

YUKOS and Putinomics

or

Russia Opts for State Power over Free Markets

or

Why is Khodorkovskii in Jail?

Harley Balzer

Most analysts have judged the arrest of Mikhail Khodorkovskii to be the Kremlin's way of punishing a wealthy businessman who permitted himself to get too involved in politics, specifically by supporting parties that will oppose the "Party of Power" in upcoming Duma elections. But is Khodorkovskii's support for political parties that will barely clear the 5% barrier for Duma representation in December's election adequate reason to jeopardize Russia's stock market values and the recent upgrade from Moody's? The attack on corrupt oligarchs is politically popular, but it is not politically necessary. There is far more to the story.

Some indication of what is at stake may be derived from a photo-op during President Putin's recent visit to New York. While Khodorkovskii was in Washington speaking to academics and business people, the Russian President accompanied LUKOIL head Vagit Alekperov at the opening of one of the filling stations LUKOIL acquired from Getty. The photo speaks volumes about Russian priorities. It fits with a raft of statements by President Putin about the importance of Russia's energy sector not only in the economy but in Russia's overall foreign policy. Writing in the Wall Street Journal on October 10, Vladimir Putin proclaimed "not a single major global or regional problem can be solved without Russia's active and equal participation." In other words, Russia is "back" as a great power. But what does Russian power rest upon?

President Putin has made it clear that he believes inexpensive energy is Russia's "comparative advantage" in the same way that favorable climate and soil benefit agricultural countries. Gazprom, rather than being broken up or subjected to competitive pressures, will remain a state monopoly to further Russian interests. The political payoffs are judged to outweigh the enormous opportunity costs incurred by preserving this inefficient behemoth. Putin's government has stated that it has a special responsibility to maintain pipelines in countries that were part of the USSR, one transcending mere sovereignty of the countries involved. The electrical monopoly, headed by an individual (Anatoly Chubais) who sees Russia having a special destiny as a "liberal empire," is seeking to re-integrate electrical power grids in the Transcaucasus and Central Asia with the Russian system. Russia's Natural Resources Minister, Vitali Artiukhov, announced an investigation into oil fields where Royal Dutch/Shell is operating, warning that other Western companies may also have their drilling licenses reviewed. All of these indicators suggest increased influence for factions and interests favoring statist economic policies over real integration with the global economy.

Mikhail Khodorkovskii should not be anyone's hero. Up to age 35 he played by the prevailing rules (or absence of enforcement of rules) in the Soviet and Russian economy.

But he was one of the first Russian businessmen to figure out that the value of a company is enhanced by making it attractive to investors. Khodorkovskii challenged the state pipeline monopoly TransNeft, suggesting that a new (private) pipeline should be built to Murmansk and advocating a pipeline to China rather than the state's proposed line to the Pacific for shipment to Japan. He explored buying a major share of the state Gas monopoly Gazprom, where he might prove to be far more effective than other minority shareholders in demanding accountability and curbing abuses.

The attack on YUKOS was initiated by LUKOIL, a company that remains largely state-owned. LUKOIL's complaint against YUKOS was supported by TransNeft, which opposes YUKOS plans to build its own pipelines based on economic rather than political or strategic considerations.

Someone who thinks in terms of American-style business would consider Khodorkovskii to be doing all the right things. His projects would reduce bottlenecks in export of Russian oil, improve the performance of the firms involved, increase the total amount of petroleum extracted, and lead to greater creation of wealth. If the Russian government wanted to implement Evgenyi Primakov's program of redistributing the oil wealth, encouraging Khodorkovskii to generate more wealth would make good sense. But for some in Russia control is more important than growth.

The forces arrayed against Khodorkovskii represent an alliance, sometimes tacit, sometimes more overt, between economic interests opposed to Russian integration with the global economy and security and defense elites seeking to use Russia's natural resources as the lever to re-establish Russian power in Eurasia and beyond. Russian political figures ranging from right-wing nationalists to "liberal" imperialists believe that Russia has a "special" role to play in Eurasia. Given the sorry state of their military, the main levers of Russian power have been sowing dissension among neighbors and brandishing ageing nuclear weapons (the latter a notoriously blunt diplomatic device). Now they are embracing economic power, particularly energy. Russia is using pipelines, electrical grids and power stations to induce former Soviet Republics to participate in its alliance system.

To conduct a foreign policy based on resource wealth, the Russian government needs control over the resources. Allowing large companies to operate independently, and to bring in major foreign partners, would make economic rationality rather than political expediency the basis for decisions.

Putin and his team are not going to relinquish their control over Russia's energy resources. It is not just that the opportunities for graft are attractive (Gazprom carries out about \$1 billion of construction per year, most of it completely untransparent). The state-dominated firms not only provide cash flow to finance the election campaigns that are still considered important to maintain the facade of democracy. They also provide major levers for foreign policy.

The longer-term implications of this strategy augur less well for Russian power. A comparison of YUKOS and Gazprom shows that the unreformed gas monopoly performs far less well economically. Gas is by far Russia's most abundant resource. The temptation for the government to waste a huge amount of it in pursuit of short-term foreign policy goals is understandable, but the short-term advantage is being purchased by squandering a far greater long-term return for the Russian economy.

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