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## Leaving to Come Back: Russian Senior Officials and the State-Owned Companies

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***Mikhail Korostikov***

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27, rue de la Procession  
75740 Paris Cedex 15 – FRANCE  
Tél. : +33 (0)1 40 61 60 00  
Fax : +33 (0)1 40 61 60 60  
Email : [accueil@ifri.org](mailto:accueil@ifri.org)

Ifri-Bruxelles  
Rue Marie-Thérèse, 21  
1000 – Bruxelles – BELGIQUE  
Tél. : +32 (0)2 238 51 10  
Fax : +32 (0)2 238 51 15  
Email : [info.bruxelles@ifri.org](mailto:info.bruxelles@ifri.org)

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## Author

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Mikhail Korostikov is an analyst at the Kryshtanovskaya Lab, a Moscow-based center for sociology, a member of British Association for Slavonic and East European Studies (BASEES), as well as secretary for the club "Russia in Global Affairs." Korostikov is the author of several publications in national and international revues on Russian-Chinese relations, and many aspects of Russian domestic politics. His publications include "Russia and China: Against the Storm" (*Journal of Communist Studies and Transition Politics*, September 2011); "New Oil and Gas Transactions between Russia and China: a Long-term Alliance Built on Mutual Benefit" (*Drilling and Oil*, May 2013); "Russia: Youth and Politics" (*Russie.Nei.Visions* No. 76, April 2014). As part of the Kryshtanovskaya Laboratory research group, Korostikov has participated in a number of sociological studies including "The Mentality of the Russian Youth: Political Guidance and Idols", "Dynamics of Protest Activity: 2012-2013" and "The Elite in Social Networks."

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## Abstract

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When Dmitry Medvedev announced in late 2014 that the presence of ministers and other officials should be sharply increased on the boards of public companies, observers were surprised, considering that four years before the former President started a campaign to remove them from the very same structures. This change of trend is symbolic and finally closes the debate about state ownership management in Russia. In the crisis context in early 2014, the Kremlin decided to make a bet on mobilizing all resources under its control by sacrificing the program aimed at increasing the transparency and openness of management of Russia's state companies. The result of this has been the gradual replacement of independent businessmen on the supervisory boards of state-owned companies with government officials—both members of “Putin’s clan” and the chiefs of other sectors of government-owned industries.

## Introduction

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History has shown that state capitalism has been the prevailing form of economics throughout Russian Tsarist and post-Soviet periods. Indeed, some researchers believe that even Soviet socialism was just another version of this form of economics.<sup>1</sup> Attempts to change have been made in recent times to reform the system Russia's confined private enterprise sector undertaken repeatedly—one of the last significant attempts was an intention announced in 2011 by former President Dmitry Medvedev to remove high-ranking officials from their positions on boards of directors of Russian state-owned companies. This measure was in line with a large-scale program of privatization and support for Russia's business environment and for private companies as well as the general democratization of the country. Russia has experienced a great deal of turmoil over the past four years. At the end of December 2014 the former President and current Prime Minister, referring to state-owned companies, declared that “taking into account the current economic situation [...] I believe it appropriate at this time to return to the question of the representation of civil servants on company boards”.<sup>2</sup>

The question of whether ministers and Kremlin representatives should dominate the boards of directors of state-owned companies is of great importance for Russia. Indeed, it is the question of whether these companies are controlled and operated by the common free market rules or the internal rules of fewer administrative barriers and less transparency that govern the closed corporations of Russian officials. Which model is more effective? Disputes between supporters of state control and the Kremlin's liberal factions on the issue were interrupted in early 2014 when the events in Ukraine and the Crimea forced the start of a radical restructuring of the entire system. How have these recent developments affected the management of Russia's large state assets? What were the events that made the current Prime Minister of Russia to abandon one of his most high-profile Presidential decisions?

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Translated from Russian by Joe Carter.

<sup>1</sup> In particular, N. Chomsky, *The Soviet Union Versus Socialism, Our Generation*, Spring/Summer, 1986, <[www.chomsky.info/articles/1986----.htm](http://www.chomsky.info/articles/1986----.htm)>.

<sup>2</sup> Introductory word of D. Medvedev to the government session, 25 December 2014, <<http://government.ru/meetings/16314/stenograms/>>.

## The State Takes its Assets Back

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After the collapse of the Soviet Union it was assumed that political and economic power in Russia would become two separate domains, allowing the birth of a new class of independent owners who would create the demands for political reforms and modernization of the social system. This process has been started, but due to the lack of the regulatory framework and property relations of power, the situation reversed and instead a class of so-called oligarchs was formed—those men who, thanks to their newly-accumulated wealth, were able to influence political decisions. However this period did not last long. After his ascendancy to power in 1999, Vladimir Putin started the centralization of the country. A number of those oligarchs who did not want to part with their political and economic influence were either expelled from Russia or jailed (as in the case of Boris Berezovsky, Vladimir Gusinsky, Mikhail Khodorkovsky, etc.), while others (including Roman Abramovich, Mikhail Prokhorov, Vladimir Potanin, etc.) willingly recognized their new relationship with the Kremlin.

