has been due to a rise in energy prices, contributing to this sense of greater clout in foreign policy matters. Although hydrocarbon exports play a critical role in Russia's foreign policy, they are only part of a larger strategy that uses the leverage of state-controlled industries to increase Russian influence abroad. This paper will examine the linkage between the state's desire to control more of the industrial sectors, and its perceived ability to execute foreign policy. During Putin's presidency, especially since 2003, the Russian government has taken overt steps to re-nationalize numerous industries which have been labeled "strategic." There are many rationales, both declared and tacit, for this reassertion of the state into the economy. One of the key motivations of Russia's political elite is the leverage gained in bargaining foreign policy matters by directly controlling certain industries. The new ideology of the Russian Federation - the "value" that it seems to be promoting abroad nowadays is simply to sell whatever it can to whomever it can and if the deals build relationships or undermines U.S. ones, then all the better.

The Re-nationalizing of Strategic Industries under Vladimir Putin

To frame the discussion, a clear definition of nationalization is in order. For the purpose of this paper, nationalization means the transfer of an economic asset from

private control to state control. Virtually all these assets were under government control until privatization of the mid 1990's. With the exception of entirely new companies, this transfer of control has been a re-nationalization of enterprises that were for only a relatively short period in private hands. (Some Russians even somewhat sardonically label the process "de-privatization."⁵) As will be demonstrated in some of the historical examples, the legitimacy with which the Russian government has re-gained control of certain assets is questionable. While superficially appearing as legal transfers of property rights, the circumstances behind many recent government acquisitions are often little more than expropriations or coerced sales. It also should be clarified that this re-nationalization process does not usually entail transferring full ownership of a corporation's assets to the government. In many of the cases, the Russian government was satisfied with a controlling packet - 50% or more of the shares of a company. Many of these companies continue to have the minority portion of their shares available for trading on various stock markets. Gaining control of the boards of directors and the deciding voice in management decisions through the state's majority ownership is what the administration has desired.

Yukos: The Beginning of a New Era

There is wide consensus that the arrests of Yukos major shareholder, Platon Lebedev for fraud in July 2003 and the oil giant's CEO, Mikhail Khodorkovsky for tax evasion in October 2003 were seminal events in Putin's first term as President, marking the beginning of the process of re-nationalizing strategic industries by the Kremlin.⁶ As will be later demonstrated, the action was predictable and almost certainly premeditated. At the time, Yukos produced about 20% of Russia's oil, slightly eclipsing

Lukoil for largest share.⁷ The first arrest came on the heels of the publication of a June 2003 report entitled “State and Oligarchy” authored by the Moscow think-tank Council of National Strategy, which allegedly had connections and funding from the Kremlin.⁸ The report stated that the oligarchs (in this context the word refers to businessmen who gained control of billion dollar assets during privatization) were a direct threat to the current regime, as they were looking to acquire a dominant position in the state. It also accused the oligarchs of privatization by theft, treason, and impoverishing the nation. The report specifically mentioned a planned merger of the oil company Sibneft with Yukos and the potential political threat Khodorkovsky could represent if he were to have the lobbying power of Sibneft’s major shareholders behind him as well.⁹

Several days after Khodorkovsky’s arrest, Yukos was charged with tax evasion in the amount of \$5.3 billion; eventually the total tax bill levied against the company by the Federal Tax Service was over \$42 billion.¹⁰ According to the statements made by the company’s management, the tax bills assessed by the government for 2001 and 2002 were actually more than the entire annual revenue of the company.¹¹ Although Yukos was evidently involved in practices to avoid paying taxes, which were common to the entire Russian oil industry, such as loopholes allowing the reinvestment of profits and reporting oil as “liquids containing oil” to lower the value of the product,¹² the government specifically targeted Yukos. The stakes were to be set higher than the company would be able to pay. Even though there were far more egregious offenders for underpaying taxes in the oil and gas industries, such as Sibneft and even Gazprom,¹³ the state had chosen to eliminate Yukos. There were numerous reasons for this; chief

among them was to make a statement that the Kremlin was not going to bow to the power of any of the oligarchs, while at the same time use the opportunity to remove a man viewed as a serious potential political rival. Yukos also provided the Kremlin with an inroad to a policy which it has been pursuing ever since - the consolidation of oil and gas assets under state control. Partitioning the assets of Yukos allowed Putin to maintain some balance and harmony between different fractions within the Kremlin. Lastly, the seizure blocked any potential acquisition of its assets by foreign shareholders,¹⁴ which was another key element of the Kremlin's re-nationalization plan - the squeezing of foreign investors from strategic industries.

The first sale of seized Yukos assets removed any doubt to the government's true intent. On 19 December 2004, a previously little-known corporation, Baikalfinansgrup purchased Yukos' largest subsidiary - Yugansneftegaz at auction for \$9.4 billion. Three peculiarities to the auction were that only Baikalfinansgrup and Gazpromneft (the former oil subsidiary of Gazprom) were allowed to attend, Gazpromneft never actually made a bid, and after about five minutes the shares were sold for \$9.4 billion – slightly more than half of Drensdner Bank's estimate of the value of the assets - \$15-17 billion.¹⁵ Two days later, Putin himself defended the sale stating it "was held in strict compliance with Russian law" and "first and foremost, an internal Russian problem."¹⁶ The next day, Rosneft, the state-owned oil company, announced that it had bought 100% interest in Baikalfinansgrup. Even worse than the now obvious fact that the sale had been arranged to transfer privately-held assets of Yukos to the state company Rosneft at far less than asset value, was the fact that Putin's long-time associate from the St. Petersburg mayor's office, Igor Sechin, had been named

Chairman of the Board of Rosneft in July 2004. Sechin was already serving as the Deputy Chief of Staff of the Presidential Executive Office at the time of the appointment to Rosneft. Sechin's pedigree as a linguist and army officer with service in Angola causes many Russians to speculate that he, like Putin, is former KGB. At the same time with Sechin's appointment to Chairman of the Board of Rosneft, Putin placed his Deputy Chief of Staff, Vladislav Surkov as Chairman of the Board of Transneftprodukt, a subsidiary of Transneft, the state-owned monopoly in charge of Russia's 50,000 kilometers of oil pipelines. Surkov, a former GRU (military intelligence) officer, like Sechin, is clearly a member of the *siloviki* - a Russian term for the top power brokers of Putin's entourage whose backgrounds consist of service in the "power" ministries – primarily the former KGB (now FSB) and military. These appointments seemed to counter-balance the position of the more moderate and non-silovik pedigreed Dmitri Medvedev. At the time of these two appointments, Medvedev, then Putin's Chief of Staff, was already Chairman of the Board of Gazprom, a position he received in 2000 after heading Putin's presidential campaign headquarters.¹⁷ In retrospect, these appointments can be seen as the necessary distribution of spoils to the various clans and fractions that make up the Presidential entourage.

By the end of 2004, it was fully apparent that the government's strategy was to move in on the gas and oil sectors and replace private ownership and corporate leadership with those loyal to the Kremlin. The Yukos seizure was the watershed event on the path to the current state of affairs in Russian industry. It not only marked the start of a very aggressive campaign of re-nationalizing assets, but it also taught the Putin administration some valuable lessons which further emboldened them. They

learned they were virtually unassailable. The government's actions were met with strong disapproval in the Russian media, and Resolution 1418 of the Council of Europe even gave the following assessment: "the Assembly considers that the circumstances of the arrest and prosecution of leading Yukos executives suggest that the interest of the state's action in these cases goes beyond the mere pursuit of criminal justice, and includes elements such as the weakening of an outspoken political opponent, the intimidation of other wealthy individuals and the regaining of control of strategic economic assets."¹⁸ Despite the fact that the Yukos matter was handled with total disregard to the rule of law, including numerous violations of the defendants' rights, there were no serious repercussions from abroad. The realization that foreign actors were basically powerless to respond to the internal decisions of the Russian government, no matter how capricious, was internalized and later evidenced in the means in which other private interests were taken back under government ownership. The toothless reactions by various foreign actors to the Russian government's cavalier attitude vis-à-vis the rule of law in these domestic issues have emboldened its foreign policy stance, as well. Having seen minimal repercussions to such egregious violations of law and contracts, the Putin administration now speaks with a sense of greater confidence, boldness, and often impunity to other world powers.

Continuing Consolidation of the Oil and Natural Gas Sectors

Yukos represented only the beginning of a major push to regain assets in the oil and gas sectors. Much of the Russian oil industry was privatized in 1997, and there were subsequent rounds of sales of oil shares, with the climax being the creation of the TNK-BP consortium of Russian companies and a subsidiary of British Petroleum in

2003. On the eve of the Yukos takeover, the Russian oil industry had four major players: Lukoil, Yukos, TNK-BP, and Surgutneftegaz.¹⁹ By the close of 2004, the state-owned Rosneft had replaced Yukos on this list of oil majors. In September 2004, just before the dramatic turn of events that elevated Rosneft to its lofty status, Putin and Medvedev suggested that Gazprom and Rosneft merge to create a state oil and gas mega-corporation. Gazprom also considered purchasing the Yugansneftegaz assets. The logic for the merger was impeccable; the state owned only 38% of the shares of Gazprom and a merger with Rosneft, simultaneous with a Gazprom-led purchase of the Yukos assets, would put the government's share in the combined company at over 50%.²⁰ On 17 December 2004, two days before the notorious auction, a Houston court, on behalf of foreign shareholders of Yukos, placed an injunction on the sale of Yukos assets until the company had time to establish a reorganization plan. This in turn caused foreign banks to pull back a proposed loan that Gazprom would have used to purchase the Yugansneftegaz assets.²¹ By May 2005, the government had officially called off the proposed merger.²² From Putin's perspective, the failure of the merger may have been a mixed blessing as the eventual Rosneft configuration created a more even distribution of the spoils - Igor Sechin and other siloviki saw their Rosneft grow enormously in value and influence. But the state still had the problem of how to regain a controlling share of Gazprom.

Gazprom

Gazprom is the world's largest natural gas company and it is no exaggeration to say it is the single most important company in the Russian economy, considering that it accounts for 6% of Russia's Gross National Product and produces 25% of the country's

tax revenue.²³ It controls over 60% of Russia's natural gas reserves and is the sole owner of the Unified Gas System (UGS), a 155,000 km long network of pipelines and gas compressor stations.²⁴ Gazprom supplies a quarter of Europe's natural gas needs, and with so many Eastern and Central European countries entirely dependent on Gazprom for their imported natural gas,²⁵ the company represents the most vital asset in the portfolio of state-controlled industries; it is single-handedly capable of leveraging foreign policy initiatives. In 2005, the state owned 38% of the Gazprom's shares and appointed the Chairman of the Board, but majority private ownership was unacceptable from the state's viewpoint of decision-making for its most important corporation.

Some very creative business acumen was then put forth by Russia's Economic Development Ministry: create a holding company called Rosneftgaz for the specific purpose of purchasing Gazprom shares. The holding company was given a 100% share of Rosneft and then raised capital through foreign banks to purchase the required shares in Gazprom. \$7 billion was spent acquiring the required 10.7% of Gazprom shares. The state had what it wanted, a slightly greater than 50% stake in the company, albeit through its ownership of Rosneft.²⁶ From the perspective of balancing the different power factions in the Kremlin, this arrangement was again especially useful – Medvedev's Gazprom was now majority government owned, but slightly over one-fifth of that government share was held in Sechin's Rosneft.

The state was now totally unimpeded in making the decisions for Gazprom. Six of the eleven members of the board of directors were now government appointees, including the corporate president in charge of day to day operations, Alexei Miller, who was also one of Putin's entourage. Free to go on a rampage to consolidate whatever

assets it chose under its flagship corporation, the state's first major acquisition was in September 2005. Gazprom paid \$13 billion to the tycoon Roman Abramovich for Sibneft (Siberian Oil), which had been the subject of a proposed merger with Yukos two years earlier. Gazprom had now entered the oil producing and refining business, with an 80% share in Russia's fifth largest oil company. Later, the company was renamed Gazprom Neft (which translates as Gas Industry Oil). Gazprom then proceeded to purchase some of the smaller independent gas producers and a 19.9% share of Novatek, one of Russia's two largest independent producers of gas.

To solidify Gazprom's position in the export markets, in July 2006, Putin signed legislation passed by the Federation Council and State Duma concerning the right to sell Russian natural gas abroad. The law stated the "exclusive right to the export of natural gas belongs to that organization which owns the unified system of gas supply or its subsidiary company..."²⁷ The passage of this law gave Gazprom not only a physical monopoly of the export of gas because of its ownership of the UGS, but also a legal sanctioning of that monopoly. From the view of domestic politics, it was another example of how the legislative branch simply rubber stamps Putin's desires.²⁸ From the perspective of foreign policy, the law represented an important step – the government now not only controlled Gazprom, but had made it illegal for any Russian independent gas companies to sell abroad. This meant that any of Gazprom's foreign customers would be dealing with an arm of the state for natural gas purchases. At this point, even though Gazprom had more natural gas reserves in its corporate portfolio than any country in total (excluding Russia itself), it was not done with acquisitions. In late 2006

and early 2007, the state and its agent Gazprom set their sights on foreign-controlled Russian gas assets.

Sakhalin 2

Nowhere is the deliberate and calculated effort of the Russian government to regain control over its natural gas assets and increase Gazprom's influence in the gas markets more evident than in the Sakhalin 2 negotiations that transpired in the latter half of 2006. The Sakhalin 2 Energy Project was originally established as a Production Sharing Agreement (PSA) between the Russian government and the Anglo-Dutch consortium Royal Dutch Shell and Japanese minority partners Mitsui and Mitsubishi Corporations. The purpose was to develop the immense oil and gas reserves in the deep ocean waters off the coast of Sakhalin Island just north of Japan. In the 1990's, the Russian hydrocarbon industries were extremely reliant on foreign investment and technology due to both sustained economic recession and a general inexperience in exploration in more difficult conditions, such as deep oceans. Therefore, Russia gave favorable conditions to these three investors.

