GOVERNING BUSINESS:
THE STATE AND BUSINESS IN RUSSIA

RUSSIA POLITICAL ECONOMY PROJECT

FOREIGN POLICY RESEARCH INSTITUTE
JANUARY 2018

The Foreign Policy Research Institute thanks the Carnegie Corporation for its support of the Russia Political Economy Project.

COVER: Vladimir Putin and Shavkat Mirziyoev, April 2017, Kremlin.ru

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Executive Summary

David Szakonyi

This paper argues that understanding the business environment in Russia requires putting the government front and center. In response to economic crisis and falling oil prices, the Russian government has gone on the offensive. Through the use of targeted subsidies, protectionist policies, and procedural reforms, it has worked to stem economic collapse and prop up economic production. Some of these efforts have had a tangible impact on the way business is conducted in Russia, though the list of obstacles private firms still must maneuver is sizable.

However, the most important development over the last decade has been the state's direct takeover of valuable economic assets and the creation of massive state-owned enterprises (SOEs). This (re)nationalization jeopardizes the economic viability of many private firms by concentrating wealth and opportunities in a small group of well-connected SOEs. Private companies have adapted to this reality by devising a set of political strategies to ensure favorable treatment from the government. From mobilizing their workers during elections to running their directors for political office, these companies understand that remaining on good terms with the government is key to survival. Urgent structural reforms are needed to unwind the government's role in the economy. Without changes, political connections will remain paramount to generating profits in Russia.

Introduction

The idea of doing business in Russia still conjures frightful images of rapacious corruption, unreliable suppliers, and roads littered with potholes. Recent high-profile events have done little to change these perceptions. Infrastructure projects such as the Sochi Olympics and the FIFA World Cup run way over budget and fail to provide the resources necessary for businesses to later thrive. Activists combatting graft are arrested and persecuted. Foreign meat, cheese, and produce are banned under an escalating tit-for-tat sanctions war.

Russia is often viewed as inhospitable to business, a place where the power of the federal authorities runs unchecked and little technological progress has been made since the fall of the Soviet Union. Per official data, the Russian government is now responsible for 70% of the country's gross domestic product (GDP), a sharp contrast to the 1990s when the government reduced its role in the economy.[1] One could rightfully wonder how private firms could survive in this environment.

But amid these systemic problems, the Russian economy—though stagnant—has not collapsed under the weight of falling oil prices and targeted sanctions. International investment (both portfolio and direct) continues to seep in. Though millions of people still straddle the poverty line, unemployment is still relatively low by international standards, and promising start-ups across several sectors spur hope of an economic future less dependent on oil and gas. Finally, international rankings provide evidence that the government is reducing obstacles to running a business. When elected to another six year term in 2012, Vladimir Putin declared he would increase Russia's ranking on the World Bank's Doing Business index from a pitiful 120th out of 183 countries in 2012 to the top 20 by 2020.[2] Five years later, its ranking improved to 40th, with the World Bank noting the adoption of many best practices concerning land registration and contract enforcement.[3] International observers have also noted Russia's progress in implementing its commitments to global anti-corruption campaigns.[4]

Which narrative is correct? Are there real opportunities for business to prosper in Russia, or has the state stacked the deck against the private sector? As is often the case, the truth lies somewhere in between. The challenges that firms face are numerous, but recent government initiatives to simplify procedures, to provide targeted support for promising sectors, and to promote effective regulation have all had a meaningful impact on the way business is conducted in the country. Section 1 uses recent firm surveys to illustrate how the business environment has changed over the last several years, sometimes for better and sometimes for worse.

The most detrimental development though over the last decade has been the dramatic increase in state ownership of key assets. The unfair advantages enjoyed by state-owned enterprises (SOEs) jeopardize the economic viability of many private firms. Section 2 examines the Russian government's recent nationalization drive and outlines what can be expected from the promises being made to undo some of this expansion. Finally, Section 3 investigates how firms have responded to the enlarged role the government has begun taking in the economy. Businesses can survive and even thrive in contemporary Russia, but only with good relations with government officials at all levels.

Endnotes

1 Ekaterina Mereminskaya, "Konkurentstiya ne stala bolshe [Competition has not become greater]," *Vedomosti*, April 16, 2017.