Vladimir Putin set out to return certain sectors of the economy over state control, above all the hydrocarbons and the defense industries. Many of his former KGB colleagues and those close to him during his period as St. Petersburg Mayor became brokers of the state interests, and were engaged in the return of assets to state control. Throughout the 2000s political consolidation and economic concentration grew in parallel and since 2003 there has been a constant increase of the role of the State in Russia's economy. In 2006 the public sector accounted for 38% of GDP, rising to 40% in 2008 and to 50% in 2012.<sup>3</sup> During the 2008-2009 financial crisis, many state-controlled companies (primarily VEB VTB, Gazprom and Rostekh) bought up shares during the readjustment of private companies, but decided not to sell them back after the economic climate had stabilized.<sup>4</sup> Whereas the shares bought by the US government when providing financial rescue assistance to companies does not translate into voting rights, in Russia it is often in the hands of government agencies who bought a controlling stake in it, as was

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<sup>3</sup> O. Kuvshinova, E. Pismennaya, "Half of Russia's Economy Already in State Sector", *Vedomosti*, 16 November 2012,

<[www.vedomosti.ru/politics/news/5739621/esche\\_odin\\_byudzhzet](http://www.vedomosti.ru/politics/news/5739621/esche_odin_byudzhzet)>.

<sup>4</sup> Ibid.

the case with the GLOBEX, Sobinbank and Svyazbank banks<sup>5</sup>, who merged with the structures of Gazprombank and Vnesheconombank.

As a result of the continuous increase in acquisitions by state controlled giants such as Vnesheconombank (VEB), Vneshtorgbank (VTB), Gazprom, Rosneft and Rostekh, the state's share in the banking sector reached 49% in 2015, while state ownership in oil production reached 45% and the transport sector 73%.<sup>6</sup> This increasing control has led to state corporations and companies forging a self-dependent network of mutual control exercised through cross-collaboration of the heads of the boards of directors and their common connection with the head of state. At the same time, senior government leadership has gained access to a resource network through personal relationships with company heads and using personal enforcement mechanisms for non-core spending.

Indeed, one can talk about the formation of a parallel government budget, used to finance large-scale projects. Rosneft, Russian Railways, Sberbank, VTB, Gazprom spend between 1 and 3 billion dollars annually on social issues and supporting prestige construction projects designed to bolster Russia's national image (among them, Olympic facilities in Sochi, the APEC summit, the Resorts in the North Caucasus).<sup>7</sup> During the privatization of the 1990 s. enterprises were actively removed from the social infrastructure budget, a situation began to reverse after the subsidence of the financial and economic crisis of the Yeltsin years. According to the deputy head of the Audit Chamber of Russia Valery Goreglyad, with the growth of the state's share in the economy inevitably grows the level of corruption, which has no place in the working relationship between two private companies.<sup>8</sup>

This process has led to the gradual erosion of the boundaries between the state and state-owned enterprises. Instead of having to withdraw their money in the budget and carry out their tasks, the state involved them as investors. This relationship with the State is much more profitable than privatization: to obtain from its budget the amount equal to the expenditures by Gazprom at the APEC summit (300 billion rubles<sup>9</sup>), the Federal Property Management Agency would have to sell a 10% stake in the corporation.<sup>10</sup> The chronic undervaluation of Russian companies on foreign stock markets is

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<sup>5</sup> M. Korostikov, "The Problem of the All-seeing Eye" *Russkii Zhurnal*, 24 November 2008, <<http://russ.ru/pole/Vsevidyaschee-oko-problem>>.

<sup>6</sup> D. Rodionov, "The Share of the Economy: Half of a State", *Economics and Life*, 9 November 2012, <[www.eg-online.ru/article/194147/](http://www.eg-online.ru/article/194147/)>.

<sup>7</sup> O. Kuvshinov, E. Pismennaya, *Op. cit.* [3].

<sup>8</sup> "Goreglyad: The Share of the State in the Economy, Needs to be Reduced", *Rosbalt*, 18 December 2012, <[www.rosbalt.ru/business/2012/12/18/1073010.html](http://www.rosbalt.ru/business/2012/12/18/1073010.html)>.

<sup>9</sup> *Ibid.*

<sup>10</sup> "Gazprom's Value Has Fallen Below \$100 Billion for the First Time after the Crisis", 3 April 2013, <[www.km.ru/economics/2013/04/03/gazprom/707556-stoimost-gazproma-upala-nizhe-100-milliardov-vpervye-posle-krizi](http://www.km.ru/economics/2013/04/03/gazprom/707556-stoimost-gazproma-upala-nizhe-100-milliardov-vpervye-posle-krizi)>.

caused by a combination of objective factors (the need to replace old production facilities, a high level of depreciation, opaque internal corporate governance) and subjective factors (lack of confidence in the Russian financial and political system) that makes privatization an affair even less justifiable in terms of raising budgetary funds. And buyers in no hurry to line up: a plan for the privatization was carried out in 2011-2013 with 56% of Parliament backing.<sup>11</sup>

The model of interaction created between government and business in Russia may be seen as corporatism where flagships of Russian industries are in fact monopolies (such as Russian Railways-RZhD, Gazprom, Rosatom, Transneft), and maintain close contact with the government and the trade unions to jointly deliver their goals. However, there is a significant difference between corporatism and the economic system in place in Russia in 2013. No formal government-business conciliatory procedures take place; most of the issues between the state corporations and state-owned companies are solved through personal dialogue with their chief government contact.

A key feature of the Russian system is that many large companies formed as a result from the dismemberment of the Soviet economic system (e.g. Russian Railways, Gazprom) are now the backbone of the Russian economy and fight against major independent businessmen and their companies (including United Aircraft Corporation-UAC, Rosneft) in the mid 2000s. Members of “Putin’s Clan” rose to power as the heads of these corporations at the beginning of 2000 s. This collective name usually implies the following set of subgroups, the total number of which—about 30-60 people (depending on the method of inclusion):

- KGB friends and colleagues of Vladimir Putin;
- Vladimir Putin's colleagues from his tenure at the St. Petersburg hall (especially from the State Property Management Board and the External Relations Division of the City Hall);
- Members of the “Ozero Dacha Consumer Cooperative”, founded in the mid 1990 s;
- Vladimir Putin's Judo partners;
- Vladimir Putin’s relatives.

