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## Genesis of Economic Nationalism in Russia

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Pan-European Institute**

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As the strategic government policies have not received their final form, it needs to be mentioned that the writing of this article was completed on the 5<sup>th</sup> of May.

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## 1 The development of strategic government policies in Russia<sup>2</sup>

The seeds of Russia's strategic government policies were probably laid in the mid-1990s during the era of turbulence and increasing disintegration inside the Russian Federation. Jack (2004) argues that Putin writes in his dissertation, defended in 1997, that raw materials are the basis for Russia becoming a superpower in the short run, and that there should be tougher state regulation alongside market mechanisms. He also emphasized the need to create conditions for investment, including foreign companies in appropriate conditions. Putin's goal is to "*increase its [Russia's] attractiveness to foreign investors while enhancing Russian state control*" (Olcott 2004, 3, for reference see Balzer 2005, 219)<sup>3</sup>.

The implementation of the strategic government policies started without major public notice after the adoption of the first economic program of the Russian Government, i.e. after the election of Putin as the President of the Russian Federation in spring 2000. The first tier of the reform included several legislative changes, such as changing the Land Code and the third part of the Civil Code. The second tier was meant to cover narrower areas, such as the natural resource sector. The implementation of the second tier of legislative changes was begun in Putin's second term (IEP 2005)<sup>4</sup>.

Russia's strategic agenda became a matter of wider public knowledge rather soon after Putin was elected for a second term in spring 2004. Several statements stressing the need for the state to control strategic natural resources appeared in the media in the second half of 2004, putting public pressure on the government to start preparing a new law on subsoil use, aiming at barring foreign companies from owning strategic resources (Lanes 2005).

In April 2005, Putin (2005) brought the core idea of the strategic government policies into the global limelight in his Federal Assembly Address. He declared as follows: "*investors sometimes face all kinds of limitations, including some that are explained by national security*"

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<sup>2</sup> The strategic government policies refer to the underlying ideology and practices of Russia's presidential administration and the Russian Government, which aim at increasing the state's direct and indirect control over key sectors.

<sup>3</sup> Sutela's thinking deviates from conclusions conducted, for instance, by Jack and Olcott (KL 2008d; Sutela 2008). With a good reasoning, Sutela doubts whether Putin's dissertation enlightens his thinking concerning the ongoing strategic government policies in Russia. However, it is not an excluded option that Putin and those who pushed him to the top masterminded the ideology of the strategic government policies much earlier than they were published. Therefore, we may raise a question should the researchers have been able to discover the genesis of the strategic government policies prior to Putin's speech in April 2005.

<sup>4</sup> Yakovlev (2006) has written a marvelous article on the evolution of business – state in Russia.

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*reasons, though these limitations are not legally formalized. This uncertainty creates problems for the state and investors. It is time we clearly determined the economic sectors where the interests of bolstering Russia's independence and security call for predominant control by national, including state, capital. I mean some infrastructure facilities, enterprises that fulfill state defense orders, mineral deposits of strategic importance for the future of the country and future generations, as well as infrastructure monopolies. We should draft and legally formalize a system of criteria to determine the limitations of foreign participation in such sectors of the economy. Simultaneously a corresponding list of industries or facilities will be determined that shall not be extended or receive extended interpretation. Some industrialized countries use this approach and we should also use it."*

In June 2005, the then Prime Minister Fradkov appointed Natural Resources Minister Trutnev to be responsible for the subsoil law development, and the Russian Government submitted the first draft law to the State Duma, which did not give unreserved support for the law (RIA 2005). In October 2005, Trutnev stated that Russia should limit foreign participation in three main areas (Alexander Gas & Oil 2005): 1) his ministry wanted limits on foreign participation in auctions for natural resources that are scarce, such as diamonds, uranium, and quartz; 2) foreign firms were to be banned from large mineral deposits; and 3) foreign participation was to be restricted in fields close to military sites.

In addition to these restriction plans related to strategic natural resources, the Russian Government started to plan the restrictions concerning the participation of foreigners in areas related to national security. In March 2006, the then Economic Development and Trade Minister Gref released information about a bill aimed towards restricting foreign access to 39 types of activity linked with the production of weapons and military hardware, nuclear materials and nuclear facilities, the space industry, and aviation (Interfax 2006).

In April 2007, Putin (2007) stated in the speech to the Federal Assembly as follows: *"Another question future generations will have the right to ask us regards the use of our country's natural resources. Are we really gaining maximum benefit from our natural resources? This question applies not only to oil, gas and mineral resources, but also to our forestry and water resources."*

Even if the core ideology behind the strategic government policies has probably remained more or less unchanged during the past 10 years, the legislative process, which has been carried out for the past 3 years, has been everything but straight-forward. As an indication of

the meandering process, the State Duma passed the law on the role of foreign companies in strategic sectors in the first reading in September 2007. However, Industry and Energy Minister Khristenko informed in November 2007 about the postponement of the law concerning strategic sectors (BOF 2007a).

Several reasons might be behind the postponement. First, both the parliamentary elections and the presidential elections were to be held within 6 months, i.e. in December 2007 and March 2008 respectively. Another explanation for the postponement was probably the fact that the Russian security services wanted to add new sectors to the law. Thirdly, the delay in the legislative process of the Subsoil Law was perhaps one reason behind the postponement (MT 2007a; TD 2007a/c; TD 2008b). Fourthly, the heated debate with the EU concerning the restrictions of foreign firms in Russia, and the EU's plan to restrict the entry of firms foreign to them, particularly, the Russian firm Gazprom, might have pushed the Russian decision-makers to postpone the adoption of the law (Liuhto 2008a/b)<sup>5</sup>.

Such a law would harm the investment climate in Russia and slow down the development of competitiveness in Russia. Moreover, one can wish that building restrictions towards foreign companies will not create a vicious circle of eternal reciprocity of restrictions between Russia and the EU / the USA. Signs of reciprocity of restrictions have been on the air for a while (Reuters 2007).

For instance, the European Commission published in September 2007 new draft regulations for the EU electricity and gas markets. In practice, this means that no operator will be able to simultaneously control energy production, transport, and distribution (EW 2007b). In this context, one may ask whether the division requirement will work. For instance, Moscow might create a Potemkin-style division of Gazprom to get around any future EU restriction (WSJ 2007).

Russia's reactions came soon. Putin pointed out that Russia's law is a response to restrictions on Russian investments in other countries, possibly referring to the US Foreign Investment and National Security Act and the EU's plans to impose similar regulations in the energy sector (TD 2007b). With a similar tone, Kosachev, head of the Russian parliament's international affairs committee, stated: "*In the same way they [the EU] are going to try to stop*

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<sup>5</sup> "Under the EU procedures, legislative initiatives of the European Commission must be approved by the European Parliament and the Council, and the new regulations will not come into force until 2010. By that time, the EC proposals may have undergone major adjustments" (EW 2007b, 3).

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*us entering markets sectors of the western European economy, we will have to limit access for our foreign partners to the corresponding strategic sectors of the Russian economy.”*

In the beginning of April 2008, the State Duma passed one law integrating the bill on strategic sectors and the law draft on subsoil use (EW 2008b). A month later, President Putin signed the law just two days before he stepped down from the presidency (Reuters 2008). The core components of the law have been summarized in Table 1.

When evaluating the impact of the strategic government policies on foreign firms, one should keep in mind that the aforementioned law forms only a tip of the iceberg, i.e. the explicit part of the strategic government policy. The implicit part of the strategic government policy is the creation of Russian-owned corporations in key industries of the Russian economy with either state finance (such as funding capital received from the state, favorable loans from Kremlin-friendly financial organizations, etc) or by using administrative measures, i.e. using authorities (such as environmental, construction, taxation, or regional authorities. etc)<sup>6</sup> to slow down the operations of a foreign competitor or non-Kremlin loyal Russian corporation<sup>7</sup>. This policy may also be called the National Champions Policy<sup>8</sup>.

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<sup>6</sup> “The country’s [Russia’s] legal system, and the perceived lack of independence, is one of the largest obstacles to investment. ‘On the one hand, the legal environment is getting better,’ Somers [Head of American Chamber of Commerce] said. ‘But at the same time, there seems to be a trend toward bringing criminal actions in parallel with civil lawsuits. Companies are put in the difficult position of deferred tax payments and a criminal investigation is opened in the middle. Sometimes, the civil act is resolved, but the criminal investigation continues,’ he said.” (MT 2008ag).

<sup>7</sup> An example of this might be RussNeft. Shares in RussNeft were frozen in 2007 as part of a criminal investigation in the company’s former owner, Gutseriyev, concerning allegations of fraud and tax evasion. Gutseriyev fled Russia in September 2007 but has denied any wrongdoing (BEE 2008c). The company may drop in the hands of Deripaska (MT 2007m).

<sup>8</sup> For those skeptics who doubt the state’s systematic takeover of certain industries and companies, I recommend them to read the interview of Oleg Svartsman in Kommersant 30.11.2007. If only a part of his interview turns out to be true, that would be enough to bring dark clouds to the future investment climate of Russia.

**Table 1. A summary of the law on strategic sectors passed by the State Duma****Main sectors to be restricted:**

- Nuclear installations and materials
- Cipherring-related activities
- Arms and military technology
- Aviation technology
- Communication services, if a foreign company has a dominant position
- Metals and metal alloys important for the army
- Extraction of minerals on subsoil plots of federal importance<sup>9</sup>
- Catching of water biological resources
- Large-scale publishing and printing activities
- Television and radio broadcasting

**Main ownership restrictions:**

- Foreign companies are not allowed to have control over those companies of strategic importance to Russia, i.e. foreign firms can own less than 50% of these companies. If the ownership reaches 50% or over, a foreign company needs permission from the Prime Minister-led commission.
- Foreign government-owned companies need permission from the Prime Minister-led commission to own more than 25% of a strategic company.
- Stricter restrictions are applied to the use of minerals on subsoil plots of federal importance. The ownership limit is set at 10% for private foreign firms and 5% for foreign government-owned firms.
- Foreign firms can own up to 50% of subsoil plots of federal importance, if the plot is located on the continental shelf of Russia, and the main partner is a Russian government-owned entity.

**Law in force:**

- Planned to be in force when published i.e. 5.5.2008.
- The law should not be retroactive.

**Some weaknesses of the law:**

- The law also covers some non-strategic sectors for the country's defense and state security, such as catching of water biological resources, publishing, printing, television and radio broadcasting.
- The process related to a foreign firm's participation in a strategic company is highly vulnerable to administrative misuse and political choice.
- The law does not explicitly state what metals are important for the army.
- It is not clear what an ownership share is when a foreign firm is regarded as government-owned.
- The law comes into force too soon, i.e. a minimum transition period of 3-5 years should have been given for foreign firms to adapt to the changed investment climate.
- The law symbolizes the end to the economic reform in Russia, and starts the era of the economic nationalism with unknown consequences to foreign firms operating in any key industry, including those key industries not mentioned in the given law.

