## Analysis

# It's Not Easy Being An Oligarch

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### Abstract

Perhaps it was inevitable, but it is hard to ignore the irony that a country that once held itself out as a new world in which extremes in wealth would be eliminated (if need be by imprisonment or even death) by 1998 had become a society in which the differences in wealth were once again extreme. Before long, Russia's major city, Moscow, had become the home of the world's second largest concentration of billionaires, second only to New York City. In 2004, Forbes Magazine, the major collector of such data, reported that Moscow actually had more billionaires than New York City. How did this once communist country, where officially as late as 1987 there were only minor disparities in income between the richest and poorest, become so top heavy with the very wealthy? And how did Russia's newly rich, the so-called "oligarchs", fare under Putin and during the recent financial crisis?


### Understanding the Rise of the Oligarchs

Moscow's oligarchs first made it into the Forbes Magazine annual tabulation of the world's richest billionaires in 1998. This achievement was notable for several reasons. The first was that none of the new billionaires had any net worth to speak of as recently as a decade earlier. They acquired all their wealth only after the collapse of the Soviet Union by seizing control of what once were state-owned assets. Second, 1998 was a disastrous year for the Russian economy. It was engulfed in a full blown recession, driving the country's leaders to throw themselves at the mercy of international lenders. Nonetheless, it was in 1998 that these individuals emerged with billions to their name despite the economic chaos around them.

The first thing to consider when trying to understand the rise of the oligarchs after 1991 is that even in the communist era, there were significant disparities, if not in money income, certainly in access to in-kind privileges and wealth. Senior members of the communist party for example, had the use of government mansions, chauffeurs and access to exclusive shops where luxury and even basic goods, such as the sugar and meat not always available to the general public, were set aside at heavily subsidized prices. The leadership at the time might have preached the virtues of equality, but out of the public view it seemed to have few qualms about enjoying its special privileges and comforts.

Open acknowledgment of inequality in wealth came only after the breakup of the USSR and the privatization of the country's assets, everything from homes to factories as well as the means of production. When Boris Yeltsin decided to privatize state industries, factory managers, in some cases even though they had been appointed by the state, simply claimed ownership of those factories for themselves.

### The "Loans for Shares" Program

Much of Russia's privatization took place under what was called the "Loans for Shares" program. The Russian government found that after 70 years of communism, very few of its citizens or businesses were willing to pay a tax on their income. Without that revenue it had a hard time balancing its budget and paying its bills. The government then decided that the best way to raise the money it needed was to turn to the recently privatized banks and ask them for loans. As collateral for those loans, the government agreed to put up newly issued stock of the about-to-be-privatized state industries.

Despite the warning of critics, government officials promised that as soon as they were able to collect the taxes that were owed, the state would repay those loans and regain possession of the stock. But those taxes were not paid and so the state was unable to repay its loans. Consequently the banks and their owners were able to claim ownership of the stock and thus ownership of those enterprises which had issued that stock in the first place. As a result many of these bankers became a new wealthy class, what came to be called "oligarchs." As the Russian economy and these enterprises regained their footing and these enterprises their profits, the prices of these stocks rose quickly and almost overnight the oligarch stockholders became dollar billionaires.

Having accumulated what only months earlier would have been considered impossible sums, these new oligarchs came to believe in their own superior talents. A large number of them came to think of themselves as independent and superior to state bureaucrats, which some of them had been before. In some cases this led them to branch over from their business activities into politics. This often brought many of them into conflict with Russian leaders and when that leader was someone like Vladimir Putin, it was almost inevitable that the leader would take affront and feel it necessary to remind these upstarts just who was really in charge.

## The Khodorkovsky Challenge to Putin

The Mikhael Khodorkovsky case perfectly illustrates what could happen to those who mistakenly came to assume they had become bigger and more important than the state. When someone like Khodorkovsky's net worth exceeds a billion dollars, he tends to act as if he is infallible and super insightful. (This is what I am told, since unfortunately I can not speak from first hand experience.) As Russia's richest man whose net worth at its peak, according to Forbes Magazine, exceeded $15 billion, Khordorkovsky not only controlled his own commercial bank, Menatep, but Yukos, the country's largest and most powerful oil company. But he had become insensitive to how much of a threat he was to Russia's ruling political elite, especially the so-called *siloviki*.

Among other affronts, Khordorkovsky began to enter into negotiations with Exxon-Mobil to sell it some of Yukos' oil fields. Such a deal would have meant selling off some of Russia's most precious assets to a foreign company, and an American one at that. Khodorkovsky also began to negotiate directly with the Chinese government for the sale of petroleum, something that had always been the prerogative of the Russian government. Khodorkovsky even decided that he should share his talents with the public at large and run for the post of president once Putin's term ended. He also openly boasted that he controlled as many as 100 votes in the Duma, the Russian parliament.