2 Ellen Barry and Sophia Kishkovsky, "Putin Takes Helm as Police Punish Moscow Dissent," *New York Times,* May 7, 2012.

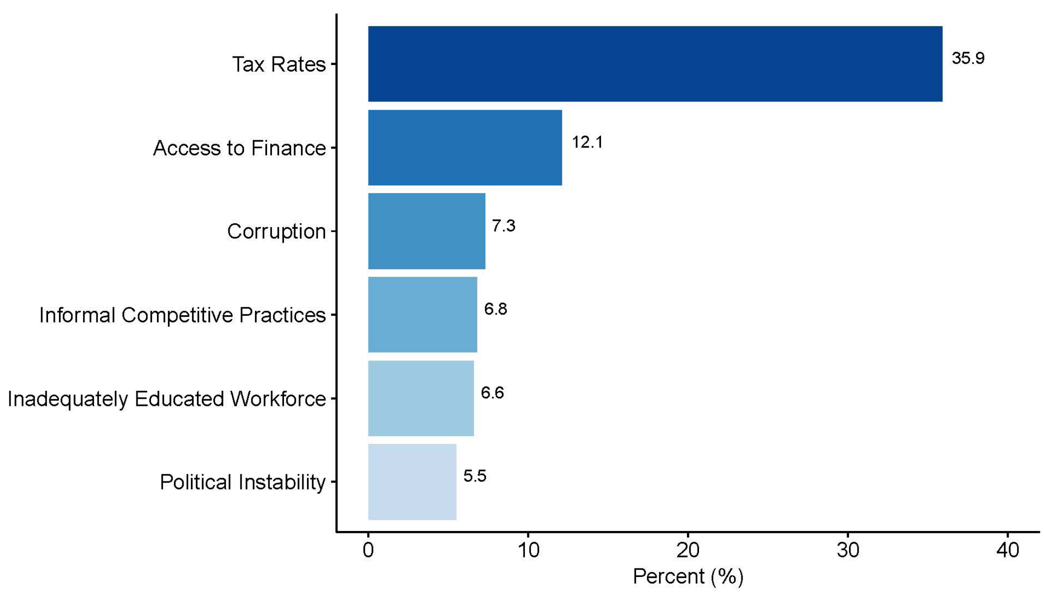
3 "Russia Advances in Doing Business Rankings: World Bank," *Reuters*, October 25, 2016.

4 Knowledge@Wharton, "Investing in Russia: Is the Risk Still Too High?" Wharton School, University of Pennsylvania, February 27, 2017.

The Business Climate in Russia

For many firms, doing business in Russia is far from easy. In 2012, the World Bank Enterprise Survey asked 4,220 managers to list the biggest obstacle they face in the business environment. Figure 1 plots the top six responses. High tax rates lead the way, followed by problems concerning loans, corruption and weak investment in infrastructure, and human capital. Furthermore, since 2012, a dramatic drop in oil prices and severe fluctuations in the exchange rate have had significant negative effects on the Russian economy. These two factors have added another layer of problems for firms across the country.[1] This section explores why Russian firms complain about these issues and what the government has done to address them. Improving the business environment requires sustained and effective government intervention, which to date has often been absent,

Figure 1: Top Obstacles Faced by Russian Firms (2012)



slow, or even detrimental. The Russian government has passed up numerous opportunities to carry out meaningful structural reforms, opting instead for a state-centric approach to economic development that has held back economic growth. That said, some progress has been made—at least on paper—to improve the business climate.

Russian government officials have also recognized that businesses are struggling under the weight of high taxes and an overbearing regulator enviornment.

Perhaps surprisingly to those who associate doing business in Russia first and foremost with corruption, 35.9% of firms in 2012 reported that the biggest obstacle they face involves taxation. Reforms during Putin's first term in office helped simplify and slightly lower the corporate tax rate, bringing it much more in line with international standards. This move helped to usher many firms out from the shadow economy. But for small- and medium-sized enterprises (SMEs), the burdens are still officially quite high, particularly regarding the contributions they must make to social funds. Therefore, a significant portion of SMEs still hide from tax collectors in the informal sector. Tax legislation also fluctuates widely, both from year to year and from region to region, complicating firms' attempts to plan. An essential tax incentive today can disappear tomorrow, and few expect that government budgets at all levels can survive prolonged concessions to the business sector.

Russian government officials have also recognized that businesses are struggling under the weight of high taxes and an overbearing regulatory environment. A two-year tax holiday introduced for SMEs in 2014 promised to spur entrepreneurship, and preliminary figures from the first half of 2017 suggest that smaller firms are increasing their fixed capital investments more than larger ones. In addition, federal authorities have taken steps to incentivize regions to pass reforms favorable to investors of all kinds. The Agency for Strategic Initiatives (ASI), a nongovernment organization (NGO) established by the federal government, has taken the lead. ASI has worked to disseminate best practices from several high-performing regions such as Kaluga and Tatarstan by creating road maps (i.e. general recommendations to increase investment) and inducing competition between regions through rankings and grant programs. Regions now vie for investors by lowering their property taxes and streamlining their business registration procedures, hoping to attract smaller firms to come out from the black market and access government programs. More and more services are being offered electronically, which could theoretically reduce bribe-taking by officials. The diffusion of investor-friendly policies across the country has helped to reduce disparities in regional development and claw back administrative barriers.

In 2008 and 2012, Russia's economy was rocked by back-to-back economic crises that have caused havoc for many companies. The country's dependence on commodity exports, such as oil and metals, created an acute set of vulnerabilities when prices for these resources fell. Currency rate volatility raised the prices of imports while also exposing many companies that had borrowed significantly on international markets to default risks. These shocks rippled through to other service industries, causing aggregate demand to drop and bankruptcies to skyrocket. Inflationary prices have also strained firms' ability to afford inputs, both domestic and foreign. One consequence is the extremely limited pool of capital available SMEs. Figure 1 lists "Access to Finance" as a key obstacle prior to the 2014 events, and the situation has only worsened since then. Banks see no reason to work with smaller firms which are viewed as only marginally profitable and very risky.