<sup>9</sup> A separate draft of amendments describes which fields will be classed as strategic. Petroleum fields holding more than 70 million tons of oil or 50 billion cubic meters of gas will fall under this category (RIA 2007a; TD 2007d; 2008b/d). In December 2007, a decree from Prime Minister Zubkov was published, declaring 32 state-owned gas fields as strategically important resources. This means that licenses for the operation of the fields in question may be awarded to economic operators without having to undergo tenders. The new regulation was adopted primarily in the interest of Gazprom, which is the main candidate to take over the fields concerned. Decisions concerning the awarding of licenses for the development of the 32 'strategic' fields (18 in the Yamal Peninsula, 5 in Yakutia, 5 in the Kara Sea, 3 in the Barents Sea and 1 in the Sea of Okhotsk), with total proven gas reserves of 5 200 billion cubic meters, will be taken by the government, which may choose to distribute these licenses without any tendering procedure (EW 2007a). Earlier information suggests that also gold fields over 50 tons, copper fields over 500 000 tons, and all the fields containing diamonds, uranium, pure quartz, lithium, and platinum would be considered as strategic (MT 2008i).



By the beginning of 2008, Russia has formed six state corporations (Wisniewska 2008)<sup>10</sup>: 1) The **Development Bank** (invests in strategic projects to the state), 2) **Rosnanotekh** (supports the state's nanotechnology policy), 3) **Fund for the Reform of the Municipal and Housing Sector** (develops the municipal and housing sector), 4) **Olimpstroy** (to be responsible for the construction of the Sochi 2014 Olympic Games), 5) **Rostekhnologii** (to develop Russia's heavy industry), and 6) **Rosatom** (to consolidate the main nuclear assets).

The state may also found **Avtodor**, a corporation to modernize the road network, and **Rosrybflot**, a corporation to foster the development of Russian fisheries. Furthermore, the government has discussed the possibility of creating a state holding in the manufacturing of pharmaceuticals. It has been argued that these state corporations will further reinforce the role of the state in the Russian economy, whilst, at the same time, enabling the Kremlin elite to continue amassing wealth (EW 2007c; FT 2007; MT 2007d).

In addition to the aforementioned state corporations, the state has recently established the **United Aircraft Manufacturing Corporation** and the **United Shipbuilding Corporation**. The first company will become an engine for modernizing aircraft manufacturing, and the second one works in all segments of the shipbuilding market, from designing and building ships to carrying out maintenance and repair work (BOF 2007b; Putin 2007).

In addition to the establishment of state-owned national champions, the Russian Government may put forward privately-owned corporations as national champions. The logic behind the use of private companies is the loyalty of certain oligarchs to the Kremlin or the Kremlin's invisible, de facto control over certain privately-owned companies. Control may be exercised via various administrative means, such as allowing licenses for natural resources, giving

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<sup>10</sup> The state corporation is "a unique legal form in Russia; the term refers to a hybrid of a joint stock company and a federal state-owned company. It has very extensive competences, and is subject to a minimum of state oversight. The laws establishing state-owned corporations provide that these bodies become owners of state property in the economic sectors for whose development they have been established. The corporations are authorised to effect any transactions involving such property and to create subsidiaries (they may be privatised through IPOs). Financial reporting requirements applicable to state-owned corporations are much less strict than in the case of joint stock companies, for instance, while state-owned corporations enjoy much more freedom in taking financial decisions. Their profits are not transferred to the budget, but instead remain with the corporation to be spent on the implementation of its statutory objectives. Even though they may carry out economic activities like full-fledged economic operators, state-owned corporations are exempt from direct supervision by competent state bodies, and instead are supervised directly by the President of the Russian Federation. The president appoints and dismisses the most important person in a state-owned corporation, i.e. the director general, whose tasks include managing the company's assets." (EW 2007c, 2-3).

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priority access to pipelines, participation in friendly auctions, offering inexpensive state loans or guarantees, or using authorities to harass a competitor's business.

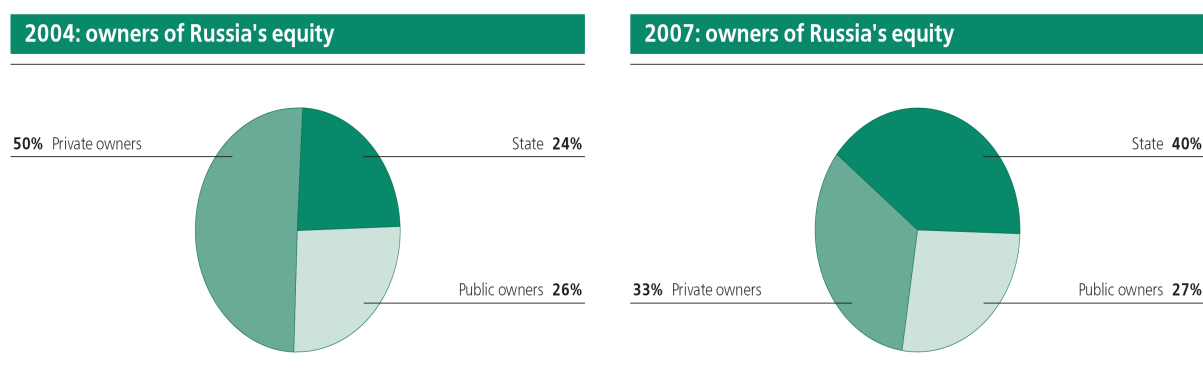
The National Champions Policy has not received unreserved support from all the Kremlin staff. In October 2007, the Kremlin's top economic advisor Dvorkovich stated that *"I view the fashion of creating state corporations as being extremely dangerous particularly for the industries being proposed"* (MT 2007c, 1). *"The concerns expressed by Dvorkovich are warranted ... With few exceptions, in most countries state-controlled enterprises are associated with waste, corruption, overstaffing and underperformance – all of which constitute a huge burden on the economy. And in a country like Russia, where the principal challenge is to develop trained, competent and honest managers – especially in the public sector – the last thing the country needs is to bring more of its economy under the control of state managers"* (MT 2007i, 9).

In December 2007, Putin said as follows (MT 2007b, 5): *"We are not planning to keep state corporations in their present form. After these corporations stand on their own two feet, then I think it will be right for them to work in market conditions. ... We need to make sure they don't strangle other businesses"*. It may take ages and hundreds of billions of rubles before these corporations stand on their own, and meanwhile, they disturb the formation of natural competition.

## 2 The impact of strategic government policies on state ownership within Russian firms and FDI inflow to Russia: A statistical view

The state has increased its role in the economic activities of the Russian Federation. In 2000, the private sector formed 70% of the Russian GDP, whereas now it accounts for some 65% (EIU 2008a)<sup>11</sup>. Even if the drop seems small at the first glance, it needs to be remembered that the Russian GDP has grown very rapidly during this decade, i.e. the state has gathered more economic power into its hands in absolute terms. Table 2 shows the growing ownership stake of the state in Russia's publicly traded companies during Putin's second presidency.

Table 2. Increasing state control in Russian business



### THE MOST AND LEAST CONCENTRATED SECTORS OF THE RUSSIAN ECONOMY IN 2007

#### 2007: government maintains controlling heights in four strategic sectors

	Sector MCap, \$ bln	Public	Private	State
Banking	117.18	27%	9%	64%
Manufacturing	15.58	17%	30%	53%
Oil and gas	643.60	29%	24%	47%
Telecoms	13.16	26%	27%	47%
Utilities	79.54	8%	55%	37%
Transport	6.67	21%	48%	30%
Chemicals	20.58	18%	78%	4%
Metals and mining	165.95	27%	70%	3%
Mobile, media and IT	86.23	31%	68%	1%
Consumer	16.79	21%	79%	0%
Retail	9.38	28%	72%	0%
<b>Market average</b>	<b>1,174.6</b>	<b>27%</b>	<b>33%</b>	<b>40%</b>

Note: Figures as of November 21, 2007.

Source: TD (2008a)

Russia experiences a FDI boom despite the Yukos case and the execution of strategic government policies. The Russian FDI stock has jumped from USD 5 billion in 1995 to over

<sup>11</sup> The private sector share is lowest in Belarus and Turkmenistan among the former Soviet republics, where it represents only 25% of the GDP (EBRD, 2007).

USD 130 billion in 2005. At the end of 2006, the stock was close to USD 200 billion (UNCTAD 2007). As a continuation of the growth trend, the FDI inflow surged by some USD 50 billion dollars in 2007 (EIU 2008a). The Economist Intelligence Unit prognoses the annual FDI inflow to be more than USD 30 billion until 2011 (BEE 2007a)<sup>12</sup>. A negative side of this growth trend is the fact that without the Yukos case and strategic government policies, Russia's FDI inflow would be even bigger. Russia seems to be prepared to sacrifice a part of the FDI inflow in order to obtain more state control over key sectors.

When compared to other large ex-Soviet republics, Russia performs well. For instance, Russia's FDI stock per capita is clearly higher than in Ukraine. Correspondingly, when compared to other emerging markets, it becomes clear that Russia has higher per capita figures than Brazil. On the other hand, there is a substantial gap when compared the FDI stock per capita figures with the USA, the leading recipient of FDI in the world (see Table 3).

Table 3. FDI and its significance in selected countries

	Inward FDI stock (USD billion)				FDI stock per capita (USD)
	1990	1995	2000	2005	2006
<b>Russia</b>	...	<b>5</b>	<b>32</b>	<b>132</b>	<b>1398</b>
Brazil	37	43	103	201	1168
China, excl.					
Hongkong	25	137	193	318	221
Poland	0,1	8	34	93	2690
Ukraine	...	0,9	4	17	486
USA	395	536	1257	1626	5941

	FDI flow as percentage of gross fixed capital formation	FDI stock as percentage of GDP
	2006	2006
<b>Russia</b>	<b>16.3</b>	<b>20.2</b>
Brazil	10.5	20.8
China, excl.		
Hongkong	8.0	11.1
Poland	20.5	30.6
Ukraine	21.0	21.1
USA	6.8	13.5

Sources: UNCTAD (2002; 2006; 2007)

International comparison reveals that FDI plays a relatively significant role in Russia's capital and GDP formation. In other words, Russia cannot afford to close its market from foreign companies. Russia needs modern technologies, advanced management skills and more competition in particular. Here, one ought to bear in mind that without intensive competition

<sup>12</sup> This prognosis has been undertaken before the State Duma passed the law on strategic sectors, i.e. it does not take into account the impact of new amendments into the strategic sector on FDI inflow.

Russia is unlikely to improve its competitiveness, i.e. by reducing foreign competition Russia slows down the development of competitiveness in the country (Liuhto 2008b).

Even if the FDI boom is a fact, it needs to be stressed that the boom is partially due to the repatriation of Russian capital, i.e. due to capital round-tripping. It is impossible to say precisely, what is the stake of Russian capital in foreign investment inflows. However, when one takes into account the fact that the share of Cyprus, Switzerland and the Virgin Islands has been 15-25% of the annual foreign investment inflows to Russia during this decade, it may give a reader a hint of the proportion of the Russian capital in the foreign direct investment inflow into the country. Russian capital also repatriates itself from other countries (see Table 4).