The only link between these people was that at some point in their life their trajectory crossed with the President. They, as well as some other officials who will be discussed later, went on to head the some of Russia’s largest companies. By the end of the first decade of the 21<sup>st</sup> century, they had concentrated more than half of the economy in their hands. But at that moment, due to the election of President Dmitry Medvedev the position of the so-called Liberal wing

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<sup>11</sup> “SP: the Government has Failed in its Privatization Plan”, 19 March 2015, <[www.vestifinance.ru/articles/54748](http://www.vestifinance.ru/articles/54748)>.

strengthened among the elite that had made the deregulation and privatization of the economy one of their objectives.

## The Market Knocks at the Door

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The over-concentration of assets under state control has given rise to inefficiency, corruption and bureaucratization of relations between economic actors. During Dmitry Medvedev's presidency (2008-2012) the need for the withdrawal of state interference in economic management in one way or another became apparent to most top government officials and experts, particularly Dmitry Medvedev,<sup>12</sup> Arkady Dvorkovich<sup>13</sup> or Sergei Guriev<sup>14</sup> among many others. Four arguments are commonly put forward in support of the replacing officials with professional management and privatization: quality of management, competitive environment, demand for institutional reforms and funding for budget.<sup>15</sup>

In March 2011, Russian President Dmitry Medvedev announced that senior officials should leave the boards of directors of companies with significant state involvement.<sup>16</sup> Officially, this decision was driven by the fact that ministers and members of the presidential administration took their positions in state-owned companies as an additional commitment and not dedicating enough attention to them, leading to a drop in the quality of business management. President Medvedev received the support of the liberal wing of the government (for example, Alexei Kudrin, Igor Shuvalov and Arkady Dvorkovich). Government bureaucracy was supposed to leave the Board of Directors by 1 July 2011. Moreover, this measure only applied to companies operating in the competitive marketplace. This meant that the government representatives would leave private entities including Rosneft and VTB, but could retain their positions in the country's infrastructure monopolies, for example in the Federal electrical company FGC UES.

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<sup>12</sup> "Dmitry Medvedev: The State Should Withdraw from the Economy," *Russkaya Narodnaya Liniya*, 30 September 2013, <[http://ruskline.ru/news\\_rl/2013/09/30/dmitrij\\_medvedev\\_gosudarstvo\\_dolzno\\_ujti\\_i\\_z\\_ekonomiki/](http://ruskline.ru/news_rl/2013/09/30/dmitrij_medvedev_gosudarstvo_dolzno_ujti_i_z_ekonomiki/)>.

<sup>13</sup> "Dvorkovich: The State Should Withdraw From the Economy," Rosbalt, 5 April 2011, <[www.rosbalt.ru/business/2011/04/05/835968.html](http://www.rosbalt.ru/business/2011/04/05/835968.html)>.

<sup>14</sup> S. Guriev, "Fatal Overconfidence", *Forbes*, 21 April 2010, <[www.forbes.ru/column/48658-pagubnaya-samonadeyannost](http://www.forbes.ru/column/48658-pagubnaya-samonadeyannost)>.

<sup>15</sup> M. Selivanov, "The Challenges of the Second Wave of Privatization Is Not Clear", *opec.ru*, 2 November 2012, <<http://opec.ru/1437585.html>>.

<sup>16</sup> "Medvedev Orders Ministers From the Boards of State-Owned Companies to Withdraw by July", 30 March 2011, RIA Novosti, <<http://ria.ru/politics/20110330/359349325.html>>.

The business community also expressed its support for this decision, counting on future participation in the privatization process. One of the key goals of this operation was pre-sale preparation of state-owned enterprises, making it very important to improve the quality of management, so that future transfers of investor's assets would yield more money for the budget. Banker Dmitry Ananyev, a Senator at the time, supported the measure, but highlighted the need to first find replacements in the form of qualified business managers, before withdrawing officials from their positions.<sup>17</sup> The risks of doing this however were clear: the Russian system of controlling the large property management sector was built over a period of years and removing the most important figures of this system could lead to unpredictable consequences.

By 1 July 2011 the removal of officials from their posts was almost completed and most of the ministers had left the boards of directors of state-owned corporations, with the exception of a few companies. This delay was explained in that specific decisions regarding these companies had not yet been taken, though most of the ministers stated they would leave their positions by July 1. The revised deadline for the completed departure of state officials from these companies was set for 1 October 2011 but Arkady Dvorkovich clarified that the law passed was only applicable to the withdrawal of federal officials at ministerial level. State employees below this rank were not affected, although they could not play lead roles on these companies' supervisory boards.<sup>18</sup> Dmitry Medvedev, commenting on 20 July 2011 about the current progress of his initiative, noted that those companies from which state officials had already withdrawn had "experienced problems with communication" (with the government), and the search for a worthy replacement was delayed.<sup>19</sup> A week later, Arkady Dvorkovich expressed his dissatisfaction with the fact that companies continued to be controlled by the directives of the Presidential Administration, even after the withdrawal of its representatives from the board of directors.<sup>20</sup> The presence of a prominent official in the Board of Directors was taken as a guarantee of a company reliability. As the President's initiative began to be fulfilled; shares in Rosneft, the company's shares fell 3% per day<sup>21</sup>

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<sup>17</sup> "Performance of Medvedev's Mandate to Replace Officials From the Boards of Directors of State-Owned Companies", 27 January 2014, RIA Novosti, <[http://ria.ru/trend/stateowned\\_companies\\_officials\\_output\\_20110701/](http://ria.ru/trend/stateowned_companies_officials_output_20110701/)>.