Through this malaise, Russian firms have come to look towards the state for anti-crisis relief. Multiple initiatives by the federal government have targeted several difficulties faced by the private sector. The government has directed subsidies to big firms at risk Fof laying off workers, import substitution regulations help restrict competition from foreign firms (see Table 1), and preferential lending rates to key sectors such as agriculture cushion the blow of being cut off from previous lines of credit. Russia has become the world's largest exporter of wheat, fueled in large part by generous financial treatment from the state. Firms now expect the Russian government to intervene in markets on their behalf, fostering a degree of dependence that may prove unsustainable over the long run (especially if economic conditions do not improve).

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Unfortunately, the government has also

looked to cut spending in many areas vital for long-term economic growth, including health, education, social services, and transportation.[2] Since 2007, thousands of rural schools and hospitals have been shuttered, with residents of many rural areas deprived of access to kindergartens.[3] Partnerships between firms and universities to train workers are taking root in some regions, but these efforts are not sufficient to close the gap between the supply of and demand for skilled workers. The Russian government faces the unenviable trade-off of subsidizing near-term economic stability while sacrificing long-term investment, where the true scale of the damage might not become apparent for years.

Finally, the scourge of corruption haunts Russian business. Officially registering a business can still be an arduous process, even as the nominal number of days to start a business has fallen from 43 days in 2003 to 10 days in 2016.[4] Once registered, arbitrary, unannounced inspections can pile up, resulting in burdensome fines or the extortion of bribes. Regulations change unexpectedly, and often it is unclear which set of

Table 1: Tools of Import Substitution

TOOLS	MECHANISM
Countersanctions	Ban imports of meat, fish, dairy, and certain vegetables from the EU, U.S., and other Western nations in 2014.
Restricting Access to State Procurement	Financial preferences in procurement tenders given to domestic producers; some foreign products, such as types of medical equipment, banned.
Localization Incentives	Offer tax breaks and special economic zones to foreign companies to move production to Russia.
State Support for Domestic Procedures	Direct funding for targeted sectors, such as agriculture, defense, and automotive production.

rules is being enforced. Moving goods across borders and navigating licensing requirements can require substantial off-the-books transfers. Winning state procurement contracts, a vital source of revenue for SMEs, often requires substantial kickbacks to bureaucrats. A multipronged approach to many of these problems has been underway since 2008: officials are now required to publicly declare their income, civil servants rotate between positions every 3-5 years, and procurement procedures have been revamped to increase transparency and weed out collusion. But trust is low that these procedures and tougher rhetoric from leaders against corruption will actually result in prosecutions, especially given the alleged scandals in the president's own inner circle.

Even if many of the anti-corruption initiatives have failed to take root, Russia has still achieved measurable success in reforming other areas connected to the ease of doing business. First, the bureaucracy opened itself up to feedback. The public can now deliberate over and provide input on key regulations under the Regulatory Impact Assessment (RIA) program. In addition, the government has invested much effort in releasing incredible amounts of open data about its activities. For a regime whose decision-making at the top of the hierarchy is so closed and often mysterious, the realms of quantitative data offered on procurement, budget expenditures, and responsiveness to citizenry is striking. Arbitration courts are also increasingly viewed as impartial guarantors of contracts, while new land registry procedures have clarified ownership after years of ambiguity. There is good reason to believe that along several dimensions, starting and operating a business has become considerably easier due to concrete steps taken by the government.

Endnotes

1 Note that this survey was conducted five years ago. A more recent survey in 2016 confirms that corruption, road quality, and tax rates still rank highly. "Leaders are the Same, but competition is still high: investment rating of Russian regions- 2016," *TASS*. June 17, 2016. http://tass.ru/pmef-2016/article/3377120.

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3 Marina Gristuk, "Shyotnaya Palata poshitala chislo skol y detsadov [Audit Chamber counted the number of schools and Kindergartens]," *Rossisskaya Gazeta*, April 14, 2015.

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The Nationalization of the Private Sector

But perhaps the most troubling recent development for Russian business sector is the renewed push government officials have made to take over valuable parts of the private sector. If during the 1990s business feared hostile takeovers from rivals and rackets, the new threat to their business is the state itself. The private sector is not just reliant on the state for subsidies and regulation, but also actively competing with it for profits. The heightened level of state ownership is due to two factors: an official policy shift towards nationalizing large private enterprises and unchecked corporate raiding by state officials.

Since 2004, the Russian government, in one form or another, has overtly taken over many of the crown jewels of the private sector. This recent turn to nationalization partially undoes the monumental efforts undertaken in the 1990s to privatize the Russian economy. Led by an intrepid set of Western-inspired reformers after the fall of the Soviet Union, Russia rapidly catapulted itself into a market economy. Thousands of SOEs were privatized in just a few short years, some falling into the hands of their communist-era managers and workers, while others were controversially snapped up during loans-for-shares[1] auctions by oligarchs. Very quickly, many of the country's most prized assets, including valuable oil and metal resources, were owned not by the average Russian citizen, but instead by a small group of businessmen (oligarchs) who wielded immense political and economic power. By 2000, 70% of Russian GDP was generated by the private sector, and the manner by which these assets were transferred still stoked anger among the population. The oligarchs that benefitted most from the chaotic market of the 1990s faced public scorn over the dubious means by which they built their fortunes, which often involved large-scale corruption and even overt violence. Many of these oligarchs took up charitable causes and did good works to try to erase the "original sin" of their illegitimately acquired assets.[2]

