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Anti-crisis programme as a way to reinforce the elite's influence on the economy

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The global financial crisis, which is increasingly affecting Russia, offers the Russian ruling group an opportunity to continue the economic policy pursued during the eight years of Vladimir Putin's presidency. The aid programme developed by the government is enabling the state to further strengthen its position in the Russian economy, e.g. by the state-owned companies taking over private assets. Moreover, the unclear criteria and methods for allocating the billions of state aid are being used to further expand the financial backing of people associated with the power elite.

The Russian economic model as developed during the last eight years

During Vladimir Putin's time in office, the Russian state reinforced its position in the economy, and people from the president's inner circle (most of whom had not participated in the privatisation processes of the 1990s) built up their financial strength. The new division of property has often required assets to be taken away from their original owners (as in the cases of Yukos and Russneft).

In recent years the Kremlin's economic policy has been based on high revenues from the export of raw materials, which guaranteed both a stable macroeconomic situation and public approval of the government's actions. The Kremlin's main objectives were as follows:

The financial crisis offers Russia's ruling group an opportunity to continue the economic policy pursued during the eight years of Vladimir Putin's presidency.

– to **re-nationalise those enterprises that were attractive** from the ruling group's point of view, and to **further concentrate assets in the hands of state-owned companies**[1]; the state expanded its presence mainly in the strategic sectors of oil and gas, machine-building and banking;

– to **establish people from the president's inner circle in management positions in the state-owned mega-holdings** (as one example of this, Putin himself has been appointed as chairman of the board of directors at Vnesheconombank, deputy prime minister Igor Sechin holds the same position at the state-owned oil company Rosneft, and the Rostekhnologii state corporation is managed by Sergei Chemezov, an acquaintance of Putin's from the period when they both worked in the Soviet intelligence on the territory of the then German Democratic Republic);

– **to limit foreign investors' access to the Russian market**. Fearing a potential undermining of the state's control of the economy, the Kremlin has imposed limits on the presence of foreign investors in the strategic sectors (especially in the raw materials sector); to this end, some

[1] As the result the share of the state companies in the GDP increased by 5 percentage points to 65% (the European Bank for Reconstruction and Development). See more in Iwona Wiśniewska, *The invisible hand... of the Kremlin Capitalism 'a la russe'*, Policy Briefs, CES, 2007.

existing agreements have been revised, and foreign investors have been forced to surrender the controlling stakes they had held in the few oil and gas projects where they were present (such as Shell in Sakhalin) in favour of Russian state-owned companies;

– **to promote the expansion of Russian companies in Russia and abroad**. This expansion has been promoted by the Russian government as an important instrument to build Russia's international position. Russian state and private companies were buying foreign (and domestic) assets for loans granted by Western banks. As a consequence, by 1 July 2008 the Russian businesses' debt exceeded US$488 billion, including US$193 billion of the banks' debt and US$295 billion on the part of the non-financial sector (for comparison, the state's own debt amounted to a mere US$35 billion).

The measures undertaken to strengthen the **state's presence in the economy have also provided an opportunity for the ruling group to build up their private fortunes**; those in charge of managing public property have been able – without any supervision – to use the state-owned corporations'[2] huge financial resources while implementing their projects, organising the export of raw materials, etc.

The financial crisis creeps into the Russian economy

The global financial crisis that started in August 2007 in the USA, and the worsening situation on the raw materials markets, have posed a challenge to the economic model that the Kremlin has been developing over the last eight years. Foreign capital has escaped from the Russian stock exchange, as a result of which the stock listings have plummeted (the Russian stock exchange index, RTS, decreased by around 60% between August and mid-November). The negative consequences of the decreasing stock listings have spilt over to the banking sector (the amount of capital has decreased while its price went up). Russian banks have started experiencing problems with maintaining financial liquidity, and consequently, they have limited the availability of loans to both individuals and companies.

The Russian economy, which is dependent on the raw materials sector, has been affected most seriously by the declining prices of raw materials on world markets.