<sup>18</sup> "Departure of Officials From State-Owned Companies in Russia", RIA Novosti, 1 July 2011, <<http://ria.ru/infografika/20110701/395675581.html>>.

<sup>19</sup> «Медведев: вывод чиновников из госкомпаний надо закончить к 1 октября» [Medvedev : Withdrawal of Officials From The State-Owned Companies Have to End by October 1], RIA Novosti, 20 June 2011, <<http://ria.ru/economy/20110720/404557320.html>>.

<sup>20</sup> "Dvorkovich: 'New Directive Makes Independent Directors of State Companies Meaningless", RIA Novosti, 29 July 2011, <<http://ria.ru/economy/20110729/409198280.html>>.

<sup>21</sup> "Sechin's Departure From Rosneft's Leadership Creates Risks for the Company – Nekipelov, RIA Novosti, 10 June 2011,

when Igor Sechin, who served as Russia's Deputy Prime Minister left the board. The Chairman of Rosneft's Supervisory Board Alexander Nekipelov said that Sechin had enjoyed enormous prestige, and his departure would have a negative impact on the company's operations.

By 1<sup>st</sup> October 2011, the last Federal officials had been completely removed from their remaining top positions on boards of directors as companies continued to operate with a new line-up of leaders. During an interview in February 2013 Arkady Dvorkovich once again raised the issue, but the tone had already changed. He noted that the problem of impaired communication between companies and the government over the last year and a half had not been solved.<sup>22</sup> As an example, they were presented difficulties with rescue rights of the Russian hydropower monopoly RusHydro, whose leadership tried to block the scheme approved by Vladimir Putin.<sup>23</sup> According to the Assistant to the President, this was just because the management did not include a single state representative.

It became apparent during the transition of company leadership that the conditions built by the Russian system of large state-owned companies meant that they operated significantly worse without having someone on a board of directors with a direct link to top state officials. The cumbersome system of state procurement along with many thousands of often conflicting tax and financial regulatory acts forced companies to find workarounds to speed up, facilitate and reduce the cost of these processes, made easier and safer with the approval by a member of the President's inner circle. This interlocutor also served as a universal channel of communication with state officials; only the informal status of a "clan" member could make a person practically untouchable and open them up to the attention of officials to Minister level. Of course, foreigners working in Russia knew about the existence of this system and have been willing to do business with organizations with such a key figures.

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<<http://ria.ru/economy/20130207/921725753.html>>

<sup>22</sup> "Withdrawal of Officials From State Companies Requires New Interaction", *RIA Novosti*, 7 February 2013, <<http://ria.ru/economy/20130207/921725753.html>>.

<sup>23</sup> "The Head of the Board of RusHydro Wants to Stop a Subsequent Offering, Putin Agrees", *Vedomosti*, 7 December 2012,

<[www.vedomosti.ru/companies/news/6938711/glava\\_soveta\\_rusgidro\\_hochet\\_sorvat\\_dopemissiyu](http://www.vedomosti.ru/companies/news/6938711/glava_soveta_rusgidro_hochet_sorvat_dopemissiyu)>.

## Impact of Sanctions on State-owned Companies

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As a result of the Ukrainian crisis that began in late 2013, leading to President Viktor Yanukovich's flight in early 2014, Russia has engaged in confrontation with the new Ukrainian authorities and began a series of moves which have aroused negative reactions in many OECD (Organization for Economic Cooperation and Development) countries. The annexation of the Crimean Peninsula, armed conflict in the east of Ukraine and the tragic events surrounding the Malaysian Airlines disaster culminated with Western sanctions against Russia which in turn affected companies and individuals. EU and US imposed individual sanctions against a number of politicians who were involved in events in Ukraine as well as almost all Crimean industrial enterprises and a number of Russian companies including Sberbank, VTB Bank, Gazprombank, Vneshekonombank (VEB), Russian Agricultural Bank, Rosneft, Transneft. The leadership of Russia imposed counter-sanctions, including a ban on food imports, on those countries which had introduced restrictions.

The result of these sanctions for major Russian companies was included the closure to Western credit markets, the sharp depreciation of the ruble along with the acceleration of inflation to 17% at the beginning of 2015, and the decline in Russia's credit rating to non-investment grade. These events seriously affected oil and gas companies: a ban on the purchase of Western technology forced them to reduce investment programs and slow the development of offshore fields. Due to the sharp fall of the ruble the Central Bank of Russia was forced to raise refinancing rates to 17% during one day, sharply reduced their lending capacity and caused problems for a number of enterprises. The state sectors of the economy bore the brunt of these events, but due to their large reach, together with miscommunication of Western partners with the Russian power system, problems arose also in private companies. In December 2014 and January 2015, Rosneft, under the mediation of the state bank VTB, held two bond placements in order to buy foreign currency amounting to 625 and 400 billion rubles respectively. Some experts (in particular, Alexei Kudrin) believe that this step had a critical impact on the crumbling of the ruble. Rosneft's public offering was held after it failed to obtain a government allocation of 2.8 billion rubles for financing 28 projects from the Russian National Welfare

Fund. Thanks to these steps, Rosneft was able to repay the bridge loans taken for the acquisition of TNK-BP ahead of time.