Upon assuming the presidency in 2000, Vladimir Putin clearly understood the popular support he would enjoy by pushing back against the oligarchs and reasserting the state. The government he inherited from his predecessor Boris Yeltsin was widely viewed as weak and fragmented, plagued by oligarchic infighting and prone to indefensible insider corruption. During his first years in office, Putin presented Russia's richest with simple terms: stay out of politics and your fortunes will be secure. Those who dared violate this handshake agreement quickly fell afoul of the justice system, as most prominently exemplified by the case of Mikhail Khodorkovsky and his oil company Yukos, at that time the largest in Russia. Accounts differ over the exact transgressions Khodorkovsky committed vis-à-vis the Russian government: from supporting political parties that challenged Putin's consolidation of power and threatening to sell his company to foreign investors to having personal conflicts with Putin. Ultimately, he paid a steep price: a nine-year jail sentence (later extended) and the expropriation of his assets, which later were acquired by the behemoth state-owned enterprise Rosneft.

The Yukos affair was the turning point in the Russian government's approach to big business. Other oligarchs, such as Boris Berezovsky and Vladimir Gusinsky, had fallen out of favor several years prior, losing many of their assets to individuals and entities closely connected with the new Putin government. But Khodorkovsky's arrest in 2004 signaled not only that private ownership acquired during the 1990s was no longer sacrosanct, but also that the federal government would take an interest in running these companies. So began the period of intense nationalization when many pillars of the Russian economy returned to state

President Putin with Mikhail Khodorkovsky, chairman of the board of the Yukos oil company, December 2002. Source: Kremlin.ru hands and new SOEs took center stage. Table 2 (below) lists some of the key moves the Russian government made to take over private companies.

Which private firms were targeted during this nationalizing push? Scholars who have examined the determinants of some of the largest takeovers have found that political considerations dominate economic ones.[3] Firms nationalized by the federal government during the 2000s tended to operate in "strategically important" sectors, such as natural resources and manufacturing, which the government was fearful of ceding control to private investors. Prime examples include oil firm Sibneft, gas trader Itera, car manufacturer AvtoVAZ, and United Heavy Machinery. Moreover, the financial health of the firms prior to their takeover wasn't an overarching factor: the most profitable, highest grossing, and fastest growing firms didn't get taken over. Instead, the Russian government went after domestically owned firms (which had been first privatized during the 1990s) that it viewed as essential to protecting

Table 2: Selected List of Nationalized Firms

Firm	Sector	Year
Yukos	Oil & Gas	2004
Sibneft	Oil & Gas	2005
AvtoVAZ	Manufacturing	2005
Stroytransgaz	Transportation	2008
Apatit (Fosagro)	Chemicals	2008
Kit Finans	Finance	2009
Troika Dialog	Finance	2011

**Based off of Chernykh 2011 and other sources* the country's national interest.

Not only were private firms taken over during this period, but many of the state-owned giants that now dominate the Russian industrial landscape found their footing. Upon acquiring Yukos-held energy assets as well as other smaller firms, the moderately sized Rosneft metamorphosed into the country's largest oil exporter. The government also upped its stake from a minority to a majority share in Gazprom, while keeping in place a Soviet-era monopoly on gas exports for its sole benefit.[4] Forced consolidations of smaller state-owned enterprises created a new behemoth, the state corporation, as evidenced by United Aircraft Corporation and Rostec (which operates in the defense and civil sector). Lastly, even one of the success stories of late-era privatization, the electricity sector, lost some luster. For all the time and resources spent on privatizing the electricity sector in the early 2000s, regional producers, state-owned enterprises, and even the federal government have crept back in, now controlling at least 40% of electricity production.

Many observers believed that economic crisis might halt the nationalizing tendency.[5] Both the 2008 and 2014 downturns exposed just how inefficient and loss-making many of the nationalized companies had become. Privatization of the most attractive SOEs would alleviate some of the pressures building on government finances. Instead, the opposite seems to have occurred.

While notionally promising to step back from the private sector, the Russian government took measures that instead bail out state-owned enterprises and promoted further consolidation.

While notionally promising to step back from the private sector, the Russian government took measures that instead bailed out state-owned enterprises and promoted further consolidation. According to a report by the Federal Anti-Monopoly Service, the Russian government and state-owned enterprises are together currently responsible for 70% of GDP.[6]

Besides nationalization, the government has also turned a blind eye to the escalation of pressure on private firms coming from predatory state officials. Corporate raiding (*reiderstvo*) has plagued firm directors since the transition from communism, but as of late, the raiders themselves appear to come increasingly from the bureaucracy and the security apparatus. Entrepreneurs are advised to keep their businesses under the radar because once officials notice lucrative assets, there are few defenses against the devious tools they can employ to expropriate funds. Trumped up bankruptcy proceedings, tax inspections, and criminal prosecutions either corner directors to negotiate an exit from their own firms or lead to a state-ordered transfer of assets.[7] The problem has become so severe that in 2014 President Putin publicly cited statistics that 200,000 business-related economic crimes had been committed.[8] The majority of those accused (83%) lost their businesses as a result, even though only 15% were ultimately convicted. Alliances with the media and non-governmental organizations, membership in business associations, and appeals to the judicial system may help protect assets against other private sector rivals, but quickly lose their fangs in battles with politically connected raiders.