Sakhalin liquefied natural gas (LNG) shipments, originally slated to begin in late 2007 or 2008, are crucial to Japan, which uses 100% LNG for its natural gas. The terms of the original PSA had the Russian government receiving profits only after the Shell-Japanese venture recouped its investment. As the cost of the venture had doubled by 2006, the Russian government was apparently going to have to wait until considerable revenues were generated from the project, before they would receive any monies. This may have been the biggest point of contention for the Russian government; since the PSA was written so much in favor of the consortium, the

government would receive no compensation until capital costs were met, regardless of cost overruns.²⁹ This provided the incentive to act and the environment provided the means. In the fall of 2006, the Russian Ministry of the Environment, Prirodnadzor, stepped in and leveled numerous environmental charges against the Sakhalin Energy Investment Corporation (SEIC), bringing the project to a near halt. It should be added that while some of the environmental concerns were legitimate, it is highly questionable if such charges would have been raised against a Russian-owned firm.³⁰

In December 2006, Gazprom, with the help of considerable pressure from these governmental environmental regulators, was able to obtain a 50% plus one share ownership of SEIC for \$7.45 billion, significantly below the market value of the controlling portion of the company which was estimated at 11 billion dollars.³¹ Under the terms of the agreement, Shell, Mitsui, and Mitsubishi all relented to proportionately dilute their ownership in return for the cash payment, thereby relinquishing controlling share of SEIC to Gazprom. When specifically asked if the Russian government made the environmental allegations to gain control of the project, the Japanese Minister of Trade, Economy, and Industry, Akira Amari, said "I feel that way but I cannot assert it in my position as trade minister."³² Putin's comment on the signing of the deal was a clear attempt to deflect any criticism that the Kremlin had orchestrated the whole takeover: "Gazprom decided today to take part in the joint Sakhalin-2 project. This is a corporate decision. The Russian government was informed about it and we have no objections to it, we welcome it." He added that "the Russian government and investors are interested in the implementation of this project.... Once again, I want to stress that we will do everything to carry this project through."³³ It is clear that Putin was audacious to spin

the situation as if it were a business decision in which the Russian government played no part, considering Dmitri Medvedev's dual-hat role as Deputy Prime Minister and Gazprom's Chairman of the Board, and the charges being leveled by a Russian ministry. In a fashion very reminiscent of the Yukos dismantling, the Sakhalin 2 takeover was undoubtedly planned and orchestrated by the highest levels of the Putin administration with his full consent.

A Favorable Court Ruling

Prior to its next acquisition, Gazprom received some help from the Russian judicial system. In 2005, Gazprom purchased Nortgaz, an independent producer which had been previously part of Gazprom's structure under previous management. The Russian Federal Anti-Monopoly Service ruled the purchase to be illegal. The ruling stated that "the Joint Stock Company Gazprom is not allowed to expand its share of (Russian) gas production through the acquisition of a controlling share in other gas producers."³⁴ Despite this ruling, Gazprom made three deals in 2006 that violated the essence of the Anti-Monopoly Service's decision by agreeing to purchase 51% of Sibneftgaz from Itera, attempting to gain a controlling share of the Yuzhnotambayskii Deposit, and acquiring the Sakhalin 2 project. In January 2007, an arbitration court in Moscow overturned this ruling, stating that the 2005 acquisition of Nortgaz did not "establish or increase the domineering position of the gas monopolist in the area of gas production."³⁵ While there may be future rulings on the legality of other Gazprom acquisitions, analysts believe that a legal precedent has been established by the arbitration court and that the Gazprom will likely be presented few obstacles to purchasing the remaining major gas independents – Novatek and Itera.³⁶ There can be

little doubt that the arbitrage court's decision fulfilled the wishes of the administration and very likely was directed by it. The decision's wording even recognizes the fact that Gazprom already is a monopoly, and then uses a very twisted logic to say that because the asset (Nortgaz) had once belonged to Gazprom, it did not increase its monopolist position. Such decisions make a mockery of the Russian justice system and like the Yukos case, show how much the executive controls the judiciary.

Kovykta

In an almost identical fashion to Sakhalin 2, Gazprom utilized the power of another state ministry to takeover the Kovykta gas field in June 2007. This field in Eastern Siberia was owned by Rusia Petroleum, a subsidiary of TKN-BP, Russia's third largest oil company behind Rosneft and Lukoil. TKN-BP is a consortium of British Petroleum in conjunction with Interros, a large Russian holding company and the Irkutsk Regional Government.³⁷ In this instance, the challenging agent of the government was Rosnedra, the Russian Federal Agency for Subsoil Use. The original PSA for the development of the Kovykta fields called for 9 billion cubic meters of natural gas per year to be supplied to the Irkutsk Region by 2006.³⁸ The agreement was written a decade before, when gas demands for the region were envisioned to be much higher. For several reasons, directly attributable to deliberate actions of the Russian government, the project was producing far less than the amount stipulated in the licensing agreement granted to Rusia Petroleum. Demand was low because much of the region did not have distribution to households, part of the Russian "gasification" project. While the Kovykta project could have produced much more gas for foreign export, Gazprom blocked any such sales.³⁹ Therefore the gas had to be sold

domestically, leaving the consortium with the unlikely option of selling the gas on local markets at rates far below market prices or literally burning it off in order to meet the quota.

In March 2007, as a clear sign that the highest levels of the Russian government were pulling all the strings again, the head of Rosnedra, Anatoly Ledovskikh, stated that the original terms of the agreement could not be amended with the current owners, but at the same time he implied that the government would amend the terms with a new owner and not be in violation of the law.⁴⁰ In the same interview, he dodged the question of why new terms simply could not be arranged with the current owners. Instead, Rosnedra gave Rusia Petroleum until May 2007 to be in compliance with the volume of production terms. The recent Sakhalin 2 takeover made it apparent to the Kovykta owners that they were going to be muscled out by the very government and its policies that prohibited them from profitably selling the gas. The large size of the field's reserves, estimated at 1.9 trillion cubic meters, and its location make it the most critical asset for future deliveries to a prospective Chinese market.⁴¹ On 22 June 2007, TNK-BP ceded control of the project to Gazprom for an estimated payment of \$700-900 million in return for a 62.89% share of Rusia Petroleum.⁴² As with Yukos and Sakhalin 2, the Russian government had orchestrated the required moves to re-obtain these highly desired resources.

Sakhalin 1 and Future State Maneuvers?

Gazprom's acquisition of foreign-controlled assets may not be over yet. The Sakhalin 1 oil and gas project, which plans to deliver LNG to China, and possibly Japan and India, is majority-owned by a foreign consortium led by Exxon-Mobil. Although the

Russian government granted Gazprom the sole right to export Russian natural gas, the PSA, under which the Sakhalin 1 consortium works, grants an exception to this export monopoly. If and when the Kovykta project is linked to China via pipeline, Gazprom will be competing against Sakhalin 1 in the Chinese gas markets. As an energy analyst recently stated, "There is no way that Gazprom is going to sit idly by and watch Exxon export Russian gas to China and compete with Gazprom's own plans to export its gas to China."⁴³ For numerous reasons, Gazprom would like to gain a controlling share of Sakhalin 1. As noted, combined with the Kovykta field, it would give it ownership of Russia's main sources for supplying China's natural gas needs - Kovykta via a proposed pipeline and Sakhalin 1 (in addition to Sakhalin 2) by LNG. Of far lesser importance from a revenue standpoint given the subsidized rates for gas domestically, but important for meeting overall consumer demand, Sakhalin 1 would give Gazprom extra production for the Khabarovsk region, whose main power generating station was connected to Sakhalin via a pipeline in October 2006.⁴⁴ Given these factors, the state may look to gain a greater share of the project. The two minority Russian owners in the project are Sakhalinmorneftegas-Shelf at 11.5 % and RN-Astra at 8.5%, which are both owned by Rosneft.⁴⁵ Therefore, the state already has a 20% stake; it would not be coincidental if some moves were made to force the other owners into parting with 30% of the remaining stake.

Defense Industry

In 2000, a Presidential Decree merged Promexport (Industrial Export) and Rosvooruzhenie (Russian Armaments) forming Rosoboronexport (Russian Defense Exports - ROE). This act was one of the very first indications that the state was

reasserting control of strategic industries. ROE was given the sole right to export and import defense materials and technologies for the Russian Federation.⁴⁶ At the same time Putin appointed Sergei Chemezov, who had served with him in East Germany from 1983 to 1988, as the Chairman of the Board of ROE.⁴⁷ Chemezov had been appointed Chairman of Promexport in September 1999, one month after Putin's naming as Acting Prime Minister. This makes Chemezov one of the "founding fathers" of what has grown into a Putin entourage of thousands of FSB/KGB officers at the heights of the Russian administration. Generally military equipment is technologically sensitive and sales are very secretive. In the Soviet Union, the military industrial complex formed a disproportionately large portion of the GDP. For these reasons, this decree was not likely to be seen as a signal that the economy of the Russian Federation would be reverting back to its previous command style, but rather as the state simply re-asserting control over an area that was vital to the economy and often tightly controlled even in the most open Western nations. In the seven years since that decree, however, ROE (and now its new incarnation as the mega-corporation Rostekhnologii) has evolved into a behemoth that defies any economic logic. In 2002 the Russian government and ROE established the holding company Oboronprom (Defense Industries) as its charter states, "to oversee government defense assets and acquire stakes in private defense firms."⁴⁸ Oboronprom's Director General is Andrei Reus, Deputy Minister of Industry and Energy of the Russian Federation. Since having been given this mandate, Reus and Oboronprom have gone on to consolidate the numerous helicopter plants of the Russian Federation into one large company – Russian Helicopters. It has also taken

control of Defense Systems, which produces the Pechora 2M low altitude anti-aircraft missile system.

ROE, through Oboronprom and on its own, has been on a buying binge, purchasing assets throughout Russia, without regard to their fit within a corporation entrusted with the state's military export business. The most bizarre acquisition by ROE was its takeover of AvtoVAZ in 2005. AvtoVaz is an automobile manufacturer, which was originally a partnership between Fiat and the Soviet Union to produce low-end cars, most famously – the Lada. Recent partnerships have included General Motors and in December 2007, Rosoboronexport sold a 25% stake in it to Renault. The method in which the state took control of AvtoVaz bordered on surreal, if not for it occurring in Russia. The Kremlin was apparently concerned that the car manufacturer was failing and a team at ROE was given the task of saving the company from bankruptcy. An anti-crisis team was formed and sent to the AvtoVaz headquarters accompanied by 300 policemen. The official explanation for the escort was to deal with the criminal elements that were rampant in the plant.⁴⁹ Despite the obvious fact that the state was moving in on another company, ROE officials denied that an acquisition was occurring, even after Vneshtorgbank (Foreign Trade Bank) had purchased 51% of the firm's outstanding shares on behalf of ROE for about \$700 million.⁵⁰ Several days later, at a vote for the board members of the corporation, the Deputy General Director of ROE, Vladimir Artyakov, was elected Chairman, along with three members of the state-run Vneshtorgbank and a member of the Federal Industry Agency. Again, when a ROE spokesperson was asked whether the state was attempting to nationalize the car manufacturer, the reply was, "The state is just delegating more efficient managers for

the plant."⁵¹ The style of the takeover was reminiscent of other state acquisitions: officials denied state involvement even though it was orchestrated at the highest levels, an arm of law enforcement was used for leverage, and the selling price was well below asset value. (In the case of AvtoVaz, \$700 million purchased a controlling stake in a company that at the time had a value of \$2.27 billion.⁵²)

Since entering the car business, Rosoboronexport has expanded into metals production, a sector of the economy which has been profitable and almost certainly needed no assistance from the state. Most notable was the acquisition in 2006 of 66% of VSMPO-Avisma, the world's largest manufacturer of titanium and aluminum alloys.⁵³ VSMPO-Avisma is one of the chief suppliers to the global aerospace industry – its output supplies one-third of Boeing's and half of Airbus's requirements for titanium.⁵⁴ The state's method of takeover was simple; it informed the three major shareholders that it was buying them out. The two who conceded quickly were able to retain a small portion of their shares. Chairman of the Board, Vyacheslav Bresht, resisted the takeover and in the words of the Russian press, "was explained with sufficient toughness, that he should not do that."⁵⁵ He ceased being a shareholder, and the state paid less than market value for his shares. Such a tactic is fairly commonplace for the Russian government; since the owners are not jailed and receive at least partial remuneration for their assets, these methods receive little to no interest in the Western press. In addition to VSMPO-Avisma, ROE has been in the process of creating Russian Special Steel Holding using similar tactics to acquire various steel plants and is also forming a new subsidiary - Russian Composites from about ten smaller companies.⁵⁶

The rationale for these types of takeovers, according to the Chairman of Rosoboronexport, Sergei Chemezov was that, “Sooner or later, VSMPO-Avisma would have ended up dependent on foreign investors. And together with it, the entire Russia aerospace sector. If the state had not intervened, then Russian companies, and not Boeing or Airbus, would have been queuing up for Russian titanium.”⁵⁷ The first part of his statement is simply nonsense,⁵⁸ in essence saying that a Russian firm with large profits from exports creates a foreign dependency relationship. The second part of his obfuscation at least hints at part of the true rationale – since Russian firms for civilian aircraft are so non-competitive in global markets, they likely will not be able to pay market prices for titanium, especially as demand is expected to increase dramatically. In the final analysis, the real reason for the state acquisition is simply to increase its portfolio of profitable industries thereby adding to the power and personal wealth of its managers. As a side-effect, the government will be able to continue to subsidize its underperforming aircraft manufacturers.