Table 4. The division of foreign investment inflow to Russia by origin (%)

	1995	2000	2002	2003	2004	2005	2006	3Q2007
<b>UK</b>	6	6	12	16	17	16	13	24
<b>Netherlands</b>	3	11	6	6	13	17	12	20
<b>Cyprus</b>	1	13	12	14	14	10	18	14
<b>Luxembourg</b>	0	2	6	8	21	26	11	9
<b>France</b>	4	7	6	13	6	3	6	5
<b>Germany</b>	10	13	20	15	4	6	9	4
<b>Virgin Islands (UK)</b>	1	1	7	5	2	2	4	2
<b>Switzerland</b>	15	7	7	4	4	4	4	9
<b>USA</b>	28	15	6	4	5	3	3	2
<b>Others</b>	33	25	19	17	15	15	28	23

Source: Vinhas de Souza (2008)

I have followed the FDI flows to the USSR / Russia since 1987, and I must admit that the FDI statistics are anything but unambiguous. Therefore, one cannot make any firm conclusion on the basis of the sector division of the FDI. The report published by the European Commission indicates that investment activity has not changed at all despite the strategic government policies (see Table 5).

Table 5. The division of foreign investment inflow to Russia by sector (%)

	2003	2004	2005	2006	3Q2007
<b>Agriculture, Hunting and Forestry</b>	<b>0.5</b>	<b>0.3</b>	<b>0.2</b>	<b>0.6</b>	<b>0.3</b>
<b>Mining and Quarrying</b>	<b>19.3</b>	<b>24.5</b>	<b>11.2</b>	<b>16.6</b>	<b>17.3</b>
<i>mining and quarrying of energy producing products</i>	17.3	21.6	9.6	14.1	16.0
<i>mining and quarrying, except of energy producing products</i>	2.0	2.9	1.6	2.5	1.3
<b>Manufacturing</b>	<b>22</b>	<b>25.3</b>	<b>33.5</b>	<b>27.5</b>	<b>24.6</b>
<i>manufacture of food products</i>	3.4	2.3	2.2	2.5	2.5
<i>manufacture of chemicals and chemical products</i>	1.2	1.9	2.7	2.8	1.2
<i>manufacture of metals and fabricated metal products</i>	10.3	12.6	6.4	6.8	12.6
<i>manufacture of transport equipment</i>	0.7	2.1	1.8	2.6	0.9
<i>manufacture of coke and mineral oil</i>	0.6	0.2	15.1	7.2	3.8
<b>Services</b>	<b>58.2</b>	<b>49.9</b>	<b>55.1</b>	<b>55.3</b>	<b>57.8</b>
<i>construction</i>	0.3	0.6	0.4	1.3	1.2
<i>wholesale, retail, repair activities</i>	36.1	32.9	38.2	23.7	42.3
<i>transport and communication</i>	3.8	5	7.2	9.6	6.5
<i>of which communication only</i>	2.3	3.4	6.1	8.5	2.9
<i>financial intermediation</i>	2.6	2.5	3.4	8.5	2.4

Source: Vinhas de Souza (2008)

Surprisingly, the World Bank (2007, 7) indicates that the share of mineral resources in FDI inflow would have surged lately. According to the World Bank, the extraction of mineral resources represented 33% of the Russian FDI inflow in 2006 and 71% in the first half of 2007.

One possible explanation for this surprising statistical development is the fact that Russian companies are involved in investing in the strategic sectors, i.e. the repatriation of Russian capital into these sectors explains that no change has occurred. One may ask, have we witnessed foreign investments, conducted by real foreign firms, worth some USD 10 billion in mining and quarrying of energy producing products in 2007? In 2007, 17% of Russia's total FDI (USD 52 billion) went towards the mineral extraction industries (BOF 2008e/f).

In order to transform the aforementioned statistics into information, which can be used to support economic policy-making, further studies are absolutely necessary. It would be of particular interest that Russia would publish the 100 largest foreign investors in the country. This is a relatively common practice in other emerging European economies. The publication of the largest investors would create the needed transparency and possibly also attract other

foreigners into the country. During the past 20 years I have not been able to receive such a list, though it probably exists.

The statistics concerning Finnish investment to Russia are also anything but accurate. An educated guess might be that Finnish investment stock in Russia is around EUR 3-5 billion, prior to major investment by Fortum in Russia. In February 2008, Fortum won the auction of TGC-10, a part of RAU UES, the main electricity producer of Russia. Fortum acquired a 29%-stake for EUR 800 million. In addition, it has committed itself to buying a further 34% to 47% through a share issue for EUR 900 - 1300 million. When Fortum makes the mandatory offer for the remaining shares, the overall investment would be around EUR 2.7 billion (MT 2008a). As can be seen from the statistics presented in Table 6, Fortum's investment is by far the largest investment conducted by a Finnish corporation in Russia.

Table 6. FDI movements between Finland and Russia (EUR million)<sup>13</sup>

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
<b>Finland's FDI stock in Russia</b>	91	196	314	458	342	374	559	1097	1676	1797
<b>Russia's FDI stock in Finland</b>	272	241	241	306	449	338	366	378	431	446

Source: BOF (2008a)

Table 7. The largest Finnish employers in Russia

<b>Company</b>	<b>Activities</b>	<b>Personnel 2007</b>
Fazer	5 bakeries, several AMICA caterings	3 700
Stockmann	4 department stores, Seppälä, Hobby Hall	2 640
YIT	Construction	2 154
Rautaruukki	Ventall, service centre	2 100
Stora Enso	2 saw mills, 3 packing factories	1 950
Sanoma	Journals, kiosks, newspaper distribution	1 820
PKC-Group	2 assembling factories	1 820
Atria	Meat product factory	1 500
Kesko	8 construction material supermarkets	1 440
UPM	Saw mill, plywood factory, logging company	1 210
Kemira	6 Tikkurila paint factories, logistics centre	1 200
Lemminkäinen	Several construction projects, Kaluga industrial park	1 000

Source: Ostint Oy, for reference see KL (2008e)

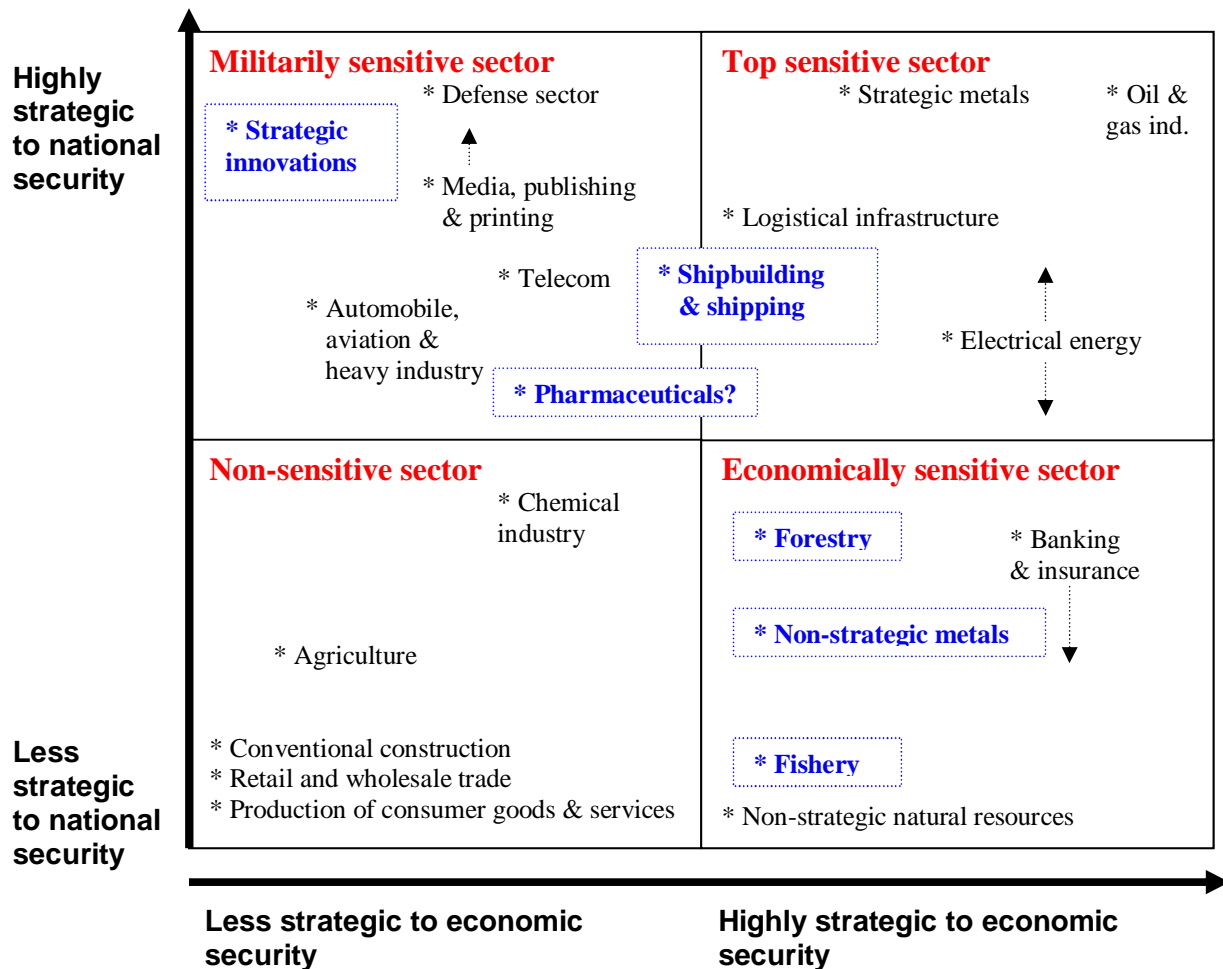
<sup>13</sup> I doubt that the total amount of the Finnish capital in Russia is nearly EUR 10 billion (AL 2008a/b; KL 2008f).



### 3 Some main events in Russia's sensitive sectors since January 2007

The strategic governance matrix published in January 2007 has not lost its relevance, on the contrary, it needs to be updated with new industries<sup>14</sup>. The industries put in a box seem to have become strategically significant for the Russian state since January 2007.

**Figure 1** Positioning Russia's key industries in the strategic governance matrix<sup>15</sup>



Source: Liuhto (2007)

<sup>14</sup> The author positions some of Russia's key industries in the strategic governance matrix by using two dimensions, i.e. to what extent an industry is strategic for the national security and the national economy. With these two parameters, the Russian economy is divided into the following four sectors. 1) The militarily sensitive sector is highly strategic for Russia's national security, just as 2) the economically sensitive sector is highly strategic for the country's economic functioning. 3) The top sensitive sector stands for those industries which are highly strategic for both national and economic security. On the contrary, 4) the non-sensitive sector has lower strategic importance in both of these dimensions.

<sup>15</sup> Pharmaceuticals has been marked with a question mark due to fact that only one source referring to the statement of Dvorkovich mentions the state's interest to run the production of pharmaceuticals (MT 2007i). As this statement is in line with strategic governance ideology, pharmaceuticals have been left in the matrix, since it may pop in there later. Abramovich sold 17% of Pharmstandard to its main shareholders (MT 2008v).



10 main observations related to strategic governance policies since January 2007 are the following:

**1) The state's takeover in the oil business continues**

- The state's role in the oil business increases.
- Consolidation of the oil industry continues.
- The position of foreign firms has weakened dramatically.