Access to subsidies and loan guarantee programs often depends on knowing the right bureaucrats in charge and making the case that one's firms is working for both the public and private interest.

This unprecedented degree of intervention by state officials into a purported market economy imposes significant costs on the remaining private (and foreign-owned) firms. First, weak property rights impede investment. Because substantial time is often required for investments to generate profits, firm owners must be sure that their stakes are secure and not vulnerable to expropriation. Both nationalization and politically connected raiding upend that certainty about the future of one's ownership claims, causing private firms to huddle and protect what they already own, instead of expanding.

Next, SOEs enjoy unparalleled advantages in maneuvering within the Russian bureaucracy. As access to state officials has become paramount to earning profits and staying alive during crises, no firms are better placed than those with active officials working as managers or populating boards of directors. State-owned enterprises benefit from regulations that erect barriers to entry into their sector, such as Russia's protectionist law that restricts foreign investment into strategic industries. Access to subsidies and loan guarantee programs often depends on knowing the right bureaucrats in charge and making the case that one's firm is working for both the public and the private interest. In 2016, the government demanded that half of the profits of all state-owned companies go back into government coffers (prior to that, companies paid no less than 25%, negotiated on an individual basis).[9] These financial contributions then bolster the SOEs' arguments that they should be first line to receive assistance and preferential treatment. Firms such as Gazprom and Rosneft have tried to push back against the order to share profits, so far with varying success.

By taking over large firms in the most vital sectors of the economy, nationalization has also decreased the level of competition within the market by creating only a handful of winners in each industry, all backed by the state. In some instances, SOEs enjoy complete monopoly power. This leads to potentially destructive market consolidation. Consumers are forced to pay higher prices; innovation is stymied; and income inequality increases. Finally, the monopolization of the economy by state corporations prevents the emergence of small- and medium-sized enterprises. As drivers of innovation and employment growth, SMEs are vital to stimulating economic growth and keeping an economy competitive internationally. How can new firms compete with well-connected, subsidized SOEs whose property rights are protected and have the dominant market share?

Every so often, Russian officials from various ministries announce a new commitment to privatizing some of the largest SOEs, such as VTB and Russian Railways. Timetables and even specific companies are put forward, stirring interest from international funds looking to win access to some of the prized

At the opening ceremony of the new deep-water terminal at the Rosneft's Tuapse Oil Refinery. Vladimir Putin, Rosneft Chairman Igor Sechin (left) and a Rosneft employee pressed the symbolic start button for loading the first tanker. Source: Kremlin.ru

Table 3: Privatization Plans versus Achievements

Company	Sector	State Share in 2013	Target Shares to be sold	Share sold (as of Nov. 2017)
VTB	Finance	60.9%	50.0%	
Alrosa	Mining	77.0%	48.0%	10.9%
Rosneft	Oil & Gas	69.5%	50.0%	19.5%
Sovcomflot	Shipping	100.0%	75.0%	
Russian Railways	Transportation	100.0%	25.0%	
RosHydro	Electricity	67.0%	50.0%	
Aeroflot	Transportation	51.2%	75.0%	
Sheremeytevo Airport	Transportation	83.0%	Full Exit	
Russian Agricultural Bank	Finance	100.0%	Full Exit	
United Grain Company	Agriculture	100.0%	100.0%	49.0%

**Source: OECD 2014, IMF 2014*

companies. The reasons given behind the change in policy run the gamut. For one, privatization could help fill government coffers at a time of low energy prices and export revenues. Reports of waste and overemployment in SOEs fill domestic media, leading to an inefficient allocation of resources and slowing growth rates. Moreover, egregious corruption scandals pull back the curtain on how irresponsibly many of these enterprises are managed. Currently, the more liberal technocrats in the Russian government appear to have won the upper hand, promising to reverse many of the destructive economic policies of the post-Yukos era.

However, time and time again, these plans are shelved, promises are walked back, and privatization stutters. Table 3 (below) lists the privatization plans put forth in 2013 and documents the relatively few sales that have occurred since then. First, officials argue that the government should sell the companies after crises have passed and assets command higher prices on the international market. But disagreements also erupt over the procedures by which shares in SOEs should be sold off, such as who would be allowed to buy stakes and how much management control the government would yield. The perception of privatization in the 1990s as unjust and potentially damaging to

Table 4: Key Russian Firm Under U.S. Sanctions

Firm	Sector	No new debt > 30 Days Maturity or Equity	No new debt > 90 days Maturity	Ban on extraction technology
Sberbank	Finance	X		
VTB	Finance	X		
Gazprombank	Finance	X		
Vnesheconombank	Finance	X		
Rosneft	Oil & Gas		X	X
Gazprom Neft	Oil & Gas		X	X
Transneft	Oil & Gas		X	
Novatek	Oil & Gas		X	
Lukoil	Oil & Gas			X
Rostec	Defense	X		

the Russian national interest colors the government's approach. While some in the government want to see Western investors bring management know-how and technological innovation to privatized firms, others see the potential for foreign actors to undermine state sovereignty and control over revenue streams. Some officials worry, for instance, that they are getting a raw deal by cozying up to China, which in their view has taken advantage of Russia's weak economic position.