Chemezov has managed to greatly increase ROE’s power over the past year with legislation which copies Gazprom’s monopoly of the right to export natural gas. A March 2007 Presidential Decree granted Rosoboronexport a total monopoly of the Russian arms export trade. The decree of November 2000 had left four companies, including MiG Aircraft, with an exception to negotiate on their own.⁵⁹ In November 2007, President Putin signed into law an act authorizing the creation of a state corporation named Rostekhnologii (Russian Technologies) and appointed Chemezov its head, thus further solidifying ROE’s power. The major asset of this new corporation is Rosoboronexport. Russian Technologies will own 100% of Rosoboronexport and all

ROE affiliates. ROE will continue to work as arms trader, but Russian Technologies will have management functions and own all licenses.⁶⁰ Chemezov described the new Rostekhnologii as the state's means to revitalize the country's heavy industries, "The bitter experience of the '90s demonstrated that our industry, without state control and mainly managed by private business, doesn't guarantee proper development. In many ways technologies are stalled at the levels of the 1970's."⁶¹ In what again is unadulterated obfuscation, Chemezov asserts that the creation of this new super-bureaucracy is in the name of efficiency and innovation. The real reason for this new level of bureaucracy is that the law authorizing Rostekhnologii creates an entity which will answer directly to the President, entirely by-passing any form of oversight by the rest of the government.⁶²

Air Defense

From the point of view of foreign policy and arms deals, the Russian Air Defense (PVO) Industry is one of the most important. Russia has sold various air defense systems throughout Asia, the Middle East, Africa, and South America, the most important of which is the S300 series anti-aircraft missile, which has been in huge demand for decades and has seen numerous upgrades. Its manufacturer became part of the Almaz- Antey Company by order of an April 2002 presidential decree.⁶³ The decree established a unified air defense corporation from 46 separate companies and scientific research agencies; its mission consists of the development and production of all of Russia's air defense and non-strategic missile defense systems.⁶⁴ Almaz-Antey is not a subsidiary of the Rosoboronexport-Rostekhnologii conglomeration; it currently stands alone as an independent, albeit state-controlled company. The large size of its

contracts, (aircraft and air defense equipment are Russia's top seller in the arms business)⁶⁵ somewhat justifies this status. Its independence also creates another spoil for one of Putin's most favored associates; Almaz-Antey has Viktor Petrovich Ivanov, Deputy Head of the Presidential Staff for Personnel and a former Major General of the FSB / KGB, as its Chairman of the Board.

Aircraft and Shipbuilding

In February 2006, President Putin issued a decree creating a mega-aircraft construction company – United Aircraft Building Corporation (OAK).⁶⁶ The core of the company was realized by the merger of Irkut with the already state-owned firms Sukhoi and MiG. It also included the assimilation of Tupolev, Ilyushin, and privately-owned Yakovlev. Sergei Ivanov, then Minister of Defense and now Deputy Prime Minister, was appointed Chairman of the Board. The decree stipulated that the corporation will be at least 75% government owned, with some of the shares available for trade on Russian and foreign exchanges.⁶⁷ Since the dissolution of the Soviet Union, the Russian aviation industry for both civilian and military products went through a serious contraction, due in large part to lack of competitiveness with foreign firms. The crisis in the civilian aircraft industry was particularly severe. The consolidation of these various companies into United Aircraft was as much an attempt to save the floundering industry as it was re-nationalization; most the companies were already majority state-owned.⁶⁸ Unlike other acquisitions where the government was taking over a thriving business, with or without the owners' consent, United Aircraft is an attempt to subsidize and save the industry.⁶⁹ As will be seen in the case studies, this conglomerate provides Russian foreign policy practitioners with a valuable tool; when offering deals for aircraft, they

speak for all the manufacturers of the different models. At the same time, it undermines competition within the country. There were numerous different aircraft design bureaus during the time of the Soviet Union; in Russia there will be only one. The consolidated effort may produce designs of more competitive aircraft that are able to compete with the likes of Boeing and EADS, but the elimination of domestic competition in conjunction with government subsidy does not bode well for either efficiency of innovation. As the largest percentage of revenue from foreign military sales comes from OAK's fighter aircraft⁷⁰, the government will be keen to see it succeed. The level of its importance explains Putin's selection of supervision by Sergei Ivanov, arguably one of the top two or three power brokers in all of Russia.

One month after establishing United Aircraft Building Corporation, Putin issued a decree forming the United Shipbuilding Corporation (OSK). It consolidated primarily government-owned ship building industries into three major regional centers. However, data is extremely scarce, and there may have been instances of private companies being bought out or offered shares in the larger corporation. The Russian shipbuilding industry in general is not competitive on global markets, particularly in the civilian sector for larger vessels.⁷¹ Accordingly, OSK is going to seek niche markets, such as nuclear powered ice-breakers, offshore platforms for oil and gas exploration, special vessels to develop the continental shelf, and other specialized equipment.⁷² OSK will also continue to focus on military ships – such as nuclear and diesel powered submarines and frigates. Russia is expected to produce an additional 40 frigates and at least three nuclear submarines for its own Navy in the next three years. It has orders for ships from India, China, Algeria, and is negotiating the purchase of five diesel submarines

with Venezuela.⁷³ Much remains to be seen if OSK can turn around the Russian shipbuilding industry, but its production for internal and limited foreign orders clearly will not be sufficient for survival. Competitiveness in civilian markets will be critical if it is to not be a subsidized burden of the state.

The Nuclear Industry

Consolidation of assets within the nuclear industry has also been underway since 2003. Most of the various companies associated with both civilian and military nuclear industry were never privatized, including three main holding companies:

Rosenergoatom - nuclear power plants, TVEL - nuclear fuel production, and Tekhsnabexport - specialized equipment for export, including uranium mining and enrichment. There were two notable exceptions within the industry that fell into the hands of majority private ownership - Atomstroieexport, the main contractor for building nuclear power plants abroad, such as Iran's Bushehr complex and ZID (the V.A. Degtyarev Plant), which produced primarily military items, including machine guns, hand-held anti-tank rockets, anti-aircraft missiles, and rifles, as well as centrifuges for uranium isotope separation.⁷⁴

A case far less known than the government's dismantling of Yukos, is the re-acquisition of Atomstroieexport which had been purchased by the OMZ (Objedinennye Mashinostroitelnye Zavody - Uralmash-Izhora Group) owner Kakha Bendukidze in April 2003. While many of the facts remain obscure, the government apparently was concerned that the control of shipments of nuclear power plant materials had fallen into civilian hands.⁷⁵ In June 2004, Bendukidze had returned to his native Georgia to become the Minister of Economics after the Rose Revolution. In November 2004,

Bendukidze, sold his controlling share of Atomstroieexport to Gazprombank for \$25 million, after the state had assessed it with a \$35 million back tax bill.⁷⁶ Since no arrests were associated with the case, it received far less publicity. At face value it looked like another case of the Russian government simply using the appropriate levers of power to retrieve lost property. Less coerced, but far more convoluted was the recovery of the assets of ZID through a series of stock swaps in 2005 and 2006. The end result was that the production lines dedicated to nuclear-use components were sold to KMZ (the Kovrov Mechanical Factory), which is controlled by the previously-mentioned state-owned Tekhsnabexport. The remaining assets of ZID, both military and civilian product lines, became part of Rosoboronexport, the state-controlled company for the export and import of defense related goods.⁷⁷

After having restored the physical ownership of the nuclear industry in 2007, the administration focused on consolidating the industry legislatively. The culminating event was reached in December 2007, with President Putin signing a law establishing Rosatom as the state nuclear energy corporation subsuming all civilian and military nuclear enterprises and research facilities. At the same time, he appointed Sergei Kiriyenko, the Director of the Russian Federal Atomic Energy Agency (also called Rosatom) as the head of the new state mega-corporation.⁷⁸ This process mirrored the consolidation in the defense sector that had been judicially sanctioned just several weeks earlier by the passing of the law establishing Rostekhnologii.

Banking Sector

A major facilitator of the state's acquisition of these assets has been Vneshtorgbank (now VTB Bank). Vneshtorgbank (Foreign Trade Bank) was originally

established in 1990 as a joint stock company with government ownership and management; its purpose was to efficiently handle foreign trade transactions for Russian companies and institutions. At its inception, the bank was 99.9% owned by the Russian government and it remains 77.5% state-owned,⁷⁹ So while the bank itself has not been an object of re-nationalization, its purchases and investments for the government have been critical. VTB is now a full service bank, handling a full range of transactions, but its status as state property not encumbered by transparency or accountability to shareholders has been undoubtedly useful to keep the numerous forced buy-outs from public attention. VTB Bank is not the only bank that acts on behalf of the Russian government; conveniently Gazprom owns the third largest bank in Russia, Gazprombank, which is also involved heavily in government purchases. As previously noted, Gazprombank was the intermediary for the purchase of Atomstroieexport in 2005, and it has handled many of Gazprom's numerous asset purchases throughout Europe and even further abroad.

Under Putin, the Presidential administration has established and refined an entire system for acquiring the property it desires. This network includes banking establishments to conduct and hide the transactions, law enforcement agencies to "assist" with those unwilling to be assimilated, ministries to exert the proper influence on foreign investors, a legislature which rubber stamps every Presidential proposal, and a judiciary which will overturn sound rulings and even violate citizen's rights. Prior to examining how these assets are used in forwarding Russian foreign policy objectives, it is useful to explore the rationales that evidently Putin and his entourage use to justify these actions.

Rationales and Motives

Government Control of Strategic Assets

The motives behind Putin's re-nationalization of these strategic industries are most likely a combination of many desired results and interrelated calculations. Putin and many of the siloviki genuinely believe that these resources are too important for the needs of the state to be put in the hands of private businessmen who do not have the interests of the nation in mind. As a product of the Soviet educational system, their perception of economics undoubtedly still favors a centralized planning approach. Putin and a large percentage of the other power brokers in the Kremlin were the products of the KGB from the late 70's and early 80's, during the leadership of Andropov. Andropov's reforms, which were never fully implemented because of his death after only 15 months, were evidently going "to combine the strengths of the military-industrial complex and the KGB by carrying out an authoritarian modernization plan that would result in a modern corporate state."⁸⁰

This upbringing and a disgust for the way Russia was privatized in the 1990's, in which oligarchs gained control of formerly state-owned property through improperly run auctions and loans for shares schemes, create a sense of justification in the minds of the Kremlin elite for their actions. It should be emphasized that another holdover of the communist mindset is that gains through government service are considered honorable and legitimate, whereas private business was held in disdain for 70 years. This phenomenon in part explains Putin's popularity among the Russian people. Even in its highly controlled media environment, the Russian people know that elites are making themselves wealthy through government service. It is accepted and even praised by

many since it is in the course of service to the state and the people.⁸¹ Perhaps the most important reason for its acceptance is that Russia itself is deeply corrupt at all levels of society, so the leadership's actions are just a more severe form of a common practice.⁸²

Putin professed his views on the subject of nationalizing strategic national resources in a 1999 article "Mineral Natural Resources in the Strategy for Development of the Russian Economy" by highlighting the need for the state to maintain high regulatory control of the resource extraction industries. In what amounts to a blueprint for his campaign to re-nationalize industry, Putin stated that a key role for the state to play, particularly within the natural resource industries, is the "creation of large financial-industrial groups – corporations with an interbranch profile that will be able to compete with Western transnational corporations."⁸³ In this article, which was published before his assumption of the Presidency, he also makes it clear that he views the government's support for industries involved in the extraction of strategic natural resources as the means to "make Russia a great economic power with a high standard of living for the majority of the population."⁸⁴ Additionally, he justifies a turn away from privatization by stating that, "the experience of countries with a developed market economy gives us many examples of effective state intervention in the long-term project to exploit natural resources."⁸⁵

Putin gave a more sinister preview of his philosophy on the role of government in controlling strategic aspects of the economy in an article entitled "Russia at the Turn of the Millennium" which he published December 30th, 1999, the day before he assumed the role of acting President, replacing the ailing Boris Yeltsin. He stated, "Today's situation necessitates deeper state involvement in the social and economic processes.

The state must be where and as needed; freedom must be where and as required.”⁸⁶ In almost unprecedented historical fashion, Putin published his manifestoes on the state control of strategic industry and resources, and then actually rose to power to implement them.

Power and Wealth

It would be incorrect to characterize Putin’s strategy as it is put forth in his academic writings as totally altruistic – in the name of the state and its people. If the benefit of the people were truly the only motivation, then the current level of shadiness of political and business associations would not be tolerated. A who’s who of senior management in many of Russia’s most important companies makes it clear that politics and business are one and the same. Whereas in the Soviet days, power was the allure of higher level service in the Communist Party, in the new system created during the Putin administration, both power and money are the attraction. Part and parcel of the process of taking strategic industries back under government control has been the appointment of Kremlin elites and their family members to top positions within these companies. Table 1 (page 31) lists the most important power brokers in the Kremlin, other than Putin himself, and their positions within Russian business.