**2) The state's control over strategic metal producers and heavy industry increases**

- Russia's aluminum industry is in the hands of the Kremlin-loyal oligarch Deripaska.
- The ownership battle over Russia's most important metal producer, Norilsk Nickel, continues, but it seems evident that the Kremlin-friendly oligarchs will strengthen their grip, and ultimately, may gain control over Norilsk Nickel's assets.
- Main producers of strategic metals evidently fall under Rostekhnologii / Rosoboronexport.
- **Aviation, shipbuilding, and heavy machinery:** decisive and systematic consolidation of heavy industry and machine building currently takes place in Russia.
- The position of foreign firms dealing with strategic and precious metals weakens further since the use of certain strategic metals becomes restricted. Even prior to the law, foreign mining firms have faced serious difficulties in operating in Russia.
- There are encouraging signs that foreign firms have managed to buy stakes in leading machine building corporations. In this context, one needs to remember that these stakes are rarely large enough to allow a foreign firm to control the Russian firm.

**3) The state is strengthening its role in hardcore logistics**

- State merges oil pipeline operators, Transneft and Transnefteproduct. Former KGB general Tokaryev was appointed head of the merged company.
- The consolidation of the shipping industry takes place.
- The state may found a state corporation, Avtodor, to modernize the road network.
- The state-owned companies have become more interested in acquiring ports inside Russia. The construction of the major port in the Russian part of the Gulf of Finland, Ust-Luga, seems to indicate Russia's aim at decreasing its dependence on transit.
- It is not fully clear yet whether the authorities' misuse concerning Container Finance in Kronstadt was orchestrated by the federal bodies or was an aggressive action by a competitor.

**4) Pyrrhic victory in the privatization of the electrical energy sector**

- Nuclear electricity is restricted from foreigners by the law on strategic sectors. The state aims at increasing the share of nuclear electricity from the current 16% to 25-30% by 2030, i.e. the restricted electricity sector widens.
- It remains to be seen whether foreign firms will face restrictions in hydropower activities.
- RAO UES, which used to produce some 70% of the country's electricity, is to be divided. So far four foreign companies, Enel, E.On, Fortum, and RWE, have acquired a strategic stake, and ultimately, allowing a control stake in four out of 20 electrical units.

- Gazprom's share in Russia's electricity production may increase up to 40% despite privatization, i.e. a sign of quasi-privatization.
- Gazprom together with SUEK, Russia's largest coal producer, provide the majority of the raw material for all the electricity units in the country, providing Gazprom with a strong control position.
- A price liberalization of electricity is still an enigma; the electricity prices for the industry ought to be fully liberalized by 2011, however, it seems unrealistic to expect that household electricity prices would be market-based, even if the Economics Ministry has indicated the aim to double the price by 2015.

## 5) Telecommunications: a mixture of stagnation and turbulence

- The law on strategic sectors implies that foreign firms face restrictions in the telecommunication sector.
- The privatization of Svyazinvest has been delayed several times, though at the moment there might be some light at the end of the tunnel. Should the privatization occur, it obviously will be carried out by Russian companies.
- Altimo has created a lot of turbulence in mobile telecommunications. Altimo's recent announcement to sell its stake in Megafon in exchange for acquiring a stake in Turkcell is a new page in the turbulent history of Russian mobile telecommunications.

## 6) Banking and insurance

- The Kremlin ideologists have explicitly noted the strategic value of banking to the overall functioning of the Russian state, though the branch is not touched in the law of the strategic sectors.
- There have been certain consolidation steps prior to Russia's possible accession to the WTO, i.e. the state has consolidated the key assets, though it has collected private capital (both foreign and domestic) via initial public offerings.
- Banking is probably the most positive surprise amongst the key industries, and several foreign banks have lately entered the Russian market with major investments. The activities of certain Kremlin-loyal oligarchs in insurance are less encouraging for foreign business.

## 7) The strategic importance of certain non-strategic natural resources has risen

- **Forestry:** the law on strategic sectors does not refer to forestry, though its risk dimension has definitely increased since Putin's state-of-the-nation address in April 2007. The address may infer that Russia might be interested in creating a national champion in this industry, not only force foreign firms to invest in Russia by increasing the export tariffs of raw wood. One of the fundamental problems of this industry, in terms of its risk dimension for foreign firms, is the public ownership of the forests. In reality, forestry should not contain any strategic value, except its economic value to the state. Russia's Forestry Strategy until 2020, when published, may shed some light on the future position of foreign firms.
- **Non-strategic metals:** there are certain ferrous metal oligarchs, who may become private national champions in this field. The position of the Kremlin-loyal firms is always more equal than others, i.e. other domestic firms, much less any foreign ones.
- **Fishery:** fishing should not have been included in the law on strategic industries. Now, the fishery industry has been classified as one of the sectors to be restricted from

foreign firms. The state may found a state corporation, Rosrybflot, to foster the development of Russian fisheries.

**8) The main assets of the media were already taken over by the state or its loyalists prior to 2007**

- Publishing and printing activities were classified as strategic by the law on strategic sectors.
- It was extremely important that Internet services did not end up in the final law on the strategic sectors despite the fact they were mentioned in some drafts. However, no-one can guarantee that the Internet services might not end up in the sectors to be restricted in the future, if the political regime becomes more conservative.
- The role of foreign firms in leisure-oriented printed media, such as fashion, sports, and the yellow media, seems to be accepted by Russia's ruling elite as long as the media in question do not touch political affairs and the main political figureheads.

**9) Consumption-related sectors remain below the Kremlin radar**

- Despite several market-specific problems, the production and distribution of consumer goods and services have stayed under the Kremlin's radar, i.e. it has remained out of the political economy. Despite this fact, it seems that some of the Kremlin-oligarchs have already made an appearance in strategic construction.

**10) Strategic, innovation-related activities positioned closely to Russia's defense industry, an increasing risk for foreign firms**

- The State Nanotechnology Corporation is perhaps an indication of the Russian state's desire to invest in the diversification of the economy and to increase its competitiveness. The state's involvement might be extremely counterproductive since by becoming an active actor in any field, it restricts the formation of normal competition, and hence the formation of sustainable competitiveness.

## 1) The state's takeover in the oil business continues

The natural gas business is under state control as state-controlled Gazprom produces over 80% of the natural gas in the country, the company controls all the gas pipelines, possesses an export monopoly, and the government decides who is allowed to use large gas fields. Even if the share of private oil companies in gas production increases in the following decades, one can argue that Russia's natural gas has always been in close control of the state, and will remain as such despite the sales of minority stakes to foreigners (Wisniewska 2007; TD 2008p)<sup>16</sup>. Furthermore, I would not be surprised to see ownership swaps between major foreign gas corporations and Gazprom in the future (TD 2007m; MT 2008ad)<sup>17</sup>.

In the oil business, the systematic takeover by the state has continued since the end of 2003, i.e. the beginning of the Yukos affair. The state's ownership share in publicly-traded oil firms has increased from 32% in 2004 to 47% in 2007<sup>18</sup>. The regional oil companies, such as Bashkir energy, seem to fall into state hands, i.e. Rosneft and Gazprom. It remains to be seen what will be the fate of Tatneft, Tatarstan's oil company, which ranks sixth among the largest oil producers in Russia<sup>19</sup>. Secondly, consolidation of the oil business is a reality, and probably the share of the six major oil producers will be over today's 80% of the total production in the next decade (TD 2008 a/c/e)<sup>20</sup>.

Thirdly, the role of foreign companies worsens due to the law on strategic sectors, limiting the participation of foreign companies in large oil fields. Moreover, global oil majors, such as RD Shell, have already experienced drawbacks, when they have been forced to sell their ownership in PSAs (MT 2008b)<sup>21</sup>. The recent difficulties of BP with the Russian authorities may indicate the continuation of the state's interest to acquire stakes from major foreign oil

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<sup>16</sup> "The Cabinet on Monday [14.4.2008] agreed to hand one of the country's [Russia's] biggest oil and gas fields over to Gazprom without a competition, acting on orders from President-elect Dmitry Medvedev. It marks the first time in post-Soviet Russia that a company has received a field without having to fight off rival bids, a Gazprom source said." (MT 2008ah). The field called as Chayanda has estimated gas reserves of 1200 billion cubic meters (NE 2008c).

<sup>17</sup> For example, RD Shell has offered Russian state-controlled Rosneft a stake in the MIRO Karlsruhe oil refinery in Germany in exchange for access to oil fields in western Siberia (BEE 2007b). Salym, a 50-50 venture between Shell and Sibir Energy, is a strange apple in Russia's garden (MT 2008af). Is the venture sustainable?

<sup>18</sup> Oil companies owned by regions or the state accounted for 15% of oil production in 2003, whereas at the end of 2007 their share has already risen to 36% (BOF 2007c).

<sup>19</sup> Possibly, as a counter-reaction to the state's increasing interest, Tatneft may have begun a strategic partnership with RD Shell (TD 2007e).

<sup>20</sup> Although the merger plan has been frozen for now, I would not completely exclude the possibility that Rosneft and Gazprom would be merged in the future (Argus 2007; TD 2007f).

<sup>21</sup> It would not be a surprise if ExxonMobil would face similar pressure from the Russian Government akin to what RD Shell and BP have already experienced earlier, even if Rosneft is already involved in ExxonMobil-led project (BEE 2007c; MT 2007e; Argus 2008c).

companies in Russia (Argus 2008a/b; BEE 2008e; EW 2008c; IHT 2008; MT 2008a; NE 2008b). Even if other foreign companies have acquired smaller shares in major fields (Total and StatoilHydro in Shtokman), I stick to my earlier conclusion that the oil business is the most evident case of the top sensitive sectors in Russia. For a foreign firm, it means extremely high political risk (MT 2008f). The rules of international politics apply better in the top sensitive sector than does the logic of international business.

## **2) The state's control over strategic metal producers and heavy industry increases**

Private individuals own some 70% of the metal and mining industry, whereas the share of the state is only 3% (TD 2008a). However, there are clear signs that economic nationalism has also risen in this sector, and the consolidation has begun (Kärnä 2007). Even without direct ownership, the Kremlin uses its indirect control via persons loyal to the state's strategic goals.

Perhaps, the classic case of a Kremlin-loyalist<sup>22</sup> is Oleg Deripaska, Russia's wealthiest person with ownership valued at USD 28 billion in the beginning of 2008. It is interesting to note that several of Russia's richest men have gained their wealth in the metal business. Earlier the oil business was the way to the top. This is another sign of the state-led takeover in the oil business (see Appendix 2).

The whole Russian aluminum sector has de facto merged around Basic Element / RusAl (Deripaska). Now Deripaska aims at swallowing Russia's leading metal producer, Norilsk Nickel<sup>23</sup>. In December 2007, RusAl started the acquisition process with a goal to buy a bit more than a quarter of Norilsk Nickel from Prokhorov<sup>24</sup>. In order to avoid a hostile takeover by RusAl, Potanin, the leading owner of Norilsk Nickel, has started merger talks with Usmanov<sup>25</sup>, owner of Gazmetall and Metalloinvest (MT 2007f/h; NE 2008a). In addition to the

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<sup>22</sup> "In July 2007 Mr. Deripaska conceded he would 'give up' Rusal to the state if asked" (BEE 2008a, 4).