At the same time things have gotten worse for those who do not possess Igor Sechin's influence. The largest applicant for governmental financial assistance was made by the legendary defense enterprise Uralvagonzavod, whose staff in 2012 famously criticized the protest movement in Moscow and showed support for Vladimir Putin. The company requested 100 billion rubles at the beginning of 2015 to cover unexpected losses due to the sanctions, the resulting termination of contracts with Western counterparts and the increase in interest rates on loans.<sup>24</sup> Projects supposed converting Olympic facilities into touristic facilities also suffered. In addition to freezing payments on loans until 2016, VEB has agreed to allow the developers to send 20% of its revenues to the maintenance and development infrastructure of the Sochi Winter Games in 2014. Despite the fact that top managers in VEB sent a letter to the Government Office asking them not to change the terms of loans, the government put pressure on the bank as the company would simply otherwise have gone bankrupt.<sup>25</sup> At the same time, the government had to capitalize VEB for 240 billion rubles.<sup>26</sup>

During the crisis, the state made strategic calculations where to allocate its resources with state corporations and large state-owned companies that were important from a social point of view as large centers of employment and their leverage on the economy as a whole gaining the most. Consequently, small businesses have suffered a blow in these conditions; in November 2014 the government introduced an amendment to the Tax Code in which employers in addition to preexisting taxes were obliged to pay between 6 and 600 thousand rubles pay into the budget on a quarterly basis.<sup>27</sup> All the government's efforts were thrown into reparation of damages inflicted by sanctions and counter-sanctions. As part of its anti-crisis policy, the government set up a special commission to source local substitutions for Western imports in March 2015. The commission consists of two sections: the civil branch, led by Arkady Dvorkovich, and the military, led by Dmitry Rogozin. Their purpose will be the selection, financing and supervision of projects, which will help replace technologies inaccessible due to sanctions. Within these enterprise projects

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<sup>24</sup> Yu. Galliamova, E. Popov, I. Safronov, "State Support One Hundred Percent", 27 March 2015, *Kommersant*,

[www.kommersant.ru/doc/2694984?isSearch=True](http://www.kommersant.ru/doc/2694984?isSearch=True).

<sup>25</sup> Kh. Aminov, "VEB is dispatched to the resort", *Kommersant*, 3 April 2015, [www.kommersant.ru/doc/2699971?isSearch=True](http://www.kommersant.ru/doc/2699971?isSearch=True).

<sup>26</sup> "The Government Decides to Capitalize VEB Bank for RUB 240 billion", 25 September 2014, *Kommersant*, [www.kommersant.ru/doc/2574862?isSearch=True](http://www.kommersant.ru/doc/2574862?isSearch=True).

<sup>27</sup> E. Malyshev, "MPs Will Impose Quarterly Installments up to RUB 6 Million on Small Businesses", RBC-RBK, November 5 2014, <http://top.rbc.ru/economics/05/11/2014/545a2b2dcbb20f5618a6ea9d>.

planning results will be introduced and managers who fail to fulfill to plan for import substitution leaders will be held accountable.<sup>28</sup> These “planning” elements have further intensified state control over the economy making specific elements of mobilization, as such instructions can only be given to state companies.

Import substitution became the leitmotif of Russian economic life and state-owned companies its main beneficiaries. State corporations and their leaders have gradually begun to simply remove themselves from common law. In early 2015 the government introduced an amendment allowing managers of state corporations to withhold publishing their official income. Instead, they will in future report to the government behind closed doors. At the same time the government prohibited state and municipal organizations (but not state corporations, which had exclusion from the application of the Federal Procurement Contract System law) from purchasing foreign (outside Eurasian Economic Union) medical and construction equipment, the vast majority of which Russia has no adequate quality alternatives. Despite the considerable number of deliberately open loopholes, this step was undoubtedly aimed at replacing imported equipment with Russian substitutes.<sup>29</sup>

While the crisis in the State sector has clearly intensified, yet the positions of two businessmen closest to V. Putin, Igor Sechin and Sergei Chemezov have particularly been strongly reinforced. Igor Sechin in Rosneft has managed to achieve some exceptional advantages during the crisis. In addition to the previously mentioned arrangement of loans totaling approximately one trillion rubles, that saved the company, but when the ruble collapsed, several moves had been made. Rosneft's special position was underlined in January 2015, when, due to technical problems with the Chinese side of the ESPO (Eastern Siberia–Pacific Ocean) pipeline project, the question arose as to whether Rosneft should use its full capacity to squeeze out the other private Russian oil companies, Lukoil, Surgutneftegaz and Irkutsk Oil Company, from the project. Rosneft has made several conciliatory attempts towards the other gas companies, but these “pipeline neighbors” haven't agreed. They believe that the state-owned company simply wants to block their eastward access.<sup>30</sup>

The state corporation Rostekh headed by Sergei Chemezov, already numbering around 700 defense and industrial companies at the beginning of the crisis, has significantly strengthened its position.<sup>31</sup> In terms of import substitutions Rostekh has expanded its

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<sup>28</sup> E. Kryuchkova, “Imports Exchanged for Cash”, *Kommersant*, 4 April 2015, <[www.kommersant.ru/doc/2702086](http://www.kommersant.ru/doc/2702086)>.

<sup>29</sup> E. Sigal, “On Course for Import Bans”, *Kommersant*, 16 February 2015, <[www.kommersant.ru/doc/2654929](http://www.kommersant.ru/doc/2654929)>.