Among analysts there is some debate as to whether or not the Kremlin’s power brokers are simply in positions of power within these newly re-nationalized corporations or have also handsomely profited from their government duties. The argument runs that power, not wealth, is their aim:

Table 1. Business Connections of Russia's Political Elite⁸⁷

Name	Government Post(s)	Corporate Position(s)
Igor Ivanovich Sechin	Deputy Chief of Staff, Presidential Administration	Chairman of the Board of Directors, Rosneft (oil)
Sergei Borisovich Ivanov	First Deputy Prime Minister of Russia; (Minister of Defense until February '07)	Chairman of the Board of Directors of the United Aircraft Corporation. Son, Sergei, is vice-president of Gazprombank.
Dmitry Anatolyevich Medvedev	First Deputy Prime Minister of Russia, Presidential Candidate	Chairman of the Board of Directors of Gazprom (natural gas)
Viktor Petrovich Ivanov	Deputy Head of the Presidential Staff for Personnel; former Major General of the FSB / KGB)	Chairman of the Board of Advisers of Almaz-Antey (anti-aircraft) and Aeroflot.
Sergei Yevgenyevich Naryshkin	Minister, Chief of Staff of the Government of Russia; Deputy Prime Minister of Russia for External Economic Activity	Chairman of the Board of state Channel One Television; Deputy Chairman of the Board of Rosneft; member of the Board of Directors of Sovkomflot (ship building)
Nikolai Platonovich Petrushev	Chairman of the Federal Security Service (FSB – formerly known as KGB)	None. Son, Andrei, is an adviser to Rosneft and Igor Sechin. Son, Dmitri, is a vice president at Vneshtorgbank
Sergei Viktorovich Chemezov	Member of the State Military-Industrial Commission	Director General of Rosotekhnologii; Board of Directors of Sukhoi (fighter aircraft) and Almaz-Antey (anti-aircraft) Corporations
Yury Valentinovich Kovalchuk	None. Alleged to manage Putin's personal assets. Brother, Mikhail, is Scientific Secretary of the Council for Science and High Technologies attached to the President	Chairman of the Board of Directors, Bank Rossiya
Viktor Vasilyevich Cherkesov	Director of the Federal Antinarcotics Service	None. Wife, Natalya, is Director General of Rosbalt Information Agency
Vladimir Ivanovich Yakunin	Former Deputy Transport Minister and First Deputy Railways Minister	President, Russian Railways
Viktor Borisovich Khristenko	Minister for Industry and Energy	Member, Board of Directors, Gazprom
German Oskarovich Gref	Minister of Economic Development and Trade until September '07	Member, Board of Directors, Gazprom
Alexey Borisovich Miller	Former Deputy Minister of Energy	Chairman of Gazprom's Management Committee
Denis Manturov	Deputy Minister of Industry and Energy of Russia	CEO, Oboronprom (subsidiary of Rosoboronexport)
Sergei Vladilenovich Kiriyenko	Director, Russian Federal Atomic Energy Agency	Chairman of the Board, Rosatom
Igor Khanukovich Yusufov	Special Envoy of the RF President for International Energy Cooperation and Ambassador at Large of the RF Ministry of Foreign Affairs	Member, Board of Directors, Gazprom
Andrei Reus	Deputy Minister of Industry and Energy of Russia	Member, Board of Directors, Rosneft; Director General, Oboronprom
Alexei Gromov	Presidential Press Secretary	Chairman of the Board, Russian TV Channel One
Vladislav Yurevich Surkov	Deputy Chief of Staff for the President of the Russian Federation	From 2004-2006, Chairman of the Board, Transnefteprodukt

But the property of the oligarchs was never the end goal of the siloviki effort. They are seeking total, state control of the national economy. A distinguishing characteristic of the siloviki -- unlike the old oligarchs -- is that, with very few exceptions, there are no billionaires among them. They are content to control property rather than own it, and prefer to exercise that control from the boardrooms of state megacorporations that dominate major sectors of the economy and that are tied together in an informal network. They envision a corporate state.⁸⁸

Such a view is likely based on a lack of incontrovertible evidence to prove that the government directors are stealing from these companies. Few of these government corporations publish financial reports that are close to Western standards. Those that trade on Western exchanges, such as Gazprom, at least have a degree more transparency than others. Gazprom's corporate statements emphasize the fact that board members who are also Russian government employees have extremely limited holdings in the company or no shares at all.⁸⁹ If one were to take this at face value, it would mean that these government appointed overseers are not getting rich with stock options or other corporate perks. The problem with such an assumption is that it looks at only one method of remuneration – *declared* stock ownership. Given the opacity of book-keeping, numerous subsidiary companies, and off-shore accounts associated with most of these companies, it would be impossible to establish a true money trail.

These top elite have absolutely no system of checks placed on them. The legislative branch is completely subservient, composed almost exclusively of United Russia or "loyal opposition" members and the judiciary also answers the beck and call of the Kremlin. The only other governmental agencies which could possibly stop the political elite from skimming the corporate coffers are those entrusted with law

enforcement. Given that the biographies of the top siloviki indicate FSB-type service,⁹⁰ it is clear that all law enforcement agencies answer to the Kremlin as well. Many of the government's acquisitions cited previously, such as Yukos, Sakhalin 2, and Kovykta, demonstrate the total subservience of law enforcement and interior ministries to the Kremlin's wishes. With all these circumstances, it is fanciful to think that the elite are not making themselves rich from their government service. With unchecked power, backgrounds from the security services (which itself is a strong indication of their scruples), and Russia's embedded culture of corruption, it is almost incomprehensible that these elites would be simply interested in only power and not the incredible wealth possible.

There is some unsubstantiated evidence that Putin's entourage has profited handsomely from their corporate postings. Oleg Shvartsman, who heads the Russian investment company, Finansgroup, gave an interview to *Kommersant* in November 2007 at a meeting in Palo Alto, California. When describing the ownership of the assets of Finans-trust, which controls some \$3.2 billion in assets, he said, "we are closely affiliated with some political figures, and we manage their assets. We have a relationship with both the presidential administration and to its power bloc."⁹¹ When further commenting on the openness of the identity of the real owners he said, "There are various off-shores, in Cyprus and other countries. These are not the presidential administration members; these are their relatives, high-placed people."⁹² He went on to describe how his corporation assisted the government, on behalf of the FSB, in taking over corporations through a variety of methods such as lowering the market value of the company and then forcing a buy out. He mentioned that he was currently using such a

method to acquire a chrome manufacturer in Orenburg on behalf of Rosoboronexport.⁹³ Upon returning to Russia, Shvartsman stated that much of the interview had been incorrectly transcribed, but never recanted any specifics.⁹⁴ This defense was very likely an act of self-preservation after so carelessly speaking about the wealth of the president's staff.⁹⁵ There also have been other allegations that Putin himself has been the recipient of billions of dollars worth of stock in Gazprom, Surgutneftegaz, and Gunvor Oil.⁹⁶ These are less reliable than the Shvartsman interview (primarily because of the impossibility to track the ownership of shares), but nonetheless they indicate that it would be naïve to think that Russia's elite politicians are working for their government salaries alone. As the late journalist Anna Politkovskaya noted, Russia has become "a bureaucratic economy whose principal oligarch is the government official."⁹⁷

Additional Rationales

In addition to the belief that strategic industries should be controlled by the government and they are a means for amassing personal wealth, the campaign of re-nationalization likely had political expediency as an original impetus as well – removal of the Yeltsin "family" from power. Transferring power from the oligarchs and away from Yeltsin-era appointees, such as the former Prime Minister Mikhail Kasianov, allowed Putin and his followers to consolidate their power base and remove any vestiges of the old, more liberal regime.⁹⁸ The Russian press has also cited several additional reasons for the government's desire to re-nationalize certain industries. These include the government's role as an anti-crisis manager in industries that are failing and a mutual desire on behalf of the asset owner and the government for nationalization.⁹⁹ These two rationales, although seriously presented, reflect either the Soviet upbringing of its

authors or the blatant attempt to justify the government's actions. State intervention in failing industries only continues to foster inefficiency; most of these companies must reform or be allowed to go bankrupt. There might be some logic to intervention in certain sectors if market conditions were not functioning properly, but this has not been the case of the intervention since 2003; it has not been targeted at saving key failing industries, but rather a wholesale grabbing of properties, including some of the most profitable. The mutual desire theory is based on the almost unfathomable notion that a profitable private company would want to be taken over by the government. While some Russian experts attribute such an explanation for the Sibneft and Industrial-Construction Bank takeovers,¹⁰⁰ the true reasons are that the business is actually not viable (in which case the government is only perpetuating inefficiency) or that its owners simply fear running afoul of the government. The example of the imprisonment of Yukos CEO Mikhail Khodorchovsky provides a good history lesson that it is better to sell at less-than market value on the government's terms than risk losing it all.

Among these reasons for re-nationalizing industry, legitimate and otherwise, greater control of foreign policy is a key subcomponent of the idea that these industries are critical for national security. By directly controlling industries in Russia's key export sectors, Putin and his entourage are able to negotiate directly with other governments speaking directly for industry. This comes into play in many ways, which will be discussed. These include being able to arrange reciprocal business arrangements directly on behalf of Russian corporations including arms deals in return for benefits to other Russian businesses, political leverage on the representatives of foreign consumers (the most apparent case is with Gazprom in the eastern half of Europe), and

the formation of a loose partnership of states to balance the influence of the West, in particular the United States.

Case Studies: Leveraging State-Controlled Industries in Russian Foreign Policy

Europe's Dependence on Russian Natural Gas

Nowhere does the Russian government's control of an industry affect foreign policy more than in the relationship of Gazprom and Europe. Most of Europe's natural gas comes from only three external producers – Russia, Norway, and Algeria. At 37.7% of the EU 27's total gas imports in 2005, Russia is by far the biggest gas supplier to the continent.¹⁰¹ Generally, the further east one goes in Europe, the greater the reliance on Russian gas imports, to the extent that seven European nations of the former Warsaw Pact and Soviet Union rely on Russia for over 99% of their natural gas. Almost all Central and Eastern European countries depend on Russia for the majority of their natural gas consumption.¹⁰² In the table below, the extreme level of dependence on Russian gas (of which Gazprom is the sole provider due to the previously-mentioned export law) can be seen. Of the countries listed only France, Greece, Italy, and Turkey have Liquefied Natural Gas (LNG) terminals which allow them to receive gas other than by pipeline.¹⁰³ The top eight countries have no external source of natural gas than via pipeline from Russia. Ukraine's 35% of domestic consumption coming from Russia is misleading. In fact, Ukraine annually imports about three quarters of all the country's gas requirements from Gazprom, but a large portion of it is Turkmen gas that transits to Ukraine on the Gazprom-owned Unified Gas System.¹⁰⁴

Table 2. Russian Natural Gas Imports as a Percentage of Domestic Consumption¹⁰⁵

Country	Quantity - billion m ³ /y	% of Domestic Consumption
Estonia	1.3	100
Latvia	1.4	100
Lithuania	2.8	100
Moldova	2.8	100
Belarus	19.8	99
Bulgaria	2.8	99
Slovakia	6.4	99
Finland	4.6	98
Greece	2.2	82
Czech Republic	7.2	77
Serbia	1.9	75
Austria	6.0	69
Turkey	14.3	65
Hungary	9.0	64
Slovenia	0.56	52
Poland	6.0	43
Germany	36.5	42
Ukraine	24.0	35
Italy	24.2	31
France	11.5	28
Romania	3.9	22

Gazprom already commands a monopoly position in Eastern Europe and the government has not been content to own upstream (production), and mid-stream (major delivery pipelines). It has been investing heavily in downstream (national gas delivery) infrastructure. Gazprom now owns a minority share in delivery companies in 17 European countries gas.¹⁰⁶ From a market perspective, this dominance creates a very unhealthy situation, in which Gazprom is not only a price-setter rather than taker in European gas markets, but also is in a position to write highly favorable long-term gas contracts.¹⁰⁷ While the Russian government is the primary recipient of the profits from Gazprom, given its 50% share and corporate taxes, even more alarming than revenue aspect of the Gazprom-Europe relationship is the incredible political leverage the company provides the Kremlin.

The dependence relationship for such a vital source of the energy mix is so drastic for some European countries that Russia is able to garner huge concessions when implementing foreign policy. At the same time Russia extorts political concessions and higher prices from foreign consumers with its nationalized gas monopoly, it can continue to provide gas to loyal partners, such as Armenia and to a lesser extent Belarus and Ukraine, at greatly reduced state-dictated rates. Only through state control could such a situation exist; these three nations continue to receive natural gas at rates far below what all of Russia's other customers pay.¹⁰⁸ The natural outcome of this relationship is that they are beholden to Russia, as they all fear what would happen to their gas-dependent economies if forced to pay market prices.

Ukraine provides a vivid example of the coercive power the Russian government wields with Gazprom. Far more subtle than the more famous case of blatantly shutting off the gas tap to Ukraine on New Year's Day in 2006, are the negotiations that Russia's Prime Minister conducted with his Ukrainian counterpart in October 2006. According to the Russian business daily *Kommersant's* sources in the Russian and Ukrainian governments, in return for a promise to keep the price of gas below \$130 per 1,000 m³, Prime Minister Yanukovich agreed to four major concessions: (1.) postponing any referendum on NATO membership, (2.) agreeing to the terms of leaving the Russian Black Sea fleet in Sevastopol until 2017 and perhaps even extending the lease, (3.) continuing to use RosUkrEnergo (a subsidiary company of Gazprom and two Ukrainian businessmen that makes hundreds of millions of dollars per year function as the middle-man between Russia and Ukraine for gas delivery) as transit partner for another five years, and (4.) agreeing to receive Turkmen gas through Russia only.¹⁰⁹ While Ukraine

is an extreme case, due to its level of dependency,¹¹⁰ it shows the coercive power that comes with dependence on Russian natural gas, especially when the state owns the company and decides on its policies. Ukrainian officials evidently fear what losing the subsidized gas would do to their economy and are therefore willing to make a variety of concessions that hand over a great deal of their sovereignty to Russia, to the extent that even decisions on collective security and stationing of foreign troops become secondary. Given the levers of power that Gazprom provides, paradoxically, the Kremlin may never wish to see Ukraine, Belarus, and Armenia paying market prices as their serf-like status would be diminished.