<sup>23</sup> "The takeover of a blocking stake in Norilsky Nickel (Deripaska seeks to take over control of NN) is another stage in Deripaska's effort to create a global giant in the non-ferrous metallurgy sector. In March 2007, he effectuated the merger of Russia's two largest aluminium companies - Russkiy Aluminium (RUSAL) and Sibirsko-Uralskiy Aluminium (SUAL) and the Swiss metal trade intermediary Glencore. UC RUSAL, the company established as a result of the merger, is controlled by Deripaska (who holds 66% of the shares) and is the world's largest aluminium concern, with assets in Russia, the CIS, Ireland, Sweden and Jamaica. RUSAL accounts for 12% of the global production of aluminium, and 15% of the global production of alumina." (EW 2008a).

<sup>24</sup> As a reward of his willingness to sell a stake to the Kremlin-loyalist, Deripaska, Prokhorov seems to receive an electricity unit, TGC-4 (MT 2008z). The deal is expected to be concluded by the end of April, 2008 (MT 2008w). However, in the first half of April the deal with RusAl did not completely clear (MT 2008y; TD 2008r).

<sup>25</sup> Usmanov is believed to have close relations with the Kremlin.

ownership battle in Norilsk Nickel, the same actors, Interros and Onexim, have been involved in the struggle over Polyus Gold, one of the country's leading gold producers. Now the gold battle seems to have calmed (TD 2008g/o). Alrosa, the diamond producer, may also step into the game later. When surrounded by Kremlin-loyal oligarchs one does not have to be a clairvoyant to predict future development.

With the foundation of Rostekhnologii<sup>26</sup> in November 2007, the Russian state aims at increasing the competitiveness of their heavy industry. Simultaneously, strategic metals, such as titanium, are concentrated under this state corporation. It would not be a great surprise to see that firms related to strategic metals would fall, one by one, under Rostekhnologii (AC 2007a/b)<sup>27</sup>. First Vice-Prime Minister Ivanov, who heads the government's Military-Industrial Commission, has opposed the plan to merge certain defense-related assets under Rostekhnologii (MT 2008d). In a similar tone, Economic Development and Trade Minister Elvira Nabiullina *"demanded that Chemezov justify why the state corporation needs interests in so many apparently unconnected sectors. ... Nabiullina is seeking to block Russian Technologies' plans to take stakes in a number of passenger airlines and 37.8 percent in truck maker KamAZ"* (MT 2008aj).

The foundation of two other state-owned companies, United Aircraft Manufacturing Corporation and United Shipbuilding Corporation, supports the assumption that the underlying goal of the Russian Government is to make Russian heavy industry more competitive via mergers. The steel tycoon Mordasov's acquisition of Power Machines suits the government's strategic agenda very well (TD 2008f). ***The era of heavy mergers in Russia has just begun.***

It has been assumed that the law on strategic sectors restricts the participation of foreign firms in the use of precious or rare metals, such as diamonds, uranium, pure quartz, lithium and platinum. Besides, the explicit restrictions, foreign firms have already faced several difficulties in this sector earlier, and now it seems that many of them may be acquired by leading Russian firms. For instance, Mordasov's Severstal, in November 2007, reached an agreement to acquire Celtic Resources after a period of aggressive bidding. Similarly,

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<sup>26</sup> Rostekhnologii brings the Russian weapons export monopoly, Rosoboronexport, together with the titanium producer VSMPO-AVISMA, the automotive manufacturer Avtovaz, the helicopter producer Oboronprom and a number of other companies (EIU 2008b). This company is headed by Sergey Chemezov, Putin's KGB colleague from their time in Dresden (EW 2007c).

<sup>27</sup> In December 2007, Chemezov submitted a list of nearly 250 state assets that Rostekhnologii was seeking to control (MT 2008g/ab).



Abramovich's Millhouse Capital acquired a de facto controlling stake in Highland Gold Mining in December 2007 (TD 2007g/h).

Despite the concentration of heavy industry assets under Rostekhnologii, a positive sign in the sector is the fact that Renault acquired a blocking stake (25%) of Russia's leading car manufacturer, AvtoVAZ, with some USD 1.2 billion in March 2008. The aim of this partnership is to reinvigorate the ailing Lada brand (MT 2008e). KamAZ, the country's largest truck producer, may also sell a quarter of its shares this year to a strategic investor. Germany's MAN, Sweden's Scania and Volvo, and Italy's Iveco are among the potential investors (MT 2008x)<sup>28</sup>.

All in all, foreign cars possess a very strong foothold in the Russian automobile market. The Russian brands occupied only less than 40% of the country's automobile market. The share of imported automobiles was 50% in 2006 (Quidet & Ivanov 2007).

An encouraging sign for foreign firms operating in the field of civilian aviation is Deutsche Bank's 7%-ownership in the national carrier Aeroflot (BEE 2007d). Similarly, Italian Alenia was given a right to acquire a blocking stake in Sukhoi's civilian aircraft division in the beginning of 2008 (BEE 2008b)<sup>29</sup>.

### **3) The state is strengthening its role in hardcore logistics**

In April 2007, Putin signed a degree of accession of Transnefteproduct (a petroleum product pipeline operator) into Transneft (a crude pipeline operator), and ordered the government to implement the merger. In November 2007, Transneft CEO Tokaryev, a former general in the KGB, informed that the acquired Transnefteproduct will retain its independence within the enlarged company (EW 2007d; TD 2007 i/j). I interpret the above integration and the appointment of Putin's former colleague to be in charge of the operation as another step to strengthen the state's grip over strategic logistical functions.

*"Sovkomflot recently [in November 2007] started merger proceedings with state-controlled shipping major Novoship, which when finalised is expected to create a shipping giant that would rank among the world's top-five shippers, with assets of nearly US\$5bn. The merged company is expected to increase its focus on the Arctic region and the transport of energy*

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<sup>28</sup> KamAZ produces nearly three quarters of Russia's dump trucks and about half of the country's other large cargo vehicles (MT 2008x).

<sup>29</sup> It seems that Finmeccanica, Italy's largest defense contractor, will buy a stake in Sukhoi Civil Aircraft (MT 2008aa).

*supplies from Russia's Far East. The new company would operate a fleet of 113 vessels with another 36 on order, many of them ice breakers designed for Arctic shipping lines"* (BEE 2007e). This implies the beginning of the consolidation of shipping. In a similar way, Russia's shipbuilding will heavily concentrate itself under the state-owned United Shipbuilding Corporation, which was established in 2007<sup>30</sup>.

Transneft, Rosneft and Sovkomflot have formed a joint company, Transneft-Terminal, to take control of a key element of crude handling operations at Novorossiysk. The emergence of Transneft-Terminal appears to be part of a wide-ranging campaign to wrest control of exports away from firms associated with Transneft's former management (Argus 2008d).

Signals on the growing state control over major sea ports are becoming stronger. For instance, Transneft started construction of the Kozmino oil terminal on Russia's Pacific coast in March 2008. Similarly, the Russian Railway Company has expressed its interest in acquiring Vladivostok and Nahodka ports. Ultimately, FESCO, Russia's largest container operator, seems to have acquired Vladivostok Commercial Seaport. Correspondingly, Ust-Luga is one of the most strategic ports in the western part of Russia, and the further development of the port is positioned highly in the top leadership's priority list (AC 2007c; IV 2008; TD 2007k; 2008h)<sup>31</sup>.

Recently, I have observed a growing interest by certain Russian companies to possibly acquire ports in Russia's neighboring countries, namely in the Baltic States and Finland. One may guess that the Russian companies might be interested in acquiring ports or controlling stakes thereof, mainly in Tallinn, Riga, Klaipeda, and perhaps easternmost sea port of Finland, Hamina.

It is not fully clear yet whether the authorities' (Rosstroy) misuse concerning Container Finance in Kronstadt was orchestrated by federal bodies or was an action motivated by a competitor. At the end of 2007, the situation calmed down when Container Finance decided to sell a major stake of two of its subsidiaries to Severstaltrans (TS 2007). One may hope that this partnership is a sustainable one and does not lead to the **Cuckoo Strategy**,

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<sup>30</sup> Aker Yards plans to build a USD-1-billion shipyard nearby St. Petersburg (KL 2008g).

<sup>31</sup> Ust-Luga expects to become the country's largest port, increasing cargo turnover more than fivefold to 36 million tons per year. The Ust-Luga port may sell 20% of its shares in 2-3 years (MT 2008s). The Russian RTL Group plans to start automobile transportation via Ust-Luga in summer 2009. The RTL Group estimates that it will transport 50 000 cars per year. Later on, car transportation may grow up to 300 000 automobiles annually (KL 2008c).



according to which a newcomer throws the original owner out of the nest when the newcomer wishes to expand.

#### **4) Pyrrhic victory in the privatization of the electrical energy sector**

In July 2007, the Russian Government approved nuclear giant Atomenergoprom's charter. The company is to comprise all the state-owned nuclear assets, including uranium production, electricity generation, and engineering assets. Ex-Prime Minister Kirienko, currently head of the Federal Nuclear Energy Agency (Rosatom), has been appointed as its BoD chairman and his protégé Travin became CEO. The company is valued at roughly USD 60-70 billion, and has only a few peers, most notably France's Areva (TD 2007l).

In addition to the state-led consolidation of the nuclear sector, foreign firms face restrictions indicated by the law. It is important to note that the restricted sector of the electrical energy increases, since the state aims at increasing the share of nuclear energy from current 16% to 25-30% of all electricity production by 2030. In order to reach the aforementioned goal, Russia ought to build 42 new nuclear reactors, when we keep in mind that the country's electricity consumption is growing. At the moment, Russia operates 31 reactors (BOF 2007d; TD 2007n; MT 2008k).

Despite the restrictions, foreign firms may find business opportunities in the nuclear sector. For instance, Siemens has signed, in November 2007, a memorandum of understanding with Rosatom for collaboration in developing nuclear power facilities in Russia and abroad. The agreement envisions cooperation in nuclear power reactors based on Russian designs and the use of Siemens' technology (BEE 2007f). Similarly, Japanese Toshiba has signed a preliminary agreement to design and build power plants and to develop production capabilities for nuclear fuel (BEE 2008f).

Currently, it is unclear whether foreign firms will face restrictions in hydropower activities. It is important to note that hydropower was left outside, when RAO UES' privatization started.

Huge hopes were laid on the privatization of RAO UES, which used to produce some 70% of Russia's electrical energy. One may observe both positive and negative development in the privatization process. The fact that four foreign companies, Italian Enel, German E.On, Finnish Fortum, and German RWE, have managed to acquire a strategic stake in four power generating units out of 20 is a definitely a positive sign in the privatization process. The fifth foreign company, Electricite de France, may buy a stake in another electricity company (MT 2008u).

However, the privatization success is shadowed by Gazprom's large role in electricity production. *"Analysts have estimated that they [Gazprom and SUEK] will control more than 40 percent of the generation assets being sold off by the former monopoly, Unified Energy System, as part of reforms. Together the partners will also have a near monopoly on the fossil fuels used to produce power, as SUEK is by far the country's largest producer of coal and Gazprom is the natural gas export monopoly"* (MT 2008j, 5). In other words, Gazprom and SUEK may use their supply leverage on all the private generating companies, including foreign ones.