<sup>30</sup> K. Melnikov, “Rosneft Can Buy all BCTO Produced Oil”, *Kommersant*, 6 February 2015, <[www.kommersant.ru/doc/2661292](http://www.kommersant.ru/doc/2661292)>.

<sup>31</sup> E. Popov, K. Melnikov, “Rostekh Saves on White-Collar Workers”, *Kommersant*, 6 April 2015, <<http://kommersant.ru/doc/2702552>>.

functions, strengthening the National immunobiological company, which according to the plans should reach 100% coverage of the Russian vaccine market by 2020.<sup>32</sup> The decision on the establishment of the company was made before the events in Ukraine, but it was after that they started to actively purchase shares of healthcare companies in other state-owned enterprises, including VEB and Rosnano. Another victory for Chemezov and Rostekh in late 2014 was the securing of budgetary funding for the construction of infrastructure for the processing of solid waste.<sup>33</sup> The culmination of success was the appointment to the post of head of the state corporation Roskosmos with Igor Komarov, his longtime colleague and his alleged, protege.<sup>34</sup> Much of Chemezov's strengthened position has been due to an increased attention as a whole in Russia's military-industrial complex. In September 2014 the Military-Industrial Commission of the Russian Federation changed from being under the command of Dmitry Medvedev directly to Vladimir Putin. The only person to come from Putin's clan was Chemezov. Nevertheless, it included 16 people, including five ministers, four heads of federal authorities and President of the Russian Academy of Sciences. In addition to Chemezov the only other head of a state-owned company invited to the commission was Rosatom head Sergey Kiriyenko, one of the last remaining figures of the 90s generation as well as Prime Minister during the 1998 default.

In general, the Western-imposed sanctions have made all the talk about the removal of officials from public companies meaningless. The desire to make state-owned companies more open and transparent by inviting independent foreign directors was compromised by the expulsion of the Finnish businessman Sepp Remes, one of the largest foreign investors in Russia. The charges, in the words of S. Remes, lay in the fact that he was engaged in gathering information about the leaders of the Russian energy industry.<sup>35</sup> In the context of degradation of relations with the West, Dmitry Medvedev stated about the need to return to senior officials in the governing bodies. Given that many of the state-owned companies were indeed monopolies in their respective industries, the appointment of ministers to their boards of directors have effectively turned certain industrial sectors into mini-ministries.

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<sup>32</sup> O. Trutnev, "Rostekh' Replaces Imported Drugs', *Kommersant*, 1 April 2015, <[www.kommersant.ru/doc/2698939](http://www.kommersant.ru/doc/2698939)>.

<sup>33</sup> A. Shapovalov, "Wind Picks up Rostekh's Debris", *Kommersant*, 28 November 2014, <[www.kommersant.ru/doc/2620321](http://www.kommersant.ru/doc/2620321)>.

<sup>34</sup> I. Safronov, "Reform of the Russian Space Agency Goes to the Second Round", *Kommersant*, 22 January 2015, <[www.kommersant.ru/doc/2650909](http://www.kommersant.ru/doc/2650909)>.

<sup>35</sup> A. Fadeeva, "Investor Seppo Remes Denied Entry to Russia", *Vedomosti*, 1 April 2015, <[www.vedomosti.ru/newspaper/articles/2015/04/01/esche-odin-investor-stal-nevezdnim](http://www.vedomosti.ru/newspaper/articles/2015/04/01/esche-odin-investor-stal-nevezdnim)>.

## Dynamics of Management Structures

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The withdrawal of officials from management structures affected Putin's inner circle, many of its members often combining the activities of public office with those in Boards of Directors of different companies. This system was very useful: the main reason for appointment of any member of this team was his personal relationship with Vladimir Putin, which meant that the loyalty of the heads of corporations was very high. During the periods of economic growth the government had to solve a difficult problem: how to make corporations more dynamic and attractive to investors, but at the same time maintain their control over them? At the moment the dilemma resolved itself: the officials have returned to their previous positions.

How effective was the process of withdrawal officials from the boards of directors? To answer this question a sample list of 26 companies fully or predominantly owned by the state, followed by the governing bodies was analyzed. The sample was created in such a manner as to cover all sectors, but only those who have made their company information accessible to the public (Table 1).