All of this challenged Putin and his entourage of *siloviki*. Some of the *siloviki* closest to Putin (including a few that Khodorkovsky had criticized as being incompetent), were subsequently overheard conspiring to put Khodorkovsky in his place, that is in prison. As caught in a wiretapped conversation, Sergei Bogdanchikov, the CEO of Rosneft (a rival of Yukos), and one of those criticized by Khodorkovsky for his incompetence as well as his dishonesty, is heard boasting to one of his *siloviki* friends that "Three days in Butyrka (a prison) and Khodorkovsky will understand who is really king of the forest," that is of Russia. Shortly after this conversation, Khodorkovsky was indeed arrested and eventually sentenced to an eight year term in prison, which is likely to be extended at least another 15 years.

## The Impact of the Financial Crisis in Fall 2008

Remarkably Putin's rough handling of Khodorkovsky seemed to do little to dampen the enthusiasm and determination of Russian and foreign businessmen to invest in Russia. With oil prices reaching as high as $145 a barrel in 2008 and Russia racking up the world's third largest holdings of dollars and euros, few businesses could afford to ignore the Russian market, political risks and all.

The situation changed radically, however, in late 2008, largely because of the change in world financial markets as well as a miscalculation by Vladimir Putin. He failed to appreciate that once oil and commodity prices began to fall from their record heights, Russian leaders no longer could ignore world financial concerns or continue their strong- armed disregard for the rule of law. True, investors initially seemed to overlook what happened to Khodorkovsky, thereby giving Putin the sense that he could do whatever he pleased. But by 2008, with the deterioration in financial conditions, this was no longer the case.

So in mid-2008 when Putin began to threaten to punish Igor Zyuzin, the CEO of the coal and steel company Mechel, in much the same way as he did with Khodorkovsky, Russian foreign investors panicked and withdrew billions of dollars in a flight of capital from Russia. The sense that the boom days were over became even stronger after Putin went to war with Georgia. To top it off, the recession in the United States began to undermine already shaky world wide financial markets, Russia's included. Given all this bad news, by the spring of 2009, the RTS index of Russian stocks had fallen 80 percent from its high.

The drop in the Russian stock market inflicted a disproportionate blow on Russian oligarchs. As one measure, according to Forbes Magazine, the number of Russian billionaires which in March 2008, totaled 87, by 2009 fell to 55. In the process, an estimated $369 billion in paper assets disappeared; they simply vaporized.

## The Putin Challenge to Deripaska

Wealth and power in Russia, especially when there is turbulence in financial markets, can be ephemeral. Like Khodorkovsky, Oleg Deripaska is a more recent example of how an oligarch can one day be Russia's richest man only to find the next day that a collapse in financial markets combined with a run in with Prime Minister Putin, can cut his net worth to shreds. The descent was made all the more painful when on Deripaska's way down, Putin decided to pile on, not only to put Deripaska in his place, but to use Deripaska to prove Putin's populist instincts. Putin felt it important to show that he stood for the masses against Russia's powerful business bosses.

In a scene out of Charles Dickens or Karl Marx, but in this June 2009 version, a drama portrayed not in literature but on You Tube video, Deripaska was called before Putin in Pikalyovo, a small town south of St. Petersburg. Putin was there because 500 unpaid workers from the town's three factories, all owned by Deripaska, had blockaded the main highway causing a 250-mile traffic jam. Fearing that the unrest might spread, Putin wanted to show that the wage arrears were the factory owner's fault, the unfortunate Oleg Deripaska. And as a benevolent czar might have done, Putin demanded that Deripaska pay the back wages.

At its peak in 2008, Deripaska's net worth was estimated by Forbes Magazine to amount to $28 billion. That made him Russia's richest man, at least until the recession. Revising its estimate in 2009, Forbes reported that Deripaska's net worth had fallen to $3.5 billion, a loss of almost 90 percent. By Putin's reckoning, however, though no longer Russia's richest man, Deripaska was not exactly a pauper either. If he put his mind to it, Deripaska could probably still scratch together enough to pay his workers what they were due. So Putin confronted Deripaska at one of his Pikalyovo factories where by coincidence a TV camera crew just happened to be filming. In a humiliating scene from the factory shown live on TV, Putin berated Deripaska for his greed, thereby demonstrating that it was an oligarch like Deripaska, not a caring leader like Putin, who was responsible for Russia's current economic problems. Acting on behalf of the masses, Putin then tossed Deripaska a pen and told him to sign an order directing his staff to pay his workers their back wages or else. Deripaska signed.

Of course Putin is not able or interested in micro managing all of Russia's oligarchs. But by no means is Deripaska the only oligarch to have found himself a target of Putin or other senior government officials. In other words, in a country where the rule of law is more like the rule of in-laws, wealth and power are subject to arbitrary actions that may reflect anything from incompetence on the part of the oligarch to greed on the part of the political leadership. It is not a climate where talent alone will assure success.

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*Further reading*


- Marshall I. Goldman, *Petrostate: Putin, Power and the New Russia*, Oxford University Press, 2008.
- Robert Legvold, "The Russia File," *Foreign Affairs*, July/August 2009.