The Pyrrhic victory concerning the privatization of Russia's energy sector also raises some doubts whether the price reform, pledged by 2011, will be similar one. There are some concerns that the full price liberalization of industrial electricity prices does not happen, not to mention price liberalization concerning households' electricity bill<sup>32</sup>. In this context, one should bear in mind that the Economics Ministry already proposes a postponement of gas price liberalization (TD 2008n).

## **5) Telecommunications: a mixture of stagnation and turbulence**

Surkov, a senior member of the presidential administration, has indicated that national capital has to be dominant in strategic communications, pipelines, federal highways, railways, most electricity transmission, the financial system, key defense production facilities and, for as long as so much in Russia depends on it, the fuel-energy sector. National capital seems to mean Russian rather than formally owned by the Russian state. Entrepreneurs who are Russians and who will obey the Russian state may be enough to preserve sovereignty. However, it needs to be remembered that there is distinction between trusted oligarchs and so-called offshore Russians (Hanson 2007).

The law on strategic sectors implies that foreign firms face explicit restrictions in the telecommunications sector in the future. Fortunately, there was a last-minute decision to de-list Internet companies and reduce the strategic sphere in the telecommunications sector (BOF 2008b). Despite this reduction, I am not completely certain, what will be the role of foreign companies in Russian telecommunications in the longer term. According to the Moscow Times (MT 2008r, 2), *"the bill classified major fixed-line telecoms companies as strategic, meaning that any sale in the government's stake in national fixed-line operator Svyazinvest would likely come under government scrutiny. The inclusion of telecoms*

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<sup>32</sup> The Economics Ministry has informed that the electricity prices paid by households are to be doubled by 2015 (BOF 2007e).

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*companies 'with a significant market share in five or more regions' or in 'cities of federal significance', a common euphemism for Moscow and St. Petersburg, would in practice mean Rostelecom and Svyazinvest."*

The privatization of state-owned telecommunication giant, Svyazinvest, has been postponed several times, and the corporation has not been included in the privatization list of 2008 (TD 2008p). The Russian military has followed this privatization process very keenly, and probably slowed down the process, since the army has been mostly concerned about long-distance services, i.e. the destiny of Rostelecom (TD 2007o/s).

The recent information indicating that Svyazinvest will be privatized within 12-18 months is encouraging. However, the interest of foreign companies is not necessarily very high, since foreigners might be afraid about the future development of the Russian investment climate. Moreover, the Russian authorities probably have the same attitude as they had in January 2007, when Medvedkov, the official in charge of Russia's WTO negotiations, stated that the Russian Government has reserved the right not to allow foreigners to participate in Svyazinvest's privatization. In addition to the concerns of foreigners and the state's restrictive attitude to sell stakes of Svyazinvest to foreigners, it needs to be remembered that Sistema is already preparing for a strong consortium with MTS and Comstar-UTS to swallow Svyazinvest. It remains to be seen whether some new foreign telecom might have courage enough to step into Russia's politically-volatile market with a major investment (TD 2007r; 2008i).

One of Russia's leading mobile telecommunication companies, Altimo, has created a lot of turbulence in Megafon (partially owned by Swedish-Finnish TeliaSonera) and Vimpelcom (partially owned by Norwegian Telenor), in particular. I would not be surprised to see a business divorce between Altimo and Telenor (TD 2008j). Altimo's recent announcement to sell its stake in Megafon in exchange for acquiring a stake in Turkcell is a new page in the turbulent history of Russian mobile telecommunications, though this is not first time Altimo offers an asset swap to TeliaSonera (MT 2007g; TD 2007q).

## **6) Banking and insurance**

Surkov has stressed the strategic importance of the financial system to the Russian state (Hanson 2007). Fortunately, the law on the strategic sectors did not deal with either banking

or insurance. However, Russia will obviously restrict certain segments of this branch, even if it will join the WTO<sup>33</sup>.

Simola (2007, 9) writes *"in the banking, direct branches of foreign banks will not be allowed even after WTO membership. Foreign banks can operate in Russian markets through a subsidiary or by buying an existing Russian bank. This means all banks operating the Russian market are subject to Russian legislation. As at present, foreign investors will be allowed 100% ownership of individual banks. But Russia will still be able to restrict foreign participation in the banking sector as a whole to some degree. The MEDT [Ministry for Economic Development and Trade] reports the limit can be set at a 50% share of foreign ownership in the total authorized capital of Russian banks. However, this figure will not include foreign investments made before 1 January 2007 or the assets invested in Russian banks privatized after Russian admission to the WTO. The insurance sector will also be liberalized. Branches of foreign insurance companies will be allowed to operate in the Russian market (with some restrictions concerning the sphere of their activity) after a transition period of nine years from Russia's accession. The branches will be subject to licensing and capital requirements formulated in Russian legislation. In most non-life insurance companies, 100% foreign ownership will be allowed upon accession, whereas in life insurance, mandatory travel insurance and mandatory automobile insurance there will be a transition period of 5 years before full foreign ownership is allowed. In the insurance sector as a whole, Russia will maintain a quota for foreign participation, but it will be lifted from the current 25% to 50%, and the same exclusions will apply as in the banking sector"*. In this context, it must be noted that should the economic nationalism in Russia continue, it will jeopardize the accession process into the WTO, i.e. growing economic nationalism decreases the willingness of Russia to join the organization.

At the end of 2007, there were over 1100 banks operating in Russia. Despite the large number of bank-like institutions, the banking sector is very concentrated and the five largest banks account for 42% of the assets of the sector. The three largest banks are under state control. However, a positive trend is the entry of foreign banks into Russia. All in all, there are over 200 foreign-owned banks in Russia, out of which 62 are fully owned by foreigners. In 2007, the foreign ownership in banking grew from 16% to 25%, mainly due to the initial public offerings of two major state-owned banks, Sberbank and VTB (BOF 2008c).

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<sup>33</sup> *"Political loyalty is becoming a prerequisite for doing business in Russia; this could explain why a group of top foreign banks have agreed to provide a cheap loan to Rosneft"* (BEE 2007h, 7).

Banking and insurance has developed most favorably among the key industries in terms of foreign participation. In 2007, a half of foreign capital inflow, including foreign loans, went to the banking sector (EIU 2008d). The following news can be taken as examples since January 2007.

- In April 2007, KBC Bank (Belgium) acquired a Russian bank called Absolut with some USD 1 billion (AC 2007d).
- In February 2008, Societe General (France) finalized its acquisition of control ownership in Rosbank with some USD 7 billion. This is probably the largest foreign investment to the Russian banking sector ever (MT 2007m).
- In February 2008, Hungarian OTP Bank announced its plans to invest USD 1 billion to expand banking operations in Russia (BEE 2008g).
- In March 2008, Barclays (UK) bought Expobank with some USD 750 million, as Barclays looks to tap Russia's underdeveloped mortgage market (MT 2008l; 2008ak).
- In March 2008, Goldman Sachs (USA) plans joint projects with Sberbank (TD 2008k).
- In March 2008, HSBC (UK) plans to invest some USD 200 million in Russia (MT 2008n).
- In February 2007, Sistema agreed to sell a 49%-stake in Rosno insurance company to Allianz (Germany) for USD 750 million. It is believed that Allianz would become the major owner of this company (TD 2007t).
- In November 2007, Generali (Italy) acquired an indirect stake in insurer Ingosstrakh. Generali paid an undisclosed price for a 49%-stake in PPF Beta, an investment vehicle managed by Czech-owned private equity group PPF Investments, which owns some 38% of Ingosstrakh (MT 2007l).
- In December 2007, Cardif, the insurance division of financial major BNP Paribas (France), has announced that it has registered a subsidiary in Russia to begin developing the company's insurance business in Russia. Cardif has said that it is awaiting an insurance license from the state regulator to begin operations in Russia (BEE 2007g).
- In January 2008, AXA (France) has signed an agreement to purchase a 37%-stake in one of the largest insurers in Russia, Reso-Garantia, for EUR 810 million, making it the largest foreign acquisition in the Russian insurance market (BEE 2008d).

The activities of certain Kremlin-loyal oligarchs in the insurance business are less encouraging for foreign insurers (MT 2007j). Deripaska-led Basic Element has a dispute over ownership in Ingosstrakh. It is difficult to say what the real reason behind the dispute is, but the Moscow Times (2007k, 9) suggests that *"the Federal Security Service and other branches of the secret services do not buy insurance from firms with foreign investors, said Oleg Ivanov, advisor to the State Duma committee on credit organizations. 'There is nothing*

*in the law that prevents these kinds of deals. But the agencies have fears that foreigners on the board would access private information', Ivanov said".* Whatever the real reason, this dispute does not encourage other foreign insurers to enter the Russian insurance business, particularly the segments considered strategic by the Kremlin or state agencies.

## **7) The strategic importance of certain non-strategic natural resources has risen**

**Forestry:** as a starting point one should note that the total wooded area of Russia is some 5 times larger than that of the EU27. Nevertheless, paper and paperboard production in the EU27 is some 15 times higher than that of Russia (Eurostat 2007). Russia is the world's largest exporter of raw wood, accounting for a third of all raw wood exports (BOF 2007f).

These figures may have motivated Putin (2007) to ask in his state-of-the-nation address: *"Are we [the Russians] really gaining maximum benefit from our natural resources? This question applies not only to oil, gas and mineral resources, but also to our forestry and water resources."* The objective of raising the processing level of raw materials in Russia resulted in the export tariffs of raw wood rising from EUR 10 per cubic meter to 15 in April 2008, and it is planned to be further raised in the beginning of 2009 to EUR 50 (BOF 2007f).

***Nobody questions Russia's right to determine its tariffs and to increase the processing level of its industries but the main issue here is about the timing of the tariff increases and the transition period given to foreign companies to adapt to the situation.***

First, one has to remember that the WTO accession process of Russia somehow binds it to existing tariffs. *"The tariff hikes are seen contradicting the terms of the EU-Russia bilateral WTO-trade terms agreed in 2004"* (BOF 2008d, 1). In a similar tone, *"the EU wants these duties scrapped and says they violate a broader 2004 deal with Russia that covers most WTO issues."* (MT 2008ac, 6).

Second, the transition period is absolutely too short, when one keeps in mind that the construction of a modern paper mill takes long time, and it is a strategic investment to the owners of the paper companies, since the erection of the modern paper mill complex costs around EUR 1-1.5 billion.

Furthermore, the foundations of Russian paper production are anything but firm since the ownership of Russian forests is in the hands of the state. Some 96% of the forests are

owned by the state and the remaining 4% is held by the regions (Karjalainen & Torniainen 2006). In other words, it is of the utmost importance to guarantee the supply of the raw material before major foreign paper companies rush into the Russian paper and pulp market to build new paper mills. In this light, it was not a surprise to see the withdrawal of the Ruukki Group, when the company was not given a priority position to obtain wood from the Kostroma region<sup>34</sup>.

The risk of newcomers cannot be reduced by the fact that International Paper and Mondi already operate in Russia (MT 2008p)<sup>35</sup>. In my opinion, an elegant decision from the Russian side would be the postponement of the decision to increase export tariffs planned for the beginning of 2009, and instead, to give foreign paper companies a 5-7-year transition period to adapt to the situation. This would give the foreign paper companies sufficient time to properly analyze the business and political risks of Russia. This is of the utmost necessity as the payback time of the paper mill investment is a lengthy one.