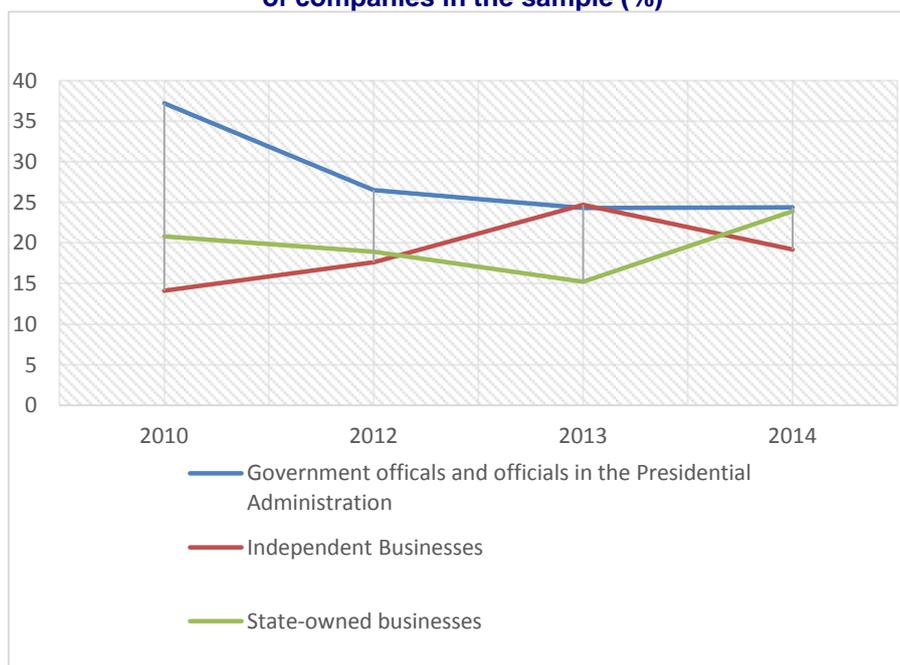
**Table 1. Sample of companies**

| <b>Company type</b>               | <b>Name of Company</b>  |
|-----------------------------------|---|
| State corporations                | Rostekh, Rosatom, Vnesheconombank (VEB), Agency For Housing Mortgage Lending Agency   |
| Venture Capital Funds             | Rosnano   |
| Mining Sector                     | Gazprom, Rosneft  |
| Infrastructure and Communications | Russian Railways (RZhD), Transneft, Rosgazifikatsiya, Syvazinvest, JSC Aeroflot, Sheremetveyo Airport   |
| Banking Sector                    | VTB Bank  |
| Industrial Companies              | United Aircraft Corporation (UAC), United Shipbuilding Corporation (USC), NPO Mashinostroyeniya, Avionika, Roselectronics, Energia Rocket & Space Corporation |
| Defense Companies                 | Izhevsk Machinebuilding Plant, Ruskhimzashita, Okean Instruments, Almaz Antey JSC, Tactical Missiles Corporation OJSC   |
| Mass Media                        | Channel One Russia  |

Of course, not all the officials on the boards of directors are representatives of the “Putin’s clan”, but they are usually nevertheless control the most significant and profitable chunks of state property. This is especially true for Putin's former colleagues including Sergey Chemezov, Igor Sechin, Nikolay Tokarev. Thus, the double bond is set: a person can be linked to the state through contact with the President (in this case, it often is not a civil servant, but state businessman, appointed to lead or "look after" the company), or can, as a bureaucrat, be guided by the directives of the Federal Property Agency or the Presidential Administration. In both cases, the market mechanism is largely distorted, but in the second case this distortion is lesser: the authorities can not ask their representatives to do anything beyond their bureaucratic mandate, while the personal request of the head of state has no such restrictions. This difference is important to understand that the distinction between officials and businessmen in the boards of Directors is not easy: there is a need to differentiate within the groups.

Updates to companies' boards of directors occur every year, usually from mid-summer to October, so at this point only from the ranks of 1 September 2010 to 1 September 2014 are available. The remaining points are also taken for the September 1 of the year (see Graph 1).

**Graph 1. Proportion of representatives of various groups on the boards of companies in the sample (%)**



Source: [Official company website](#)

The number of state managers on the boards of directors declined until 2013, and then stabilized. They were mostly department heads (Property Management Agency, Ministry of Industry and Trade, etc), but not ministers and heads of executive

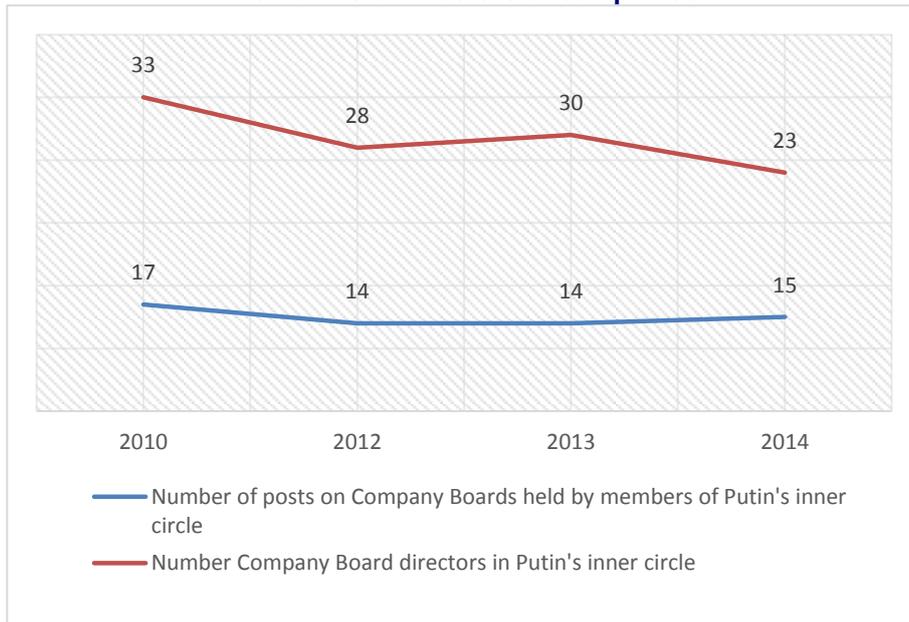
agencies. The number of independent directors in boards of public companies peaked in September 2013. Earlier in 2012 Alexei Navalny, the main opposition leader and a fighter against corruption joined the board of directors of Aeroflot, Russia's flag carrier. However, in 2013 he was not re-elected. In 2014, the proportion of independent businessmen and managers in the sample decreased and in second place came the representatives of state business and the members of Putin's inner circle. They can not be fully considered as officials, as they still operate in a competitive environment, but they have not to be confused with private businessmen: they must comply with requirements pertaining to positions of executive power and are not completely independent.