However, from the point of view of the Russian economy, which is dependent on the raw materials sector (especially the oil and gas sector)[3], the drop in oil prices on global markets have been a much more severe consequence of the financial crisis (the price of a barrel of Brent crude oil fell by more than two-thirds between July and November, to around US$50 per barrel). As a result of the financial crisis and declining raw materials prices, consumer and investor demand has started to fall, as many Russian companies had to revise their ambitious investment plans. In the following stage, the negative tendencies observed in the financial market started to affect other branches of the Russian economy visibly, especially the construction, automotive and metallurgical sectors. In addition, many Russian companies have begun experiencing difficulties with handling their debts, especially loans contracted abroad. Under the loan agreements currently in place, Russian economic operators will have to pay their creditors more than US$47 billion in the fourth quarter of 2008, and another US$160 billion in the course of 2009. Most of the loans are secured with liens on shares of the borrowing companies.

As a consequence of the financial crisis, the growth rate of the Russian economy will slow down in 2009, to as low a figure as 3% of GDP (compared to the previously projected 6%), and – if the oil price drops below US$50 per barrel – the federal budget will report a deficit that will have to be covered from the reserve funds.

[2] Iwona Wiśniewska, *State-owned corporations - a new way of managing the Russian economy*, Eastweek #102, CES, 2007.

[3] The share of the energy sector in Russian GDP is approximately 30%, it makes under 50% of the federal budgetary revenues, and it constitutes more then 60% of export receipts.

The government's anti-crisis plan

The deepening crisis has forced the Russian authorities to support the economy. The value of the aid programme developed by the government has already exceeded US$200 billion, but the Russian authorities are prepared to provide even more aid. The government of the Russian Federation has offered assistance not only to the financial sector, but also to other sectors of particular importance for the economy (the oil and gas, automotive and construction sectors). The state-owned Vnesheconombank (VEB) is the main distribution channel for state aid. Aid has been offered to the following sectors:

– the banking sector (more than US$75 billion), in order to maintain the financial liquidity of the Russian credit institutions. Most of the funds have been allocated to state-owned banks (Sberbank, Vnesheconombank); at the same time the government has identified those sectors to which the banks should provide financial assistance, including the military-industrial sector, agriculture, the construction and automotive sectors, air transport, as well as the state-run monopolies and corporations;

– the Russian stock exchange (around US$7 billion); these funds are intended for interventions designed to sustain the stock listings of the main Russian companies (such as Gazprom and Rosneft). So far, there have been no reports of VEB buying the stock of Russian companies;

– companies of key importance for the economy (US$50 billion), for the refinancing of their foreign debt in order to prevent Russian businesses from being taken over by foreign banks. The aid is addressed solely to those Russian companies or their foreign daughter companies whose activities are of major importance for the economy of certain regions or strategic sectors of the industry (such as Gazprom, Rosneft and LUKoil). While offering loans, VEB may demand that its representatives be appointed to the management boards of the beneficiary companies, or ask for additional guarantees from their shareholders, or establish liens on their shares or export contracts;

The government has provided financial support to banks while at the same time indicating which sectors of the economy they should offer loans to.

– the oil sector (around US$5.5 billion). The government has changed the procedure for establishing export duties on oil and petroleum products (as the reaction time has been shortened); these duties have already decreased by 40% since September.

The government is working on further instruments to support the economy (through public procurement and import duties on cars), the objective being to stimulate demand and boost production. The initial assumption is that in 2009, the value of public procurement is to be doubled, to US$320 billion. This programme will mainly benefit Russian companies, in particular the state-owned oil and gas companies. In addition, public procurement procedures are to be simplified. Finally, import duties on cars are to be increased to 30%, which will mainly benefit the state-owned Avtovaz, Russia's largest car producer.

The real objectives behind the state aid

It is specific to the Russian anti-crisis measures that in most cases, they are mainly of benefit to those responsible for distributing the aid funds (for example, the deputy prime minister Igor Sechin, who is also chairman of the board of directors of Rosneft, one of the beneficiary companies). In early September, nearly US$600 billion from the central bank's currency and gold reserve, and more than US$160 billion from the Stabilisation Fund, was put at their disposal. The government's anti-crisis plan has enabled a continuation of the policy pursued during the eight years of Putin's rule, the objectives of which were as follows:

– **to expand the presence and strengthen the role of the state in the economy** by re-nationalising and concentrating assets in the hands of state-owned economic operators, purchasing shares at low prices, or strengthening the role of the state-owned banks in the sector. The financial aid offered to private companies is also another way to make them dependent on the state. However, it is the companies in which the state holds shares that benefit most from the anti-crisis programme. The financial assistance is a way to expand the state's stakes in these companies, for example in the banking sector. State-owned banks (Sberbank, Vneshtorgbank and Vnesheconombank) have expanded their assets not only because they have been entrusted with the public aid funds to be distributed, but also because they have taken over the assets of several private banks, including Svyazbank (taken over by VEB) and KitFinance (taken over by the state-owned Russian Rail). The ruling group is also taking measures to ensure financing for the major infrastructure projects by subsidising state-owned companies.