Certain Russian oligarchs have shown their interest in forestry which increases the political risks involved in Russian forestry<sup>36</sup>. I would not be surprised at all to see certain metal oligarchs move into the paper and pulp industry, and hence, increasing the political risk of the given industry.

Secondly, the public opinion of Russian citizens towards private and foreign ownership of the forests is old-fashioned, giving the Russian leadership an easy political support in restricting forest-related business from foreign firms in the future. Therefore, the mentality change of the Russian population is extremely necessary in order to transform Russia's forests into usable assets. In this process, the Nordic system could be useful, i.e. the system that guarantees all Russian citizens with everyman's rights to use the forests even if the forests would be owned by private entities (Karjalainen et al. 2007).

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<sup>34</sup> Russia has not seen a new paper and pulp mill in 30 years, and therefore, the regional administration may be unaware of all the certificates and requirements (KL 2008a). According to non-confirmed news, Vice-Prime Minister Naryshkin gave Kostroma regional officials new instructions on Ruukki's plan, and therefore, the company may be able to construct a pulp mill in Kostroma (MT 2008p). The involvement of the Aspek Group behind the change in the regional authorities' stance towards the Ruukki Group cannot be ruled out (KL 2008b).

<sup>35</sup> For instance, Mondi has started a modernization project exceeding EUR 500 million in Syktyvkar (KL 2008e).

<sup>36</sup> Oleg Deripaska's Basic Element is the majority owner of Baikalsk Paper and Pulp Mills (MT 2008ai).



Even if Russia's forestry strategy until 2020<sup>37</sup> may somewhat clear the rules of the game, and hence, reduce the political risk involved, the strategy does not solve the problems related to state ownership and improve the infrastructure needed to collect a sufficient amount of raw materials from remote areas.

**Non-strategic metals:** there are certain ferrous metal oligarchs, who may become private national champions in this field. The position of the Kremlin-loyal firms is always more equal than others, i.e. other domestic firms, not to mention any foreign ones. Perhaps, in order to secure their energy supplies some steel companies have recently acquired major coal units. As an example, one can name Evraz' acquisition of Yuzhkuzbassugol and MMK's deal with Belon (MT 2008q; TD 2008l).

**Fishery:** fishing should not have been included in the law on the strategic industries. Now, fisheries have been classified as one of the sectors to be restricted to foreign firms, and the state may establish a state corporation, Rosrybflot. It can only be guessed why fishing has become strategic unless this is the way the Russian navy aims at restricting the movement of foreign ships in Russia's territorial waters. Ecological concerns are hardly behind the decision to include fishing on the list of strategic sectors.

#### **8) The main assets of the media were already taken over by the state or its loyalists prior to 2007**

The electronic media was already taken into direct or indirect state control prior to January 2007. In early 2008, the last somewhat liberal TV station, RenTV, was merged with TV5 (TE 2008). TV5 is owned by Kovalchuk, who is believed to have links with the Kremlin<sup>38</sup>. In addition to electronic media, some printed media has also dropped into the hands of Kremlin-loyal tycoons. For instance, Kommersant has dropped into the hands of Usmanov, Ekspert weekly into the hands of Deripaska, and Komsomolskaya Pravda into the hands of Beryozkin (EW 2007e).

Moscow Times (MT 2008r, 2) writes *"large-circulation newspapers and publishing companies with the capacity to print 200 million pages per month are included, as are periodicals with a circulation of at least 1 million copies. According to the bill, broadcast media covering at least half the country would be deemed strategic. This effectively excludes foreigners from holding*

<sup>37</sup> The strategy indicates that the forestry industry would require a EUR 33 billion investment through 2020. Measures to increase investment in the sector have included hikes in raw wood export tariffs and reductions in forest leases for priority projects. Russia's industry ministry indicates that 13 project with a combined value of over EUR 4 billion have been declared priority projects by now (BOF 2008g).

<sup>38</sup> In March 2008, CTC Media acquired the DTV channel from the Swedish MTG Group (TD 2008m).



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*majority stakes in television stations such as state-controlled Channel One, Rossia, and NTV, all of which have nationwide coverage."*

Even if the Internet service providers were de-listed from the law, no-one can guarantee that Internet services would not end up in the sectors to be restricted in the future, if the political regime becomes more conservative and nationalistic. In this context, one should not forget, back in March 2007 *"President Vladimir Putin moved to establish a new agency that will license media outlets and monitor their output. The new agency will have control over television, radio, newspapers, and the Internet. ... the new agency is directly subordinate to the prime minister's government, not to the Ministry of Information Technology and Communications or the Ministry of Culture and Press."* (IHT 2007, 4).

The role of foreign firms in leisure-oriented printed media, such as fashion, sports, and the yellow media, seems to be accepted by Russia's ruling elite as long as the media in question do not touch political affairs and the main political figureheads.

## **9) Consumption-related sectors remain below the Kremlin radar**

Despite market-specific problems, such as tremendously increased corruption and 'normal' (non-federally orchestrated) administrative misuse, the production and distribution of consumer goods and services have stayed under the Kremlin's radar, i.e. the consumption-related sector has remained out of the political economy. Despite this fact, it seems that some of the Kremlin-oligarchs, such as Deripaska, have already appeared in strategic construction.

In April 2007, Deripaska's investment vehicle purchased a 30%-stake in Strabag for an estimated EUR 1 billion. The deal envisions a long-term partnership between Strabag and Deripaska's construction assets, and in effect, creates one of the largest construction groups in Russia, with annual turnover of around EUR 2 billion (BEE 2007i)<sup>39</sup>.

Deripaska and his staff have explicitly stated that they are interested in investing heavily to develop the Russian infrastructure and to create public-private partnerships. As Transstroi builds roads, ports and railways, it obviously becomes more privileged than the majority of its competitors. Deripaska-run companies have also shown a major interest in developing St. Petersburg and Sochi. I would envision deals with Deripaska and Olymstroi, a state corporation in charge of the Sochi 2014 Olympic Games. Even if Deripaska probably

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<sup>39</sup> Deripaska-led RusAl owns stakes in several construction companies; Glavstroi, Transstroi, Hohchtief (Germany), and Strabag (Austria). For a more detailed description see BE (2008).

focuses on the development of major infrastructure projects in the aforementioned cities, his activities may also disturb competition in other construction-related sectors, when the construction projects are big enough in scale. Here, one should not forget that Deripaska has pledged to invest USD 20 billion in St. Petersburg by 2015 (MT 2007m/n).

In addition to construction, agriculture belongs to the upper level of the non-sensitive zone. Therefore, it was not a surprise, when Prime Minister Zubkov in March 2008 intensified calls for the government to prop up Russia's agricultural industry and raise the domestic portion of food products to 70% by 2012 (MT 2008t). Here, one should not forget that food and agricultural products represented almost 17% of Russia's imports in 2006 (EIU 2008c). In other words, the exporters of foodstuffs to Russia may live in interesting times in the near future.

#### **10) Strategic innovation-related activities positioned closely to Russia's defense industry, an increasing risk for foreign firms**

As far as I am concerned, there are two simultaneous phenomena in this sector. First, the Russian state wants to invest in the diversification of the civilian economy and to increase its competitiveness. One attempt to push the diversification of the economy was the establishment of the state corporation in nanotechnology. However, the state's involvement might be counterproductive since by becoming an active actor in any field, it restricts the formation of normal competition, and hence the formation of sustainable competitiveness. Remes (2007) questions whether a new technological breakthrough could be accomplished by using these national champions, since they are usually too bureaucratic, authoritarian, and too heavily specialized in old industries to become the engine of a technology breakthrough.

Second, the army needs technological innovations in order to make a serious comeback in the arena of major military superpowers. Therefore, it was not a surprise to read the First Vice-Prime Minister Ivanov's comment in May 2007 (MT 2007o, 6): "*Generally, there is every reason to call the military-industrial complex the locomotive of diversification*". This statement does not come as a surprise as during the Soviet time the majority of civilian high-tech goods were produced by the military-industrial complex.

Even if Russia would start to use the remedies of the past in modernizing its innovation sector, one should not forget that a military-led reform will be much more expensive than a reform conducted by private entities. Moreover, its results are far from certain, and foreign

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innovation-related firms will most likely hesitate to participate in any innovation building run by the Russian army. In addition, many of the army-related activities have already by now been classified as strategic, and thus, they have become off limits to foreign firms.

#### 4 What next?

It is important to notice that the law on strategic sectors is only the tip of the iceberg and the genesis of economic nationalism rather than its final destination. In other words, the major part of the economic nationalism in Russia is below the legislative surface, and therefore, the main dangers to any foreign investors are in the operations of state corporations and the Kremlin-supported oligarchs.

On the one hand, I would not be surprised to see more state involvement, for instance, in forestry and logistics. State involvement can also be indirect by nature, i.e. the use of the Kremlin-loyal oligarchs is very probable in the aforementioned sectors. In addition, several precious stones and metals will obviously fall under the control strategic government policies. As long as state-owned companies are heavily involved in the electricity generation, it will remain sensitive, and therefore, the rules of international politics apply more than the rules of international business in its development. Uncertainties concerning the role of foreigners in Russian telecommunications have not disappeared with the law, quite on the contrary.

On the other hand, I anticipate that FDI inflow to Russia will remain at a high level despite the strategic government policies due to the fact that foreign companies are tempted by Russia's fast growing private consumption. I assume that the majority of future FDI deals will be conducted in the non-sensitive sector of the Russia economy, i.e. in the private consumption-related sectors, including retail banking. Also big deals are to be expected in sensitive sectors, when foreign firms acquire *minority* stakes.

The aforementioned also applies to Finnish firms, i.e. the overwhelming majority of Finnish firms operate outside these strategic sectors, though the major investments – the current and future ones – belong to the sensitive sectors of the political economy.

It would be an important task for President Medvedev to stop the implicit widening of economic nationalism in Russia. The consequences of this hidden economic nationalism may dramatically worsen relations between Russia and the EU / the USA, and one day, we might find ourselves in an investment and trade war, or even worse. Medvedev's presidency puts his expressed economic liberalism to a real litmus test. Hopefully, the test results will not be too acidic for foreign firms.

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It has been aptly concluded: *“Mr. Medvedev may perhaps push through some moderate liberal changes but he seems unlikely to alter what, for the moment at least, has proved to be successful. The main impetus for change in Russia’s strong-state economic model will not be the personality of its next president, but the performance of the economy. If GDP growth dips sharply, the pragmatists in Russia’s leadership will seek change. The fact that there is a relatively liberal president might then tip the balance in favour of change towards more market-based solutions, rather than more statism”* (EIU 2008c, 4).

Do we need to wish for stagnation in the Russian economy in order to see improvement in the position of foreign firms in Russia? Following the same line of thought, do foreign firms have any sustainable position in Russia or are they used as long as they do not have any Russian replacement available?