These distinct sources of resistance do not bode well for the prospects of further privatization. The government claims to be fixing the problems from within by replacing underperforming managers and building partnerships (without selling stakes) with foreign firms. Individual ministries lobby hard to prevent the presidential administration from putting their main properties up for auction, fearing that the loss of revenue will curb their power and influence within the federal government. Both the Transportation and the Agriculture Ministry have worked to protect their key assets.[10] It is also unclear whether sufficient foreign demand exists to buy up minority shares given concerns over future threats of expropriation and the risk of violating international sanctions. Most of the attractive companies are currently prevented from accessing Western credit markets, which, for international investors, presents a clear roadblock to meaningful expansion (see Table 4 for a list of some of the most prominent firms currently targeted by U.S. sanctions). Russian officials claim that they are waiting for the price of oil to rebound and the budgetary gains from selling stakes to increase. But even under that scenario, privatization is still unlikely: why would officials part with the enormous revenue streams earned from $100 barrels of oil?

The past decade has seen a significant expansion of the government's role in the economy. When the Putin first came to power in 2000, most of the economy was in private hands. Since then, SOEs have come to dominate a variety of critical sectors, with the government time and again declining to privatize or step back from this high degree of economic intervention. The competitors for the remaining private and foreign firms are often entities connected to the government. This increases the importance of political connections and shapes the strategies these companies use to survive and get ahead in such a tilted marketplace.

Endnotes

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Strategies for Acquiring Political Influence

Given the many obstacles to doing business in Russia, the most successful private companies have been forced to adapt to a new reality of state capitalism. Whereas the late 1990s and early 2000s were marked by roughly on par exchange between the business sector and the state, the power balance between the two sides tipped after the Yukos affair. Even a prolonged economic crisis has not shaken this hierarchy. Governments at all levels in Russia have undue influence to shape the profitability and expansion of firms. Private firms must not only remain on good terms with state officials, but also learn how to coax needed assistance and preferential treatment. Effective corporate political activity is vital to survive (and hopefully thrive) in a state-centered business environment.

In most developed countries, business interests adopt one of two political strategies to gain the benefits they need from the government. First, firms can contribute to electoral campaigns in the hope that their preferred candidate returns favors while in office. Contributions can take the form of money, votes, or even helpful information, helping to create a dependence of the candidate on business interests for their success in office. After elections have passed, firms lobby politicians on specific issues either individually or under the aegis of a business association. Lobbying is a perfectly legal way for firms to get their interests heard by legislators and regulators. Acknowledging the necessity and usefulness of allowing special interest influence, many governments in the West regulate how campaign contributions and lobbying are conducted, demanding transparency and documentation to prevent conflicts of interest.

Russian elections are expensive, and much of the money used to fund them comes from private and corporate donations. Although campaign contributions by firms are documented and monitored by the Central Election Commission, the official receipts of political parties pale in comparison to the sums actually spent. This heightens suspicions that Russian electoral campaigns rely predominantly on dark money. It is simply impossible to calculate the full extent of illegal campaign financing in the country, but both anecdotal evidence and academic research paint a grim picture. Analyzing transactions to fly-by-night firms around elections, academics Maxim Mironov and Ekaterina Zhuravskaya document enormous sums of money flowing to gubernatorial candidates from private firms; in return, these firms receive state contracts after their preferred candidates win.[1] Golos, a prominent NGO in Russia, also uncovered that firms officially donating to the United Russia party (Putin's political party) were rewarded with procurement streams after the elections.[2] Analysts still don't have a full grasp on the extent of corporate money fueling Russian politics, but seeing the enormous pressure authorities place on companies that try to donate to the opposition, these funds appear important for maintaining the government's hold on power.

Through their ability to offer rewards and punishments, employers command considerable influence over the political behavior of their workers.

Beyond dark money, recent work on Russian elections has also investigated another channel through which firms develop relations with government authorities: mobilizing their workers to vote for certain candidates. Winning elections in Russia requires getting citizens to the polls, an often times arduous task when ballot options are limited and people prefer to stay out of politics. Thus, leaders of the ruling United Russia party have resorted to other tactics to generate turnout. Through their ability to offer rewards and punishments (bonuses, promotions, firings, etc.), employers command considerable influence over the political behavior of their workers. Getting employees to turn out helps firms demonstrate their commitment to the survival of the regime and puts them in line for preferential treatment down the line. Surveys conducted after the most recent national elections in 2011 and 2016 suggest that close to 25% of all employed individuals have encountered politics at their workplace, from candidates being allowed to hold rallies there to employers explicitly endorsing specific parties and providing transportation to the polls.[3] Officials often inform firms that their ability to access subsidies and state contracts depends on employee turnout.

However, the weakness of political institutions in Russia, such as political parties and absence of independent media, complicates firms' decisions to donate to campaigns and lobby officials. First, Russia has not yet passed an official lobbying law that would both sanction and regulate the practice. Firms attempting to lobby lawmakers are technically operating in a legal grey zone, where they run the risk of an aggressive prosecution (potentially spurred by a helpful tip from their rivals). Some business associations, such as Delovaya Rossiya and the Russian Union of Industrialists and Entrepreneurs (RUIE), purportedly claim to represent business interests in high-level dealings with the government. In fact, the former head of Delovaya Rossiya, Boris Titov, was appointed business ombudsman in 2012, receiving greater authority to advocate for the rights of business owners. But several years later, the achievements have been piecemeal: thousands of entrepreneurs still sit in jail, accused of having committed economic crimes, and RUIE still works within fiercely defined limits set by the state.