Recent negotiations with the Republic of Serbia, which depends on Russia for 75% of its natural gas (and over 90% of imports with no access to other sources such as Norwegian or Algerian gas), are another stark demonstration of the leverage that Gazprom provides Russia in foreign policy matters. Gazprom is in talks with the Serbian government to purchase a controlling stake in Naftna Industrija Srbije (NIS), which has a monopoly on the distribution of oil and gas in Serbia. Gazprom is offering to route at least one leg of its planned South Stream Gas Pipeline through Serbia, rather than Romania, which would be a source of transit revenues and quite a coup.¹¹¹ While the price for NIS is still being discussed, Russia is able to use Gazprom as its agent of entry to the market, via its virtual monopoly status, and its UN Security Council vote to almost certainly seal the deal. Serbia has been a long term ally of Russia and benefits from Russia's veto power over any measure to declare Kosovo an independent country. In such a manner, Russia is able to expand its political and economic sphere of influence; if NIS is eventually sold, it will almost certainly go to Gazprom at a price

lower than what other EU competitors would have been willing to pay. With the asset, Gazprom will hold a controlling stake in both oil and gas distribution in Serbia, which only stand to further its political influence.

Gazprom - Influence, Control, and Corruption

One of the most sinister implications of the return of so many assets to the direct control of the Russian government and the power brokers of the Kremlin is the spread of corruption abroad. Academic Celeste Wallander has made the argument that the Putin administration has created a domestic situation which is inconsistent with globalization. The economic system, with elites earning rents from their government positions, is one that requires “self-isolation to prevent the loss of control, to resist transparency, and to prevent any kind of competition,”¹¹² This creates a dilemma for Russian elite as the still developing economy requires foreign investment and participation in global trading, which would require openness and accountability. To circumvent this, she argues that Russia seeks to create “transnational elite networks for access to rent-creating opportunities in the globalized international economy.”¹¹³ Russia therefore seeks to find foreign elites with whom it can continue to expand its economic power, while at the same time not sacrifice the opaque nature of these state-controlled businesses. This manifests itself in the export of corruption.

Former German Chancellor Gerhard Schroeder’s assumption of Board Chairman for Gazprom’s Northern European Gas Pipeline project in December 2005 is one of the best-known cases of questionable ethics in recent Russian deals with international partners. In September of that year, Schroeder, on behalf of the German government, signed an agreement with Putin, to build the pipeline. Ten days later, his party and he

lost an election, but it took little time for Schroeder to become the figurehead for a project he had just brokered as a politician. His starting annual salary for this adviser's position was € 250,000.¹¹⁴ The line between his actions being simply a conflict of interest or corrupt behavior is extremely fine and the controversy has yet to entirely disappear, primarily because of the politically charged and divisive nature of the Baltic pipeline project. The pipeline would allow Russia to ship natural gas directly to Germany, by-passing Estonia, Latvia, Lithuania, and Poland, giving it diversification from the main routes through Ukraine and Belarus, through which almost all of Russian gas transits to the market-rate paying customers of the European Union. For Germany, the pipeline would provide direct access to Russian energy without the concerns of possible interruptions resulting from spats between Russia and transit countries. When considering the economics of the pipeline, which may cost up to three times as much as a land-based alternative,¹¹⁵ it may not be in the best interests of Gazprom's bottom line, but that is not the key concern. The pipeline serves a key Russian foreign policy goal - to divide the EU and NATO upon fault lines of old and new, thereby increasing its own relative influence, in this case gaining at the expense of its former partners in the Warsaw Pact. Since Gazprom answers to its state appointed board members rather than the corporate bottom line, such deals are possible.

While this case is fairly notorious for the coverage it received in the West, there are other examples of similar behavior in intergovernmental deals between Gazprom and the CIS. RosUkrEnergo is a prime example of the creative ways in which money can be moved from corporate to personal accounts, thereby gaining political loyalties, in this case with the leadership in Ukraine. RosUkrEnergo was established in 2004 as a

Swiss-registered company to act as intermediary between Gazprom and the Ukrainian state oil and gas company Naftogaz to broker the sale of Turkmen gas to Ukraine. RosUkrEnergo is 50% owned by Gazprom and 50% owned by two mysterious Ukrainian businessmen Dmitry Firtash and Ivan Fursin,¹¹⁶ whose identities were begrudgingly given to investigators by the Austrian Raiffeisenbank which holds the proceeds from their 50% stake. As Gazprom has sole ownership of the Russian gas pipelines and exclusive right to export gas, the logical question to pose is why was a Swiss-registered corporation earning profits of hundreds of millions per year needed? Clearly all the accounting for the movement of Turkmen gas through Russia could be done on the Gazprom ledgers and the sales made directly to Naftogaz. Gazprom already was the middleman and yet a subsidiary was established to introduce other middlemen.

The Ukrainian President, Viktor Yushchenko, denied knowing who the owners of the company were that supplies all his country's imported gas.¹¹⁷ President Putin, however, pointedly blamed his Ukrainian counterpart for the company.

Well, you ask Viktor Yushchenko. Gazprom has a fifty-percent stake and the Ukrainian side has a fifty-percent stake. I said to Viktor Yushchenko, "we would welcome it if your 50 percent is held directly by Naftogaz Ukraina". But this was not our decision. This was the Ukrainian side's decision. Who the names are behind the 50-percent stake held by Raiffeisenbank, I don't know anymore than you do, and Gazprom does not know either, believe me. That is the Ukrainian half of the company and you would have to ask them. I said to Viktor Yushchenko, "Give Naftogaz Ukraina direct participation. If you don't want to, let's set up another company". But they did not want to. It was they who proposed that Rosukrenergo supply gas to Ukraine instead of Gazprom. We agreed. The main thing for us was the price formula.¹¹⁸

This statement is strange for two reasons. First, it shows that the Russian and Ukrainian Presidents themselves directly negotiate business deals and the creation of companies to sell gas. This admission shows the extent to which gas is used for political purposes by Russia's leader. Second, if taken at face value, it means that Gazprom leadership entered into a business venture involving the trade of several billion dollars worth of gas annually, but they did not even know who their partners were. In addition to this, the Chairman of Gazprom and Naftogaz have both publicly stated that they believe the gas trade should be handled directly from one company to the other.¹¹⁹ Apparently, one is to believe that despite the fact that both the governments and their nationalized gas companies were against such an entity, it was created anyway. Although impossible to prove conclusively without more evidence, one reason for the arrangement's existence appears to be the ability to divert funds from corporate accounts to facilitate bribery at the highest levels.¹²⁰ This seems even more apparent when considering the previously cited concessions Ukraine made in negotiating gas prices in October 2006. Coercion may have been the main tool, but the fact that agreeing to use RosUkrEnergopro was one of the terms, corruption seems to play a part as well.¹²¹ In a recent turn of events, one of the top agenda items of the newly elected Ukrainian Prime Minister Yulia Tymoshenko is the removal of RosUkrEnergopro as middle-man, specifically charging the gas trading operation as a tool for corrupt interests.¹²²

Greece – A Trojan Horse

Russia has a special relationship with Greece that began with ancient religious and cultural bonds and continues today with close economic and political ties. These ties are most evident in the military and energy support that Greece receives from

Russia; in return, Russia receives political support, especially in dealings with the greater EU. Although a NATO member, Greece has purchased significant amounts of military equipment from Russia. Past deals have included the purchase of S300 surface to air missiles, Tor M-1 air defense systems, and Cornet anti-tank missiles.¹²³ In December 2007, Putin and Greek Prime Minister Karamanlis discussed the purchase of 400 BMP-3M infantry fighting vehicles for approximately \$1.7 billion.¹²⁴ Greece and Russia have also apparently come to a bargain that will allow Greece to be the first NATO member to have the rights to produce spare parts for Russian military equipment.¹²⁵

Greece, like Serbia, gets the majority of its natural gas imports from Russia, but the dependency is not as severe, given that Greece has a regasification terminal near Athens and a 21-year contract with Algeria for LNG.¹²⁶ Greece also has the potential for future offsets of gas from Azerbaijan via Turkey. Still, Russia is a major provider of gas and oil to Greece. The day after the BMP-3M deal was reported, Putin announced that Greece was interested in a long-term gas contract for 2016 to 2040 that could lead to a doubling of the current amount of natural gas sent there.¹²⁷ Additionally, they are both looking to intensify this energy relationship with two major pipeline projects - one oil and the other natural gas. Greece, along with Bulgaria, is participating in the only Russian-controlled oil pipeline within the EU, the Burgas-Alexandroupolis. The pipeline, scheduled to be built from 2008 to 2011, will allow Russian and Caspian oil exports to by-pass the overcrowded Bosphorus and the Dardanelles. Russia will have a 51% ownership in the pipeline through three of its state corporations - Transneft, Gazprom, and Rosneft.¹²⁸ Greece has also signed up to participate in the proposed South Stream

gas pipeline, Gazprom's project clearly aimed at obviating the need for the Nabucco pipeline and thereby cutting access to non-Russian routes to Central Asian gas supplies.

Russia's relationship with Greece has been termed a "Trojan Horse" in a policy paper by the European Council on Foreign Relations, in reference to the means in which Russia has its voice heard in the EU via Greece.¹²⁹ In interviews with EU state officials, it is commonly heard that in return for Russian support, Greece has become a "promoter" of Russian positions to the EU.¹³⁰ The most compelling example of this assertion is a proposal in April 2007 to send EU liaison officers to Abkhazia and South Ossetia (breakaway regions of Georgia where Russia maintains peacekeepers and works to maintain the status quo, thereby undermining Georgian attempts to re-unify these regions). Greece was the lone member to veto the proposal.¹³¹ In support of its proposed pipeline projects with Russia, Greece opposed a proposal by the EU's Energy Commission to introduce to the legislation on unbundling – the breaking up of monopolistic energy providers. The legislation, which would not allow producers of energy to also be the same owners of the transit and distribution systems for that energy, has Gazprom as one of its main targets. Gazprom is a partner in both projects.

Through its dealings with Greece, which are centered on business from state-controlled corporations, Russia is able to further several key foreign policy objectives. These include the division of EU policy on critical issues and increasing regional economic influence. The December 2007, Putin- Karamanlis talks in particular emphasize the importance state enterprises play in Russian foreign policy flexibility. Putin was able to personally represent the interests of gas, oil, and defense industries

and arrange on their behalf significant deals which simultaneously furthered Russian strategic objectives.

Iran – a Three-Pronged Approach

Russia's business dealings with Iran present one of the key stumbling blocks in the US-Russia relationship - the assistance to Iran's nuclear program, in particular the Bushehr nuclear reactor, and conventional weapons sales. The US looks at the issue and negotiates from a geopolitical standpoint, wondering why Russia is willing to provide an Islamic state that sponsors terrorism the means to eventually develop nuclear weapons and at the same time increase its ability to defend those nuclear sites with conventional weapons.¹³² The simple answer is that Atomstroieksport and Rosoboronexport are government-owned, and the Iranian ties present the Russian government with a possible long-term business relationship. However, Russia's dealings with Iran are more nuanced and understandable after examining Russian foreign policy priorities.

Russia has a three-pronged approach with Iran that involves defense items, nuclear equipment and fuel, and hydrocarbons which work in synergy to achieve several goals. First, Russia foresees a long-term relationship of building nuclear power plants and being the agent for providing nuclear fuel and removing nuclear waste as part of the fuel cycle, all in accordance with Article IV of the Non-Proliferation Treaty. This could potentially result in tens of billions of dollars in business for the state nuclear industries – Atomstroieksport (reactors) and TVEL (nuclear fuel).¹³³ A lasting partnership with Iran could also be the inroad to establishing similar business with other countries looking to gain nuclear power. If Russia were to build a record of success (no weapons

proliferation) with Iran, it would be justification to deal with just about anyone. Through its nuclear program with Iran, Russia is also able to push for alternatives to sanctions in the UN Security Council. Russia wishes to delegitimize sanctions as Moscow itself has frequently been subject to them.¹³⁴ Second, defense equipment sales to Iran are not exceptionally large but they do represent an important market to Russia, especially as India and China, their biggest customers, have more and more independent production.¹³⁵ Much to the chagrin of the United States, in early 2007, Russia delivered to Iran 29 TOR MI surface to air missile in a contract valued at a \$700 million. At the end of December 2007, Tehran reported that it had an agreement to purchase the even more sophisticated and longer-range S300 anti-aircraft missile system in a deal estimated at 500 million to one billion dollars.¹³⁶ This announcement came right on the heels of an announcement that Russia had delivered the first shipment of nuclear fuel to the Bushehr reactor. In 2005 and 2006, Russia sold SA-15 Gauntlet surface to air missiles, and upgrade packages for previously purchased SU-24 and MiG-29 Aircraft, and T-72 tanks.¹³⁷ The anti-aircraft missiles are particularly important as they pose a true threat if any attempts were made to disable nuclear sites by air strike – in this manner Russia blatantly disregards U.S. concerns. While defense sales to Iran are at best a billion dollar a year business for the Russian arms manufactures, they do much to build the relationship between the two countries and undoubtedly carries Russia favor when Western countries will not deal with them.