## Epilogue

*"I cannot forecast to you the action of Russia. It is a riddle, wrapped in a mystery, inside an enigma; but perhaps there is a key. That key is Russian national interest."*

**Sir Winston Churchill, October 1939.**

One does not have to be a clairvoyant to forecast national interest of politically uniting, economically expanding and militarily strengthening Russia. The only riddle with Russian national interest is when and how we will face it, and then, what will be the reaction from the West and ultimately, the outcome of the clash. Despite my less optimistic view, we should not forget that the future is not deterministic, and we may change the course of it, but the change does not occur only by observing the ongoing development<sup>40</sup>.

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<sup>40</sup> There are certain similarities between contemporary foreign firms in the strategic sectors and foreign concessions in the USSR eight decades ago. *"Often in reality neither foreign concessions nor mixed enterprises were nationalised but more or less strangled to death. In order to maintain the relations with the West, the Soviet state considered the use of economic measures rather than nationalisation more desirable. The most obvious economic means available was the refusal to renew the concession rights. This was easy because trade concessions usually had only one-year concession contracts. Besides the short term concessions, there were concessions with lease contracts valid even until the 1970s. Examples of these were British Lena Goldfields, Japanese Hokushinkai Oil Concession and Caucasian-American Concession. To terminate these, the Soviet state had to apply different methods altogether. The following measures proved particularly efficient: introducing high taxation and thus making economic activity unprofitable, altering the foreign trade rights, setting artificial prices, interpreting the concession contracts according to one's own views, inventing deviations from contracts and collecting high fines. In addition to these, foreign concessions were often without justification accused of sabotage and espionage"* (Liuhto 1994, 32).

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## Appendix 1. Major state acquisitions, 2004-2006

Company	Sector	Date	Mechanism
Guta Bank	Banking	August 2004	State-owned bank Vneshtorgbank purchases 85.8% stake with central bank support.
Mosenergo	Electric power	Summer-Autumn 2004	Gazprom raises its stake above "blocking" (25%+1) level.
Promstroibank St Petersburg	Banking	September 2004	Vneshtorgbank purchases a blocking (25%+1 share) stake.
Atomstroiekspost	Nuclear construction	October 2004	Gazprom-controlled Gazprombank purchases 54% stake.
RAO UES	Electric power	Autumn 2004	Gazprom raises its stake to 10.5%
Tuapse oil refinery	Oil refining	December 2004	Rosneft purchases 40% from minority shareholders to take full control of the refinery.
Yuganskneftegaz	Oil and gas	December 2004	Rosneft purchases 76.8% stake from the firm OOO "Baikalfinansgrupp", the winner of a state-organised auction of Yuganskneftegaz shares to settle tax debts.
Tambeyneftegaz	Oil and gas	May 2005	Gazprombank purchases a 25% stake from Novatek.
Northgas	Oil and gas	June 2005	Gazprom regains control of independent gas producer Northgas, taking over a 51% stake following litigation.
<i>Izvestiya</i> (daily newspaper), <i>Chas pik</i> (weekly newspaper)	Media	June-September 2005	Gazprom-Media purchases control.
Gazprom	Oil and gas	July 2005	State-owned Rosneftegaz purchases 10.7% of Gazprom to raise state's direct stake in Gazprom above 50%.
Selkupneftegaz	Oil and gas	July 2005	Rosneft purchases 34% stake from independent gas producer Novatek.
Sibneft	Oil and gas	October 2005	State-owned gas monopoly OAO Gazprom buys 69.66% stake for \$13.1bn.
Verkhnechonskneftegaz	Oil and gas	October 2005	Rosneft purchases 25.9% stake from Interros Holding.
AvtoVAZ	Autos	October 2005	State arms export concern Rosoboroneksport takes control over 62% and installs new management.
OMZ	Machine-building	November 2005	Gazprom-controlled Gazprombank purchases a 75% stake.
Ulan Ude Aviation Plant, Moscow Helicopter Plant, Kazan Helicopter Plant, Kamov Holding, Rosvertol, Moscow Machine-building Plant "Vpered", OAO "SMPP"	Aviation	2005	State-owned defence company Oboronprom takes control of these enterprises in the course of forming a single, state-controlled helicopter holding via the consolidation of shares already held by the state, purchase of additional shares and share swaps.
Power Machines ( <i>Silovye mashiny</i> )	Machine-building	December 2005	Electricity monopoly RAO UES purchases 22.4% stake, raising its stake above 25%, and acquires voting rights to another 30.4% until end-2007.
Udmurtneft	Oil	June 2006	Rosneft acquires a 51% stake from Sinopec after the latter buys 96.7% from TNK-BP for an estimated \$3.5bn.
Sibneftegaz	Gas	June 2006	Gazprombank purchases a 51% stake from Itera.
Novatek	Gas	June-July 2006	Gazprom purchases a 19.9% stake for a sum reportedly exceeding \$ 2bn.
VSMPO-Avisma	Titanium	September 2006	State arms export concern Rosoboroneksport purchases 41% stake for an undisclosed sum.

Note: The table excludes acquisition of foreign assets by state-owned companies.

Source: OECD from various sources.

Source: OECD, 2006, 3.



## Appendix 2. Russia's 87 Exposed Billionaires in 2008 (ownership in USD billion)

Name	Business or sector	2008	2007			
1 Oleg Deripaska	Basic Element	28.0	13.3			
2 Roman Abramovich	Millhouse Capital, Chelsea	23.5	18.7	Deripaska	Abramovich	Mordashov
3 Alexei Mordashov	Severstal	21.2	11.2			
4 Mikhail Fridman	Alfa Group	20.8	12.6			
5 Vladimir Lisin	NLMK	20.3	14.3	Fridman	Lisin	Rybolovlev
6 Mikhail Prokhorov	Onexim	19.5	13.5			
7 Vladimir Potanin	Interros	19.3	13.5			
8 Suleiman Kerimov	GNK (formerly Nafta-Moskva)	17.5	14.4			
9 German Khan	Alfa Group, TNK-BP	13.9	8.0			
10 Vagit Alekperov	LUKoil	13.0	12.4			
11 Dmitry Rybolovlev	Uralkali	12.8	3.3			
12 Iskander Makhmudov	Urals Mining and Metals Co.	11.9	8.0	Usmanov	Gutseriyev	Timchenko
13 Alexander Abramov	Evrast Group	11.5	5.6			
14 Viktor Vekselberg	Renova, TNK-BP	11.2	10.4			
15 Alexei Kuzmichyov	Alfa Group	10.8	6.2			
16 Viktor Rashnikov	MMK	10.4	7.0			
17 Igor Zyuzin	Mechel	10.0	2.1			
18 Vladimir Yevtushenkov	Sistema	10.0	9.1			
19 Alisher Usmanov	Gazmetall	9.3	5.5			
20 Nikolai Tsvetkov	UralSib	8.0	8.0			
21 Leonid Fedun	LUKoil	6.4	5.3			
22 Boris Ivanishvili	Banking	6.4	4.7			
23 Sergei Popov	MDM-Bank	6.4	4.6			
24 Andrei Melnichenko	MDM-Bank	6.2	4.6			
25 Yury Zhukov	PIK Group	6.1				
26 Kirill Pisarev	PIK Group	6.1				
27 Dmitry Pumpiansky		6.0	5.7			
Name	Business or sector	2008	2007			
56 Sergei Petrov	Rolf	1.7				
57 Andrei Kosogov	Alfa Group	1.7	1.1			
58 Andrei Kozitsyn	Urals Mining and Metals Co.	1.6	1.5			
59 Andrei Rogachyov	Karusel, Pyatyorochka	1.5				
60 Alexander Svetakov	Former Absolute-Bank shareholder	1.5				
61 Oleg Boiko	Ritzio Entertainment Group	1.5	1.5			
62 Lev Kvetnoi	Gazmetall (former co-owner)	1.5	1.4			
63 Sergei Sarkisov	RESO-Garantia (founder)	1.5				
64 Nikolai Sarkisov	RESO-Garantia (founder)	1.5				
65 Vladimir Iorikh	Former Zyuzin partner (Mechel)	1.4	1.3			
66 Maxim Blazhko	Don-Stroi	1.4				

28	Pyotr Aven	Alfa Bank	5.5	3.6	67	Farkhad Akhmedov	Nortgaz	1.4	1.5
29	Alexander Frolov	Evrast Group	5.5	2.4	68	Dmitry Zelenov	Don-Stroi	1.4	
30	Leonid Mikhelson	Novatek	4.7	4.3	69	Sergei Veremeyenko	Banking	1.4	
31	Yelena Baturina	Inteko	4.2	3.1	70	Alexander Skorobogatko	Novorossiysk Commercial Sea Port	1.4	
32	Vasily Anisimov	Coalco, Gazmetall	4.0	2.0	71	Alexander Ponomarenko	Novorossiysk Commercial Sea Port	1.4	
33	Mikhail Balakin	SU-155	4.0		72	Ruben Vardanyan	Troika Dialog	1.3	
34	Andrei Molchanov	LSR Group	4.0		73	David Davidovich	Millhouse Capital	1.3	1.0
35	Gleb Fetisov	Banking	3.9	1.5	74	Boris Berezovsky	Businessman	1.3	1.1
36	Rustam Tariko	Russky Standart	3.5	5.4	75	Andrei Komarov	ChTPZ Group	1.3	
37	Andrei Skoch	Metalloinvest	3.3	1.7	76	Alexander Mamut	Portfolio investor	1.2	
38	Filaret Galchev	Eurocement	3.1	2.4	77	Igor Kesayev	Mercury, Dixy	1.2	
39	Alexander Lebedev	National Reserve Corp.	3.1	3.7	78	Sergei Polonsky	Mirax Group	1.2	
40	Vyacheslav Kantor	Akron	2.6	1.4	79	Aras Agalarov	Crocus Group	1.2	
41	Mikhail Gutseriyev	Former Russneft president	2.6	2.9	80	Viktor Kharitonin	Pharmstandard	1.1	
42	Vladimir Bogdanov	Surgutneftegaz	2.6	3.7	81	Gavril Yushvayev	Wimm-Bill-Dann	1.1	
43	Gennady Timchenko	Gunvor	2.5		82	Megdet Rahimkulov	Former Gazprom chairman	1.1	
44	Alexei Ananyev	Promsvyazbank	2.3	1.7	83	Sergei Generalov	Industrial Investors	1.0	
45	Dmitry Ananyev	Promsvyazbank	2.3	1.7	84	Vadim Moshkovich	BIN Bank	1.0	
46	Shalva Chigirinsky	Sibir Energy, ST Development	2.3	1.6	85	Vitaly Malkin	Banking	1.0	
47	Danil Khachaturov	Rosgosstrakh	2.0		86	Igor Kim	URSA Bank	1.0	
48	Sergei Pugachyov	Rosgosstrakh	2.0		87	Georgy Krasnyansky	Eurocement	1.0	
49	Sergei Galitsky	Magnit	1.9	1.7	In April 2008, the number of Russia's discovered billionaires was 110 (MT 2008ae).				
50	Yury Kovalchuk	Bank Rossiya	1.9						
51	Igor Altushkin	Russian Copper	1.9		Source: MT (2008c)				
52	Anatoly Sedych	OMK	1.8	1.2					
53	Pyotr Kondrashev	Silvinit	1.8						
54	Igor Yakovlev	Eldorado	1.8	1.6					
55	Alexander Dzhaparidze	Eurasia Drilling	1.7						



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