The decision-makers in charge of the anti-crisis program are at the same time its main beneficiaries, as they are the managers of the companies receiving aid.

The programme whereby VEB intends to refinance Russian companies' foreign debts, may become yet another opportunity for re-nationalisation. If the beneficiary companies fail to repay the aid received from VEB, their assets on which liens have been established may be taken over. The ruling elite may use this instrument to further reduce the holdings and influence of private businesses not directly associated with the Kremlin team (such as Vladimir Potanin, the co-owner of Norilsk Nickel, and Mikhail Fridman, the co-owner of the Alfa Group investment company).

– **to keep strategically important Russian companies in the hands of Russian capital**. Russian companies with excessive foreign debt are experiencing difficulties repaying their loans. So far, this problem has only affected their foreign business assets which have been taken over in recent years. For example, the Russkie Mashiny company, owned by the billionaire Oleg Deripaska, has disposed of a 20% stake in the Canadian Magna automotive company and a 10% stake in Hochtief, the German construction company. However, foreign banks also hold liens on shares in strategically important Russian companies. VEB has allocated US$4.5 billion for the refinancing of Deripaska's loan contracted to purchase 25% in Norilsk Nickel (secured with a lien on the shares in question), even though under the bank's bylaws, the maximum amount to be lent to a single customer is US$2.5 billion. However, the VEB board of directors (chaired by Vladimir Putin) decided to make an exception to this rule.

The terms and conditions for allocating the limited amount of public aid are not transparent, and the aid is being used instrumentally by the ruling group to tighten state control of the economy.

– **to protect the private property of people associated with the ruling group**, for example, by assigning them selective public aid based on unclear criteria. The multi-billion public procurement scheduled for next year may be a means to this end. Unclear criteria, such as those for drawing up the list of goods that may be purchased on preferential terms, may create enormous opportunities for abuse.

Conclusions

The terms and conditions for the distribution of limited public aid funds are not transparent, and are being instrumentally used by the ruling group in order to consolidate its control of the economy. In a situation in which Russian companies are facing restrictions on access to international capital, the financial resources of the Russian Federation amassed during the last eight prosperous years give the Russian ruling group a huge advantage over private business, that is not directly linked to the elite.

If raw material prices continue to decline, and if the state's financial resources shrink substantially in consequence, the government may be forced to halt some of its economically-unjustified measures; this may in turn create divisions within the current ruling group.

The financial crisis is forcing the authorities to intervene and apply non-traditional solutions in order to save companies in financial difficulties. These measures are necessary to stabilise the country's economic situation. However, the hastily developed public aid instruments are being devised by those who are directly benefiting from the aid. In a situation in which all power in Russia is concentrated in the hands of the executive bodies, and the control of public spending is being steered by the ruling elite, the possibilities of developing effective support mechanisms are limited, and the public aid is often reduced to being merely a way for the ruling class to take over more privately-held business assets.

So far, the Russian government has been developing its anti-crisis programme while acting on the conviction that the reserves it holds are sufficient to protect Russia from serious financial trouble for a long time (a period of more than two years has been mentioned in earlier calculations from the Finance Ministry). The Russian elite hopes that by that time, the negative trends on the finance and raw materials markets will reverse.

The duration of the financial crisis will be decisive for the scale of its impact on ownership transformations in Russia. So far, the crisis has been too short to force the ruling group to revise its original economic policy. The situation of insufficient revenues is a novelty for the elite, which has been accustomed to budget surpluses. At the moment, the elite is using the crisis to promote the re-distribution of property in Russia, of which it is the main beneficiary. However, should the crisis exacerbate and the prices of raw materials continue to decline, the Russian authorities may be forced to stop providing economically-unjustified aid along the current lines, and instead start to spend public money to strengthen its decreasing social support. In addition, if the crisis continues for a yet longer period, the Russian state may run short of funds, which may create divisions and conflicts within the current ruling group.

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