The third part of Russia's deals with Iran involves what may be the biggest boon to Russian influence, power, and wealth – hydrocarbons. Iran has the world's second largest amount of natural gas reserves. Between Russia and Iran they control about

43% of the world's natural gas. For several years there has been discussion of the possibility of a natural gas cartel with Russia at its head. While it is not the intent of this paper to discuss the viability of such an organization, it would clearly require the participation of Iran to be successful. Whether via a cartel, or simply the continued domination of the Central and Eastern European gas markets, Russia knows that Iran is a critical player in facilitating or impeding its position. Iran, within a decade, could be a major supplier of gas to the eastern half of Europe via Turkey on the proposed Nabucco pipeline, undercutting Russia's monopoly position. It is very much the desire of Russian political elites to retain Gazprom's current position in the eastern half of Europe.¹³⁸

Russian influence with Iran, which has been gained in large part through the nuclear and military sales, may very well create the grounds for greater cooperation (Gazprom already owns a 30% stake in Iran's South Pars 2 and 3 projects¹³⁹) in the gas industry.

From the Russian perspective, such a relationship with Iran is beneficial if one of several scenarios emerges. If a global natural gas cartel with Iran as a member were to be formed, it could have major economic benefits for Russia. As a lesser prize - the continued control over eastern European natural gas markets, Russia would stand to gain a great deal from Iran focusing its sales to other markets. In September 2006, President Putin, speaking on behalf of Gazprom, which he does quite frequently, said the company was prepared to contribute financing and technology for a gas pipeline from Iran to Pakistan and India.¹⁴⁰ Such a pipeline would be extremely useful for Russia in its hydrocarbon strategy for Europe. Ensuring that Iranian gas fed the ballooning Indian market would leave the European markets and the influence associated with them for Gazprom and its master, the Kremlin. Russia sees this relationship with Iran

as one fraught with the potential danger of creating a new nuclear weapons state, but at the same time sees the tradeoff of huge benefits that may accrue from a lasting relationship in the natural gas, nuclear power, and lesser extent defense businesses – all of which are controlled by and act on behalf of the desires of the Russian government. This three-pronged approach has the potential to deliver huge profits, but it also achieves another important foreign policy goal – it undermines U.S. and European influence in the region and works toward the goal of re-establishing a multi-polar world.

Algeria - Weapons on Credit

In March 2006, President Putin personally brokered a very large deal with Algeria. It displayed the ease with which Russia's foreign policy practitioners can make arrangements with the control of and ability to speak on behalf of key industries. In return for the cancelling of approximately \$4.7 billion of debt owed to the Soviet Union, Algeria, according to the official announcement from its government, agreed to purchase goods and services from Russia equaling the total of the debts.¹⁴¹ Orders for the Algerian Air Force included 36 MiG 29SMT fighters, 28 Su-30MK interdiction aircraft, and 16 Yak-130 Mitten combat trainers, as well as upgrades for 36 older MiG-29s, ground-based radar systems, and training for technicians and pilots.¹⁴² For the ground forces, the package included 180 T-90S main battle tanks, 30 Tunguska self-propelled air defense guns, 8 S-300 Surface to Air Missiles (the same system that Iran ordered in December 2007), and laser-guided anti-tank missiles.¹⁴³ Additionally, as part of the deal, Putin gained access for Gazprom, Itera (an independent gas Russian gas company with about 20% Gazprom ownership), and Lukoil, (not majority state owned)

to joint ventures in Algerian gas and oil field ventures. Since this major deal, Rosneft along with Stroitransgaz (Russia's largest oil and gas infrastructure company whose largest minority owner is Gazprom) invested \$1.3 billion for a 60% stake in the Block 245 Oil project in Algeria, which has oil reserves as high as 415 million barrels.¹⁴⁴

Much as the case with Iran, Russia has much to gain from a relationship with Algeria. Behind Russia, Algeria is the second largest supplier of natural gas to Europe at 16% of imports.¹⁴⁵ Algeria's largest markets logically are in southwestern Europe, with pipelines running under the Mediterranean to Spain and Italy, who along with France represent Algeria's largest customers.¹⁴⁶ Just as Iran could disrupt Russian dominance in eastern European gas markets, Algeria could break the monopoly position with increased shipments through Italy and on to Central Europe.¹⁴⁷ While a gas cartel is more problematic, simple cooperation with Algeria on long-term contracts and their destinations could be very beneficial. Russia could also gain technical help from Algeria as it is one of the most experienced LNG exporters and could be quite useful in assisting Russia as it builds liquefaction terminals in the far east, northwest, and near Saint Petersburg.

Rosneft, Lukoil, and Gazprom have clearly benefited from the favorable relationship the Putin government has created with Algeria by gaining the chance to expand their portfolios of oil and gas reserves. The Soviet Union was a large supplier of military items to Algeria, but after a long hiatus, Russia returned to the Algerian market in major fashion in 2006. The total value of the arms deal has been estimated at \$7.5 billion, far more than the debt cancellation.¹⁴⁸ Analysts believe that the financial arrangement is such that arm sales were made in return for the Russian companies'

access to oil and gas-rich regions. Proceeds from the hydrocarbon sales would be split between the producer and the Algerian government in the fashion of a typical PSA. The Algerian government would then be bound to transfer the revenues to Russian arms manufacturers, until such time as the debt is paid off.¹⁴⁹ As with the Iranian relationship, the state's ability to negotiate on behalf of industry was critical to gaining the inroad. Algeria wanted weapons, but did not have the means to pay. In this case, the state's ability to negotiate the payment schemes for United Aircraft Building Corporation and Rosoboronexport created an opportunity for Russian oil and gas companies to gain major concessions.

Summary

Russia has similar relationships that are also heavily based on mutual business ties with other countries with which it has virtually no ideological similarities. Russia has arrangements with Venezuela based on armaments and energy similar to the ones described with Algeria. For Russian strategic objectives, a major difference is that while the Russo-Algerian relationship has the potential of increasing Russia's influence with the EU, Moscow's dealings with Venezuela are aimed at reducing U.S. regional clout. Russo-Venezuelan relations have the common thread of building tighter bonds with major hydrocarbon producers, as well. Russia also has exceptionally complex relations with China and India. Primary foundations of these are also energy and defense deals in an almost complete absence of worldview similarity. Discussions of these would be prohibitively long and are left to other research.

In a rather infamous article Putin wrote for *The Wall Street Journal* entitled "Energy Egotism is a Road to Nowhere," Putin spoke of how Russia "will strive to create

an energy security system sensitive to the interests of the whole international community.”¹⁵⁰ Russia’s foreign policy action has shown time and again that what Putin terms as cooperation, really means collusion. Dealings with selected partners in Europe, Algeria, Iran, and Venezuela demonstrate how Russia is not interested in market relations for energy, but rather in building a system in which it can most successfully exploit its dominant resource position. The Russian Federation has shown repeatedly that common values play almost no role in its consideration of its trading partners. It often builds relationships with countries that most openly thwart Western values of free markets and democracy. In this regard, the Russian Federation behaves like “Russia Incorporated.”¹⁵¹ It uses its re-nationalized industries to further its wealth and influence, the latter often at the expense of the EU and the U.S.

Analysis and Implications for the Future

As has been demonstrated by the case studies, the Russian government uses its re-nationalized industries to considerable advantage in implementing its foreign policy. This campaign of de-privatization has major impacts on domestic economic and political reform. In turn, they greatly affect the implementation of foreign policy. Therefore, to attempt to predict the implications of re-nationalization on the future course of Russian international relations, one needs to analyze the degree of internal change.

A Return to a Controlled Economy?

After all the asset grabbing over the past several years by the Russian government, the critical question for the future of the Russian economy is to what extent it has reverted back to a planned system – has the government resumed a position where so much of the economic activity of the country is under its direct control that market forces are stifled and even will cease to function? A recent survey by the *Economist* of the state of reform in Russian multi-national corporations reported rather optimistically that progress is being made, but the better business practices are seen in the second-tier companies rather than in the larger ones.¹⁵² Despite this optimistic report about reform in Russian mid-caps, from a micro-economic level, especially at the level of the firm, there is considerable evidence that the system has begun a reversion to its former Soviet image, particularly in the industrial sector. It is difficult to argue that free market principles are the primary driver of the business decisions for the government-controlled enterprises. Gazprom, which accounts for about 25% of Russian tax revenue,¹⁵³ is a prime case in point. It consistently executes business decisions that defy the logic of a company with a core strategy to be a “global energy

leader providing secure deliveries of natural gas and other fuels and raw materials to the world and domestic energy markets.”¹⁵⁴ Gazprom Media Holding Company bought the Russian newspaper Izvestia in 2005, to add to its ownership of Russian TV stations NTV, TNT, and several radio stations.¹⁵⁵ The politically motivated desire to control the media is so obvious that it bears little commentary other than the irony that Putin has picked Dmitri Medvedev, Gazprom’s chairman, as his successor for President. Conveniently, Medvedev now has his own media support in-house. Rosoboronexport’s acquisition of the car producer AvtoVaz certainly holds little logic from the perspective of a defense company. This and takeovers of various metal producers beg the question what the company’s core function is - finished defense products, civilian autos, or raw materials?

Placing a precise value or percentage of the Russian economy now controlled by the state would be virtually impossible, especially since market capitalizations, revenues, and profits are all figures still unreported for most Russian companies. Table 3 (page 55) lays out the largest of the state’s mega-corporations and then uses the best available data to show their scale of economic activity. Adding up the revenues of these state conglomerates, they accounted for about \$150 billion of economic activity in 2006, \$120 billion of which was in the industrial sector. Many smaller state-controlled companies such as the railways and Aeroflot - the state airline, are not included here. If data were available for their economic activity, they would add a considerable amount to

Table 3. - Russia's State Corporations and Their Economic Size¹⁵⁶

Company / % State Control	Description	2006 revenue
Gazprom / 50.002%	Owner of 60% of Russia's gas reserves, monopoly owner of the Unified Gas System; assets include 166 subsidiaries and downstream ownership of assets in 17 EU Countries.	\$50.8 billion
Rosneft / 75%	One of Russia's two largest oil companies (Lukoil). Current reserves of 20 million barrels of oil; owner of two major refineries; investor in numerous foreign projects including Kazakhstan and Algeria.	\$33.1 billion
Rostekhnologii / All subsidiaries are at least 50% state owned	Conglomeration of numerous corporations within the defense and high tech sectors. Major assets include: Rosoboronexport (defense exports) whose subsidiaries include Helicopters of Russia, AvtoVaz (cars), VSMPO-Avisma (producer of titanium and magnesium alloys), Defense Systems (air defense and radio-electronic equipment), Russpetstal (steel alloys), Kronshtadt (flight and maritime simulators, navigation equipment).	Estimated at \$15 billion based on domestic and foreign arms sales and metal revenues.
Vneshtorgbank (VTB Group) / 77.5%	Banking consolidator; presence in all 12 CIS states; main banking arm of the government for pursuing the development of key industries.	2006 profits - \$1.2 billion
United Aircraft Building Corporation / 75%	Aircraft conglomerate formed from the following manufacturers and designers: Irkut, Mikoyan, Sukhoi, Ilyushin, Tupolev, and Yakovlev.	Approximately \$3.2 billion. Expected to rise to \$5.4 billion by 2008.
United Shipbuilding Corporation / 100%	Shipbuilding conglomerate focusing on military and specialty craft such as ice-breakers and oil/gas exploration platforms.	Estimated at \$3 billion (based on order book of ship contracts)
Almaz-Antey / 75%	Air defense systems including long, medium, and short range surface to air missiles and radars.	Approximately \$2 billion
Unified Energy System / 50%	Owner of 70% of Russian Electric Power generation and 96% of the high voltage transmission grid.	\$27.7 billion
Rosatom / All subsidiaries are at least 50% state owned	Conglomerate of all companies associated with the civilian and military nuclear industry including Atomenergoprom and its subsidiaries.	Unknown. Estimated at less than \$10 billion.

this figure. Russia's GDP for 2006 was estimated at \$734 billion.¹⁵⁷ The economic activity was distributed with 39.3% in industry and 55.8% in services in 2006.¹⁵⁸

Industrial activity was therefore about \$288 billion. At the lowest estimate, 40% of the

industrial activity in Russia was in state-controlled enterprises in 2006, and this percentage has almost certainly risen with additional acquisitions in 2007. While the majority of Russian economic activity is in the service sector, the government's control of close to a majority of the industrial activity of the nation, especially with its heavy reliance on natural resource production, indicates that there should be considerable concern that the country is on a path to return to a controlled economy.

It is difficult to predict whether the Kremlin will continue its acquisition of privatized companies, but recent actions and proposed laws do not bode well for a lessening of government control of industry. At a meeting of the Russian Chamber of Commerce and Industry in December 2007, President Putin tried to assuage businessmen's concerns by stating,

We do not plan to create state capitalism. This is not our choice, not our path.

However, we see that without the support of the state, we could not restore some vitally important sectors of the economy... I want to tell you that we do not plan to keep these government corporations in the form in which they were created forever. After they stand on their own legs and are competitive on world markets, we will attract to them private businesses. And in various proportions (of ownership). Possibly in key and even controlling proportions in the future. I do not want to exclude such a possibility, and I think that we will do such things.¹⁵⁹

However, within just a few days of Putin's remarks, a draft law was introduced to the Duma, the Russian Parliament, which is now controlled by the Kremlin's party, United Russia, which would allow the state to retroactively tax 20% of the first ten years' worth of profits on enterprises which were formed by loans-for-shares during the 1990's privatization auctions. It has been noted that such a law would be a "reserve weapon"

for subordinating more private businesses to the state, especially those that might be incapable of paying the tax.¹⁶⁰

A chronology of key events in the re-nationalization of strategic industries, Table 4 (page 58) graphically portrays an alarming trend. While there is some degree of arbitrariness to assigning the label “key event”, an attempt has been made to identify those milestones that portend or actually bring about major change in the relationship between the state and industry. Noticeably, the amount of such events has not slowed, but has actually increased pace in 2006 and 2007. Both years have seen significant numbers of decrees establishing or expanding the power of mega-state corporations. This increase in activity gives the appearance that Putin has set the stage for continuing and consolidating the campaign he has set in motion, even after he hands the Presidency over to his successor.