By April 2015 the government has already agreed on a preliminary list of boards of directors for several companies in the sample (Rosneft, Aeroflot, Rosnano), so one may now judge part of the focus of the new policy. Two representatives of the private sector at Aeroflot will be replaced by UAC (United Aircraft Corporation) head Yuri Slusar. Rosnano will get approximately one more state representative at the same time one less businessman since Finnish investor Seppo Remes, a member of the former Board of Directors, has been declared persona non grata in Russia due to suspicions of espionage. Rosneft has received the most civil servants: its board of directors will complement but not limited to the current and former Energy Ministers Alexander Novak and Sergey Shmatko (the President's special representative for international cooperation in the field of electric power), and board member Mikhail Poluboyarinov VEB of state and the head of the Federal Property Agency Olga Dergunova.

An important indicator of the degree of infiltration of Putin's inner circle in the management structures of these companies is the number of posts for one representative in the group in comparison to the total number of seats occupied by them (Graph 2).

Despite the fact that the size of Putin's inner circle in the sample companies grew to September 2014 for one person, the number of occupied posts decreased significantly. Top-rankings in the number of occupied positions at the same time became the chief economist of Vnesheconombank Andrei Klepach (5 posts), the head of the state corporation Rostekh Viktor Chemezov and General Igor Borisov (4 posts), Matthias Warnig (a friend and colleague of Putin's career in East Germany), Yuri Slusar (UAC President ) and Ivan Kharchenko (deputy head of the military-industrial Commission). Of these, only Klepach does not apply to groups which have traditionally been associated with Vladimir Putin.

**Graph 2. A sample of the number of members of Putin's inner circle on the boards of directors of companies**



Source: Official company website

More than likely, the sanctions have had a negative impact on the integrity of the President's inner circle, together with strengthening the power of the state over the economy it was decided to break up the emerging individual "fiefdoms", i.e. prevent excessive strengthening of individual representatives within the inner circle. This has been reflected in a decrease in the number of open positions with increasing numbers of people: one man now normally controls one company. Deviations from this, as in the case Chemezov and Warnig are a demonstration of great trust.

## A Setback

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As a result of the crisis the idea to make state capitalism in Russia more open and market-orientated was a fiasco. The trend that emerged from the middle of 2014 was that independent representatives on the boards of state-owned companies with a high degree of probability be gradually replaced by those of the official authorities and members of Putin's inner circle. It is noteworthy to compare this situation with China and other quasi-state economies, where the majority of state-affiliated forms try to craft an independent image for their companies while carefully concealing the political affiliation of board members not only to the executive branch, but also to the Communist Party of China. The difference with China is that state-owned enterprises have the task to “hunt” for major resource assets around the world, something foreign governments are aware of and should be treated with utmost suspicion. Russia by contrast, is not buying oil and gas resources from abroad and invites foreign companies to exploit its own resources and to participate in projects. In Russia, given the conditions of its precarious institutional environment, the guarantees of officials (and even better Putin's confidants) are very valuable.

However, now the situation has changed: the return of officials is dictated by the desire not to give guarantees to foreign investors, but to protect sources of government revenue and to strengthen the support base and mobilize resources. If the foreign policy crisis and sanctions were unable to cause a schism within Russia's elite, then it at least provoked friction since it radically changed the entire structure of the group's relations. Most high-ranking officials, including those who came under Western sanctions have Western property interests, bank accounts, educated their children in Western countries and vacationed there. Commercial disputes and transactions are often held abroad, mostly in Anglo-Saxon Common law jurisdictions in London or the British Virgin Islands. Vladimir Putin has had to somehow compensate for the loss of access to these Western perks the elite has suffered due to his policies.

A four-year history to reduce the control of state-owned companies to complete the return to the same point from which they emerged not least of all is the result of Western policies towards Russia. By introducing industry-wide bans and restricting Western access to Putin's inner circle, the US and the EU had hoped to create a faction within this group. The reality however achieved the opposite effect. Indeed, in respect to compensation for the most valuable

personalities in the ranks of Putin's inner circle, and at the same time the most inclined to dissatisfaction, will acquire additional sources of income; the state will in turn increase its control over the economy resulting in less space for the private sector and independent policies. The high refinancing rate and the inability to acquire cheap Western loans will force public companies to turn to the National Welfare Fund (as in the case of Rosneft) or incorporate into state companies sources of profitable company revenue, hiding losses in other areas (as with Rostekh).

Private Russian companies do not have this capability, and for many of them, 2015 may be their last year of existence. The first to be hit will be the construction, banking and entertainment industries together with the luxury segments of the retail and automotive market. In February 2015 the Ministry of Economy of the Russian Federation adopted a resolution on the establishment of a list of 199 priority companies that will be provided state support in the event of financial difficulties.<sup>36</sup> It included some private companies (even forming the majority), whereas total number of small and medium-sized enterprises, which are suffering the most, numbered 5.6 million at the beginning of 2014.<sup>37</sup> Most of them will probably disappear in order to save the “state directors” of Russia's economy.

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<sup>36</sup> “List of Strategically Important Organizations”, 2015, <<http://economy.gov.ru/wps/wcm/connect/e08d2b67-3322-49a0-8530-0579e366e507/Списокорганизаций.pdf?MOD=AJPERES&CACHEID=e08d2b67-3322-49a0-8530-0579e366e507>>.

<sup>37</sup> A. Filimonov, “Small and Medium-Sized Businesses: the Main Developments and Prospects for 2015“, *garant.ru*, 21 January 2015, <[www.garant.ru/article/602378/](http://www.garant.ru/article/602378/)>.