But even when lobbying avenues are available, firms need to trust that the politicians they support, financially or otherwise, will follow through on their side of the bargain. That is, after receiving a contribution or lobbying overture, a politician will not simply renege on the deal and offer nothing in return. Interviews with Russian businesspeople suggest a marked degree of skepticism about the utility of adopting either of these strategies. Firms often heavily invest their resources and funds into both politicians' campaigns and lobbyists, only to see little return on their investments and continued isolation from the political sphere. When pressured by officials to contribute, private firms oblige, but working through intermediaries may be the most cost-effective ways to gain access to politicians.

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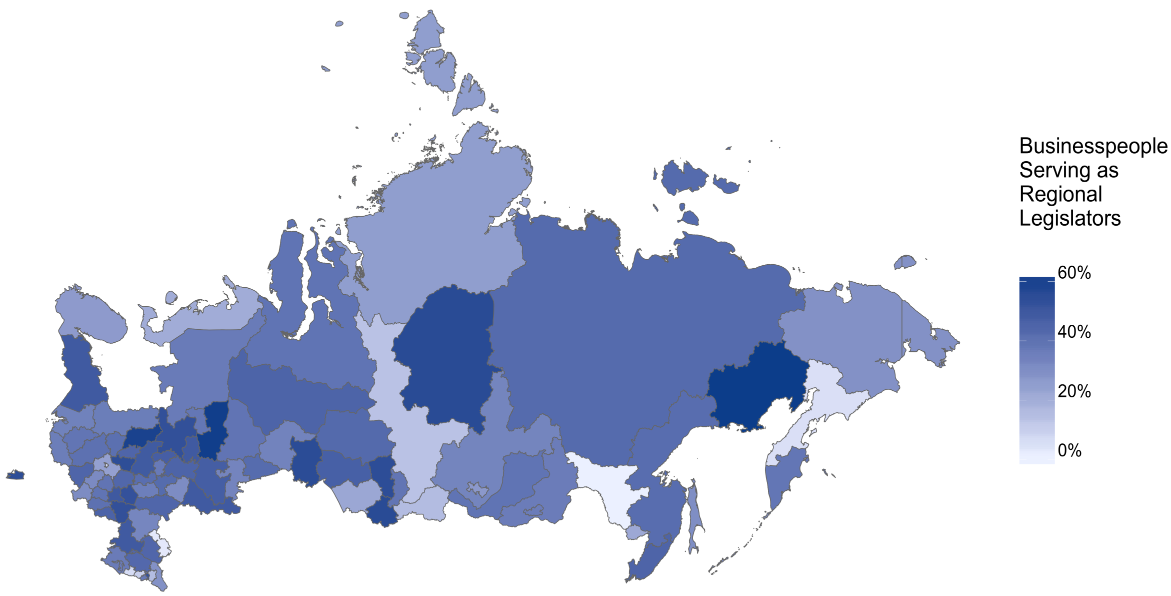
So what options do firms then have beyond offering campaign contributions and lobbying? The most effective ways of achieving access to government involve what are termed "*direct* strategies," when companies engage state officials without the use of intermediaries.[4] One of the most prominent examples involves bringing in officials to serve on the board of directors. This practice was commonplace during Putin's first two terms as government entities insisted on having personal representation within companies after taking minority stakes. In 2011, former President Dmitry Medvedev signed a law to outlaw state officials from serving on the boards of SOEs, but it was subsequently reversed by Putin in 2014. Bureaucrats now populate boards of directors in sectors across the economy, providing some degree of assurance to ownership that the government will be looking after their interests. That protection comes at the cost of prioritizing the state's political interests in addition to pure profit-making ones.

Acquiring political connections has also become a family affair. Putin's team has now been in power at the federal level for nearly 18 years, and many central figures are pondering their next steps after serving in office. To insure against future reprisals as well as to perpetuate the system they have developed, many of these officials have assisted their relatives into reaching high-level positions in both the government and the private sector. Table 5 displays several of these connections, drawing on journalistic accounts that have tracked the careers of these well-connected kin.[5] The sons of former and current government

Table 5: All in the Family Business

State Official	**Mikhail Fradkov**, former Prime Minister and head of the Foreign Intelligence Service	**Sergey Ivanov**, former first Deputy Prime Minister and Minister of Defnese	**Evgeny Murov**, former head of the Federal Guard Service	**Nikolai Patrushev**, Secretary of the Security Council	**Dmitry Rogozin**, Deputy Prime Minister
Relatives	**Petr Fradkov** (son); first deputy chairman of Vnesheconom bank, a state-owned development bank	**Sergey Ivanov** (son); President of Alrosa, a state-owned diamond company	**Andrey Murov** (son); Chairman of the Management Board at Federal Grid Company (UES)	**Dmitriy Patrushev**, (son); head of the supervisory board of the Russian Agricultural Bank **Andrey Patrushev**, (son); head of the board of directors of TsentrKaspNefteg az, a joint project between Gazprom and Lukoil	**Aleksei Rogozin** (son); general director of the "Ilyushin Aviation Complex."



bureaucrats manage Russia's largest diamond company (Alrosa) as well as high profile oil exploitation endeavors (a partnership between Rosneft and Lukoil) and Russia's electricity grid operator. Moreover, even completely private companies that hire the relatives of ranking federal officials benefit from improved access to state procurement.[6] These relationships, so vital between business and government, will literally be inherited by the next generation.