At the time of this writing, a proposed bill was before the Duma on delimiting 39 sectors of the Russian economy deemed as strategic. If passed, it has ominous implications for further government involvement in industry. The proposed law stipulates that:

“a foreign company will only be able to buy more than 50 percent of the shares in a Russian company classified as 'strategic' with prior permission from the Russian government. State-owned foreign companies will be allowed to buy only small stakes of less than 25 percent of 'strategic' Russian companies. The Federal Security Service (FSB) will monitor the law's enforcement. If it finds that foreigners have been buying up shares in strategic enterprises via front firms, the Russian government will have the right to protest against such purchases in court.”¹⁶¹

Table 4. – Chronology of Key Events in the Re-nationalization of Strategic Industries¹⁶²

Date	Milestone
1999	Putin publishes his manifesto on the role of the state in economic development, “Mineral Resources in the Development Strategy of the Russian Economy.”
November 2000	Presidential Decree merges Promexport and Rosvooruzhenie establishing Rosoboronexport as the sole exporter and importer of defense materials and technologies for the Russian Federation.
April 2002	Presidential Decree establishes Almaz-Antey as a government controlled Joint Stock Company responsible for the production of air defense and non-strategic missile defense systems.
July 2002	Rosoboronexport and the government of the Russian Federation establish the joint enterprise Oboronprom to oversee government defense assets and acquire stakes in private defense firms.
October 2003	Yukos CEO Mikhail Khordokovsky is arrested for tax evasion.
June 2004	Putin appoints his Deputy Chief of Staff, Igor Sechin, Chairman of the Board of Rosneft.
November 2004	Kakha Bendukidze, Georgian Minister of the Economy sells his controlling share of Atomstroieksport, a subsidiary of his OMZ, to Gazprombank for \$25 million, after the state had assessed it with a \$35 million back tax bill.
December 2004	YUKOS asset Yugansneftegas sold to Baikalfinansgrup; Rosneft buys Baikalfinansgrup.
June 2005	Government-owned Rosneftegaz buys 10.74% of Gazprom’s stock from several of its subsidiaries; the complex deal puts the government’s percentage of Gazprom ownership at 50.002% - controlling share.
September 2005	Gazprom buys Sibneft for \$13 billion from Roman Abramovich, forming Gazprom Neft.
February 2006	Presidential Decree authorizes the creation of United Aircraft Building Corporation.
March 2006	Presidential Decree authorizes the creation of United Shipbuilding Corporation.
July 2006	Russian Federal Law grants Gazprom the sole right to export natural gas, creating an absolute monopoly and leaving independent gas producers only the option sell on domestic markets at controlled prices.
December 2006	Gazprom purchases majority ownership of Sakhalin 2 project from Japanese / Dutch consortium after environmental violations citations.
March 2007	Putin signs a decree removing all exceptions to previous decree (2000) establishing Rosoboronexport as the official export monopoly for arms trade.
June 2007	Gazprom purchases majority ownership of Kovykta gas field from TNK-BP after it fails to meet PSA stipulated production quotas.
August 2007	Final Yukos assets liquidated.
August 2007	Arrest warrant issued for RussNeft owner Mikhail Gutseriev; Gutseriev flees the country and his \$6 billion assets are frozen.
November 2007	Law establishing Rostekhnologii as state corporation goes into effect; Putin appoints Sergei Chemezov as Director General of the corporation.
December 2007	Putin signs law establishing Rosatom as state nuclear energy corporation subsuming all civilian and military nuclear enterprises and research facilities.

Such a law will have more affect than simply keeping foreign investment from gaining controlling share in certain companies; it will give the FSB even freer reign than it has now (if that is possible). Implicit is that the FSB will have the authority to monitor all money flows and stock transactions – in the name of protecting the people and the state from unwanted foreign control. Such information will be very valuable in the hands of certain people in the administration. If passed, this law, like the proposed back tax law, would provide the government with even more capability to seize private properties. This is not likely to be an atmosphere that will encourage foreign capital, which is needed particularly in the heavy industries and resource extraction.

It has also been argued that the state has offered Initial Public Offerings (IPOs) of state-controlled enterprises such as Rosneft and Vneshtorgbank and will continue to do so.¹⁶³ Superficially, this gives the appearance of a market approach, but it must be considered that none of these IPOs is going to put a controlling percentage of these firm's shares on the market. Majority ownership, and therefore corporate control, will be maintained by the government with a 50% or higher share and the continued appointments of key board and management positions.

Taking all these factors into consideration - the fact that the government has already taken control of close to half of industrial output, the increase in the pace of re-nationalization decrees, and prospective laws that could both create the means for the government to access back taxes and increase its monitoring of financial transactions – the future of economic liberalization in Russia does not look propitious.

Stifled Initiative

Consolidation of strategic industries is creating a unique problem. Whereas before there may have been some semblance of competition between different firms, this will certainly vanish as industries, such as aircraft and shipbuilding, answer to the government's oversight rather than the forces of the market. The only competition will come from abroad; Russian products will compete globally or be relegated to internal use only; in such case, government subsidies and regulations will be required to keep their manufacturers in business. Commenting on the state of the Russian economy Ukrainian Prime Minister Yulia Tymoshenko had the following to say, "Of course the Kremlin leadership will find it hard to admit that the centralized system it is re-creating lacks the capacity to spur initiative that Russia, despite its vast natural resources, remains a very backward country. The subservience that the Kremlin demands is stifling the vitality and creativity that Russia needs if it is to grow for the long term, let alone sustain its place in the world."¹⁶⁴

In addition to strangling competition and innovation, the takeover of so many companies has had some negative financial affects on numerous state corporations. The Russian government itself has been amassing a large Stabilization Fund from its oil and gas sales over the past several years due to large increases in the prices of hydrocarbons. But at the same time, the financing of many of the asset purchases has been through foreign banks. According to *Vedomosti*, the accumulated debt by state-controlled companies like Gazprom, Rosneft, and Vneshtorgbank totals \$120 billion, which will require them to spend some \$200 billion over the next 10 years to service

these loans.¹⁶⁵ The state foreign debt is now listed at \$37 billion;¹⁶⁶ this figure is misleading however. Since the government is the majority owner of so many companies, their debt is in essence state debt as well. Much of this debt has been accumulated by the purchase of assets both domestically and abroad. Western banks, in particular European ones, have literally been loaning Russian firms the money to buy up assets within their own countries. An extremely negative outcome to all this corporate debt is that if competitiveness is stifled, they may have difficulty generating revenues sufficient to service their debts. A fall in oil and natural gas prices could have an exceptional impact on subsidies for Russia's more debt-leveraged industries, due to an overwhelming reliance on hydrocarbon revenues for the state budget.¹⁶⁷

Industry as a Power Base of the Political Elite

Re-nationalized industries have become an integral part of the power base of Russia's political elite. The control over strategic industries by highly placed administration officials who also serve as corporate heads greatly increases their political might and their personal fortunes. Georgi Satarov, head of Moscow's Indem Foundation, which has been studying Russian corruption for years, summed up the current situation,

There's one reason why corruption grew so greatly in the last few years -- that there's absolutely no control over bureaucracy. During all the previous times, bureaucracy was somewhat controlled either by aristocracy, nobility or party leadership. During Yeltsin times, there used to be effective opposition, media freedom, diversified institutions of power, independent courts, more or less free civil society -- all of these served as controlling tools. During the last six years, all of these tools were destroyed."¹⁶⁸

While he likely overstates the amount of controls that existed to limit the executive during the Yeltsin period, the point is clear that there are few checks on the current political elite.

The fact that so much of the Putin entourage's personal wealth is tied to the government's practice of asset grabbing does not bode well for the future of political plurality or democratic reforms. If a change in party leadership were to occur, the current elite would lose not only political power, but the sources of their personal wealth would almost certainly be exposed. Political change in Russia is now unthinkable for the existing elites, for the stakes could entail the loss of fortunes and possible imprisonment. This wholesale theft of businesses has created a situation which is extremely dangerous; the incentives to maintain political control are so high that taking the reigns of power from the *siloviki* and the highest members of the Unified Russia Party will be extremely difficult, for they will not go willingly. This in turn may lead to an increase in authoritarian measures to ensure their stay in power.

Russian History as a Guide

When considering the implications of this re-nationalization campaign, Russia's long history cannot be ignored, for it too may be a strong indicator of the future. Before communism, for centuries of tsarist rule, the state controlled the land, property, resources, and with serfdom – even the labor.¹⁶⁹ The notion of private property and the system of laws and courts to protect it are only nascent, not developing, and not at all a concern of the current party of power – United Russia.¹⁷⁰ Russia has had no experience of rule other than the autocrat. Re-nationalization, with economic assets becoming one of the prizes of the political elite, is only reinforcing the autocratic system,

albeit in a new form. As Russia analyst Stephen Blank has argued, “Putin’s justification of state control merely replicates tsarist and Soviet official’s defense of their autocratic and patrimonial systems of rule.”¹⁷¹ (By patrimonial he refers to the model of state property ownership in which assets are only on loan to those who serve the state and answer directly to the sovereign.)

Another motif common to Russia’s leaders is the conviction that being a great power is central to Russian historical identity.¹⁷² One of the ways it most commonly represents itself is the justification for an empire. Such a world-view has a profound effect upon the implementation of foreign policy. Restoration of the empire, if not literally, then at least through greatly increased influence in the former Soviet Union and even globally, is a top agenda item. When accounting for Russia’s past experience, its collective memory, and culture (such as the ubiquitous and accepted nature of corruption), they do not lead to an optimistic view of where the country may be heading, either.

Combining all these factors, Russia appears to be a country teetering on the brink of returning to a corporate version of its Soviet self. Economic indicators, the increased pace of re-nationalization legislation, consolidation of industry and the elimination of internal competition, the self-enrichment and need to maintain power by its political elites, and Russia’s historical experience all point ominously toward a severe break from Western market-oriented democracy.

The Affect on Foreign Policy

One of the most profound implications of the re-nationalization of industry on foreign policy implementation is that the state itself has become the chief sales

representative for these enterprises. The bottom-line interest of the corporation is now the concern of the state and vice-versa. The problem of corporate interests subverting the foreign policy apparatus is exacerbated by state representatives as the chief managers. The success of “their” firms will often be directly related to how well the state promotes them to prospective foreign customers. For many of these dual-role government-appointed managers, their personal wealth can be tied to this process as well. The West can therefore expect increasing amounts of military, hi-tech, and nuclear sales, along with energy agreements that directly undermine its policies. Government-forced consolidation has made this process even easier for the Russian salesman (often Putin himself) pitching guns, planes, or ships since virtually everything in the arsenal can now be found with one-stop shopping at Rostekhnologii, United Aircraft Building Corporation, or United Shipbuilding Corporation respectively. Payment options have been made easier as well with transfers arranged through government banks and credits established with oil and gas assets as collateral.

Russia, with a military that is only a shadow of its former Soviet incarnation, will clearly attempt to maximize its economic instrument of national power abroad. This will be an even more fundamental part of the Russian strategy given all the aforementioned domestic consequences of the re-nationalization campaign. Lessened internal competition, implying decreased efficiency and innovation, is almost certainly going to force the Russian government to be more proactive about selling its products abroad. The impulse to sell to virtually anyone will also be strong if the state corporations are struggling to service the debt on their foreign loans. Opacity and corruption in many of the Russian state-corporations will certainly be a source for more cases of bribery of

foreign officials. The lack of financial transparency is also likely to lead to a vicious circle of trade with other regimes who have equally low standards of corporate accountability. Even worse is the possible spread like a virus of these lower standards to Western business partners.

One further reason the U.S. and its closest allies can expect Russia to use these industries in a way that undermines their interests is simply because the Russian administration sees it in their best interest. The Russian foreign policy paradigm still views international relations as a zero-sum gain. Undermining Western influence is the best way to increase one's own. Russian elites operate with this balance of power outlook combined with a cultural framework that believes (quoting Putin):

Russia was and will remain a great power. It is preconditioned by the inseparable characteristics of its geopolitical, economic, and cultural existence. They determined the mentality of Russians and the policy of the Russian government throughout the history of Russia and they cannot but do so at present.¹⁷³

Therefore, the top item on the agenda of Russia's foreign policy practitioners is to restore Russian greatness. If it can no longer be termed in the size of the empire, then it will be at least measured in the level of influence Russia exerts abroad. Such an worldview combined with the corporate state outlook almost guarantees the leveraging of re-nationalized industries in foreign policy endeavors totally devoid of any motivation other than simple balance of power calculations and profit.

Conclusion and Recommendations for the West

Russia analyst Dmitri Trenin asserts that Russia's economic gap with the West will be narrowed to "the extent that Russian capitalism embraces the rule of law, constitutionalism, and eventually some form of democracy built on civic

responsibility.”¹⁷⁴ This is true, but unfortunately Russia’s current government does not value any of these ideals. Putin and his entourage ransacked corporations in the name of the state and then became the trading partners of virtually any regime regardless of its international standing. This behavior demonstrates that Russian commitment to “the precedence of law and broad democratization of international affairs,”¹⁷⁵ as its Foreign Policy Concept states, is nothing more than rhetoric. Trenin also states that “the West would do best by dealing with Russia on Russia’s own terms, reaching for an acceptable balance of reciprocity, and not on the basis of normative principles such as democratic reforms.”¹⁷⁶ Such a suggestion turns a blind eye to the fact that Russia does not deal with reciprocity. Case in point is Russia’s acquisitions of energy infrastructure throughout Europe, while at same time refusing to ratify the Energy Charter. Its ratification would open Russian energy infrastructure to transit by foreign suppliers and break the complete monopoly it maintains on both its gas and oil pipeline systems.¹⁷⁷ Russia feels entitled to ownership of foreign energy distribution assets; in return, it does not even allow the use of the same type infrastructure for export by non-state-controlled gas companies. Russia is more than willing to exploit free market rules abroad but not apply them at home.

Trenin ultimately argues that the best way for both the United States and EU to improve their relations with Russia is more business ties. This would create “a better understanding of each party’s goals and a convergence of interests.”¹⁷⁸ However, simply increasing business with Russia would have many negative consequences. The most detrimental aspect of dealing with the government-

controlled enterprises is that it condones the behavior of the state and thereby undermines the chances of democratic and market reforms. Western banks have loaned Rosneft billions of dollars to buy Yukos assets.¹⁷⁹ Essentially, they have facilitated the purchase of stolen goods. The only way to ethically rationalize such business practices is to say the Yukos seizure was “legal” under Russian law. Actions such as Gerhard Schroeder’s joining the Gazprom Nord Stream project only embolden Russian bullying of certain EU nations and will ultimately build bitter divides in EU consensus building. It is easy to say that business partnerships will build new bonds, but in many ways they will legitimize and reinforce the unethical behavior of the Russian government.

There are no easy solutions. The U.S. and EU can not possibly regulate all the commerce with Russia and therefore will have limited control over the business partners of Western companies. Ideally, Western business partnerships would be only with Russian firms that have transparency in their financial reporting and management free from government control. This is indeed wishful thinking, as many of Russia’s most opaque businesses are in the most profitable sectors and despite the risks, they will continue to draw foreign capital and gain access to Western markets. Condescendingly preaching to Russian leaders about democracy will have no effect, nor will attempting to marginalize or belittle Russia, as this will likely create backlash. However, totally backing away from normative principles is not a solution, either. Western governments must continue to voice their displeasure with Russia’s regression.

The best U.S. and European governments can do is to approach Russian business with caution. The U.S. Departments of State, Commerce, and Energy, and their analogous counterparts in EU countries, should emphasize with prospective businesses the perils of Russia's nationalized industries. Simply increasing business relationships will not miraculously spark reform. Selective engagement on behalf of Western governments and companies that makes it clear to Russian elites that their opaque state corporations are being intentionally shunned would have far more positive results. EU governments which have recently cozied up to Russia in the hope of better energy deals at the expense of their neighbors would be well-advised to re-think their actions. Given the interconnected nature of Russian companies to the global economy, the West still has some leverage to promote reform within Russia. It must act cautiously and selectively if it wishes to turn Russia back to the course of reform. The process will take decades to overturn the most recent setbacks and the centuries of collective memory, but the reward would be the world's richest resource country fully integrated into a global free market system.

Endnotes

Much of this research was taken from original Russian texts. The translations are the author's own. For ease of finding resources for the bi-lingual reader, the title of the original text in Russian is listed first with the English translation following.

The general concept of this research project was formed while writing another, currently unpublished manuscript - "Europe's Dependence on Russian Natural Gas: Perspectives and Recommendations for a Long-Term Strategy," and there is minor overlap in themes when discussing Gazprom's acquisition activities. The sections entitled *Sakhalin 2, A Favorable Court Ruling, Kovykta, and Government Control of Strategic Assets* contain revised elements from the prior manuscript, as well as Table 1, which has been updated to include countries germane to this research - see note 105. This research builds upon the earlier work which focused exclusively on Gazprom's strategy in Europe.

¹ Vladimir V. Putin, Text of 10 February Speech to the 43rd Munich Conference on Security Policy, <http://www.securityconference.de/konferenzen/rede.php?sprache=en&id=179>; accessed 17 December 2007.

² "Foreign Policy Conception of the Russian Federation," as cited in Andrei Melville and Tatiana Shakleina, eds., *Russian Foreign Policy in Transition*, (Budapest: CEU Press, 2005), 91.

³ Ibid, 90.

⁴ "British Petroleum Statistical Review of World Energy 2007: Oil Production, Natural Gas Production," British Petroleum Corporate Website, <http://www.bp.com/sectiongenericarticle.do?categoryId=9017903&contentId=7033469>; accessed 20 January 2008.

⁵ The term in Russian is *deprivatizatsiya*, which has a very borrowed sound to a Russian's ears since the prefix and the word itself are taken from English, as is *privatizatsiya*.

⁶ Lilia Shevtsova, "Revolustya Putina", *Moskovskiye Novosti*, 4 November 2003. Ms. Shevtsova was one of the very first to recognize the Yukos arrests as a critical change in the actions of the Putin administration.

⁷ Wojciech Kononczuk, *The Yukos Affair: its Motives and Implications*, (Centre for Eastern Studies, Warsaw, Poland 2006) 35.

⁸ Valeria Korchagina, "A Whiz at Black PR Stirs Up a Storm," Johnson's Russia List, 5 August 2003, <http://www.cdi.org/russia/johnson/7277-12.cfm>; accessed 19 December 2007.

⁹ Kononczuk, 56.

¹⁰ Ibid., 46.

¹¹ Ibid., 54.

¹² "Управляющий "дочкой" "ЮКОСа" сознался в неуплате налогов," "The Head of One of YUKOS's Subsidiaries Admitted to Tax Evasion," *Lenta*, 12 September 2005, <http://lenta.ru/news/2005/09/12/samara/>; accessed 19 December 2007.

¹³ Kononczuk, 54.

¹⁴ A month before Khodorkovsky's arrest *The Wall Street Journal* had run a story citing the possibility of a Sibneft-Yukos acquisition by Chevron-Texaco or Exxon Mobile. Sales of shares to Exxon-Mobile had been discussed. Ibid., 45.

¹⁵ "Yukos Subsidiary Auctioned off to Obscure Company," *Radio Free Europe Newslines*, 20 December 2004, <http://www.rferl.org/newslines/2004/12/1-RUS/rus-201204.asp>; accessed 19 December 2007

¹⁶ "Putin says Buyers of Yukos Subsidiary Experienced in Energy Business," *Radio Free Europe Newslines*, 22 December 2004, <http://www.rferl.org/newsline/2004/12/1-RUS/rus-221204.asp>, accessed 19 December 2007.

¹⁷ "Medvedev Dmitry Anatolievich," *Gazprom Corporate Website*, <http://www.gazprom.ru/eng/articles/article8822.shtml>; accessed 19 December 2007.

¹⁸ Text of Resolution 1418, Parliamentary Assembly of the Council of Europe, dated 25 January 2005, <http://assembly.coe.int/Documents/AdoptedText/TA05/ERES1418.htm>; accessed 19 December 2007.

¹⁹ Yakov Pappe and Ekaterina Drankina, "Как национализируют Россию: нефтегазовый сектор," "How Russia is being Nationalized: The Oil and Gas Sector," *Kommersant*, 17 September 2007, <http://www.kommersant.ru/doc.aspx?DocsID=804680>; accessed 27 December 2007.

²⁰ "New Snag to Gazprom-Rosneft Merger," *Business Report*, 4 October 2004, <http://www.busrep.co.za/index.php?fSetId=304&fSectionId=565&fArticleId=2248927>; accessed 27 December 2007.

²¹ Simon Romero and Erin E. Arvedlund, "U.S. Court to Hear Case for Dismissal of Yukos Case," *The New York Times*, 7 January 2005, http://www.nytimes.com/2005/01/07/business/worldbusiness/07yukos.html?_r=1&oref=slogin; accessed 21 January 2008.

²² Erin E. Arvedlund, "Gazprom merger plan collapses," *International Herald Tribune*, 17 May 2005, <http://www.iht.com/articles/2005/05/17/business/yukos.php>; accessed 27 December 2007.

²³ Chris Skrebowski, "Gazprom regrets..." *Energy Institute*, <http://www.energyinst.org.uk/index.cfm?PageID=1064>; accessed 27 December 2007.

²⁴ "Annual Report 2005," *Gazprom Corporate Website*, http://www.gazprom.com/documents/Annual_Report_Eng_2005.pdf; 54-55, accessed 30 December 2007.

²⁵ Bernard A. Gelb "CRS Report for Congress, Russian Natural Gas: Regional Dependence," <http://www.fas.org/sqp/crs/misc/RS22562.pdf>; accessed 15 September 2007.

²⁶ "Kremlin agrees price for Gazprom," *BBC News*, 16 June, 2007, <http://news.bbc.co.uk/2/hi/business/4100820.stm>; accessed 27 December 2007.

²⁷ "Федеральный закон Российской Федерации от 18 июля 2006 г. N 117-ФЗ Об экспорте газа," "Federal Law of the Russian Federation of 18 July, 2006 on the Export of Gas," <http://www.rg.ru/2006/07/20/gaz-export-dok.html>; accessed 30 December 2007

²⁸ A great discussion of the steps taken in 2003-04 to make the Russian Duma appear to have a multi-party system, when in fact much of the opposition is simply created by or aligned with Putin's United Russia Party is to be found in Anna Politkovskaya, *A Russian Diary*, (New York: Random House, 2007), 1-109.

²⁹ Interview with Jonathan Stern of Oxford Institute for Energy Studies, "Energy Analyst Looks at Sakhalin 2 Take-over," *Radio Free Europe/Radio Liberty*, 22 December 2006, <http://www.rferl.org/featuresarticle/2006/12/5170bf7d-c480-4c81-a238-e8d14b4aa5c0.html>; accessed 26 December 2007.

³⁰ This became evident when all environmental concerns apparently were dropped after the sale of the assets to Gazprom. Putin specifically stated on 21 December 2006, that he was "very pleased that our environmental agencies and our investors have agreed about the resolution of the questions which have arisen." "Gazprom Takes Control of Sakhalin 2 from Shell," *Radio Free Europe/Radio Liberty Newslines*, <http://www.rferl.org/newsline/2006/12/1-RUS/rus-221206.asp>; accessed 26 December 2007.

³¹ Faced with the prospect of losing their entire investment because of the stalemate over the environmental issues, SEIC was basically forced to sell at less than market value. "Gazprom secures half

of Sakhalin-2 for 7.45 billion dollars," *AFP Business News*, 22 December 2006, <http://au.biz.yahoo.com/061221/33/10x70.html>; accessed 26 December 2007.

³² "Japan urges Russia to be "responsible" after gas takeover", *AFP Business News*, December 22, 2006, <http://au.biz.yahoo.com/061222/33/10yr8.html>; accessed 26 December 2007.

³³ "Gazprom Takes Control of Sakhalin 2 from Shell," *Radio Free Europe/Radio Liberty Newsline*, <http://www.rferl.org/newsline/2006/12/1-RUS/rus-221206.asp>; accessed 26 December 2007.

³⁴ "Газпром получил право покупать газодобывающие предприятия," "Gazprom Granted the Right to Purchase Gas Producers," *Kommersant*, January 15, 2007, <http://www.kommersant.ru/doc.aspx?DocsID=733954>; accessed 27 December 2007.

³⁵ Ibid.

³⁶ Russian legal and business analysts Valerie Nesterov and Andrei Gromadin as cited in "Газпром получил право покупать газодобывающие предприятия," "Gazprom Granted the Right to Purchase Gas Producers."

³⁷ "Росприроднадзор начал проверку Ковыктинского месторождения по сценарию "Сахалина-2," "The Russian Ministry of the Environment began checking the Kovykta deposit in the same manner as the Sakhalin-2 Scenario," *New.RU.com*, 18 January 2007, <http://www.newsru.com/finance/18jan2007/prirodnadzor.html>; accessed 26 December 2007.

³⁸ "TNK-BP unable to Eliminate License Violations," *Kommersant*, 6 March 2007, http://www.kommersant.com/p-10254/r_529/kovykta_license/; accessed 26 December 2007.

³⁹ "Росприроднадзор начал проверку Ковыктинского месторождения по сценарию "Сахалина-2," "The Russian Ministry of the Environment began checking the Kovykta deposit in the same manner as the Sakhalin-2 Scenario."

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¹⁷⁰ Such is the general impression one forms of the state of reform in Russia and the role of the United Russia Party from the free press. For a journalistic and scholarly works on the subject see Anna Politkovskaya, *A Russian Diary*, (New York: Random House, 2007) and Lilia Shevtsova, *Putin's Russia*.

¹⁷¹ Stephen Blank, *Rosoboroneksport: Arms Sales and the Structure of Russian Defense Industry*, (Carlisle Barracks, PA: Strategic Studies Institute, U.S. Army War College, 2007) 15.

¹⁷² "The Putin Era in Historical Perspective," 2.

¹⁷³ Vladimir V. Putin, "Russia at the Turn of the Millennium," 1999, <http://www.geocities.com/capitolhill/parliament/3005/poutine.html>; accessed 24 January 2008.

¹⁷⁴ Ibid., 104.

¹⁷⁵ "Foreign Policy Conception of the Russian Federation," 91.

¹⁷⁶ Dmitri Trenin, "Russia Redefines Itself and Its Relations with the West," *The Washington Quarterly*, Spring 2007, 104.

¹⁷⁷ "The Energy Charter Treaty," 48, www.energycharter.org; accessed 24 January 2008.

¹⁷⁸ Ibid., 105.

¹⁷⁹ Andrew E. Kramer, "Russians Report Huge Loan to Buy More Assets of Yukos," *The New York Times*, 21 March 2007, http://www.nytimes.com/2007/03/21/business/worldbusiness/21rosneft.html?_r=1&oref=slogin; accessed 24 January 2008.