The other important avenue for firm directors to access policymakers is to become one themselves. In Russia, businesspeople must stop operating their firms personally when winning a parliamentary seat in the State Duma, but only must declare potential conflicts of interest if they become a member of lower level legislatures. As a result, roughly 40% of all regional legislators in Russia arrive into elected office straight from the private sector (see Figure 2 below for a map about how that figure varies across regions). Serving in office opens up innumerable opportunities to help one's firm, from drafting legislation and regulations to protect their market share from competitors to pressuring bureaucrats to tailor procurement tenders for their firm's benefit. Research has uncovered that winning a parliamentary seat at the regional level can result in increases in firm revenue by roughly 60% and profitability by 15% over the course of a term in office.

The line between public official and private businessperson is exceptionally blurry in Russia, especially when extended family members are considered. The sophisticated methods firms are using to ingratiate themselves with authorities help to bind the two sides even more closely. Developing effective political connections opens doors to firm managers (such as access to government largess and concessions to exploit natural resources), while also helping to protect property rights and ensure fairer treatment by inspectors and regulators. Success in the business world above a certain size threshold basically requires that firms engage politically to some degree, lest they become exposed to a rainstorm without a roof.

Endnotes

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4 David Szakonyi, "Businesspeople in Elected Office: Identifying Private Benefits from Firm-Level Returns," SSRN Working Paper, 2017.

5 RBK "Kak sklyadyvaetsya kar'era detey rossisskyih chinovnikov [How the careers of the children of Russian officials have been built]," June 6, 2017; and Dmitry Travin, "Putinskiy Sinecures" *Rosbalt*, March 21, 2016.

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Looking to the 2018 Presidential Election

Given all these challenges, the expectation of a prolonged and severe downturn for the Russian economy would not be unwarranted. However, instead of economic collapse, the new norm has been stagnation: a low, but steady rate of economic growth and little demonstrable improvement in the wellbeing of the average Russian citizen. Part of the credit for the unpredicted durability of the Russian economy must go to the specific measures taken by the government at the margins of the business environment. Not every initiative has worked as intended, with wasteful subsidies and opportunistic cheating of regulations apparent on multiple accounts. Moreover, many of the most impactful structural reforms are still off the table, especially privatization, breaking up monopolies, and definitively

Vladimir Putin visiting the Yamal LNG plant, which accounts for a major share of Russian Arctic shipping in December 2017. Source: Kremlin.ru rooting out corruption. But Russian authorities have been able to stem some of the economic bleeding by empowering technocrats to identify and resolve some of the lower level blockages while also protecting promising sectors, such as agriculture and pharmaceuticals.

The real question remains whether these partial measures can prop up the economy against a sustained dip in oil prices and the long-term consequences of international sanctions. The Russian government is already feeling the squeeze of reduced revenue, and more and more, it is looking to borrow from abroad to cover its widening deficits. To maintain even the current measly growth rates, significant public investments are needed in infrastructure and human capital. Where those resources will come from is an open question if the country cannot find sources of private investment and diversified exports soon. The sanctions imposed on Russia by the international community in 2014 will have their greatest impact five to ten years from now. Without access to loans and technology, Russia's oil companies will struggle to exploit their more isolated and perilous reserves. Revenue from energy exports will fall, with aftershocks for the host of other industries dependent on the natural resources sector. In all, the headwinds on the Russian economy show no signs of abating, and the government will have to reform in order to survive.

These pressures raise significant complications for the next presidential election and beyond. In March 2018, Vladimir Putin will presumably contest his fourth term (non-consecutive) in office. In bailing out and protecting key oligarchs that otherwise might have financed a real challenger, Putin has bought himself and the regime some additional time. The financial incentives for most of Russia's richest individuals to maintain the status quo are simply too substantial to risk one's empire and face down a ruling party bent on prolonging its power. However, convincing economic elites not to jump ship and mobilizing voters to turnout to the polls are two separate endeavors. Russian citizens have tolerated a deep downturn in their livelihoods since 2014, and fewer and fewer believe that the current government (outside of the Putin) is adequately addressing their needs.

The 2018 election thus presents a tough test of Putin's personal popularity and the economic reality of life on the ground. We should expect the authorities to not take any chances in ensuring victory for Putin. This will involve even greater pressure on SOEs, private firms, and budget institutions to deliver the vote. However, we know from the 2011-2012 election cycle that the more steps the regime takes to manipulate their way to electoral success, the greater the potential backlash will be on the streets. Moreover, get-out-the-vote efforts will also strain budgets as expenditures will rise and officials will look to pump the economy to ensure citizens vote with optimism, rather than disappointment. As we have seen in years past, when money gets tight, business-government relations become extremely strained. With fewer budgetary resources to siphon off rents from, officials revert to predatory behavior towards firms. The next year will herald even more jockeying among firms for political protection and a chance get a piece of the ever-shrinking pie.

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