

Part 2.

THE ECONOMY

Strategic priorities of the Russian Federation

In 2007 – beginning of 2008, one of the main priorities of the economic development of the Russian Federation was lowering inflation. In order to realize this goal, the authorities put in place a moratorium on rising prices. The introduction of the moratorium was a major point of contention between Aleksey Kudrin and Aleksey Gordeyev¹⁷. This confrontation was due to their different jurisdictions and differing economic priorities.

Previously the main opponent of the head of the Ministry of Agriculture in putting the moratorium in place was German Gref¹⁸. At that, the interests of the ministers collided exactly on inflation in the grain market. In the beginning of the fall, the rise in prices for these products significantly quickened. This was the result of relatively low supply in the domestic market. Moreover, agricultural producers gained from the situation in the world markets, first of all in the EU.

It was exactly the rise in the price of grain that provoked the high rate of inflation in September of 2007. This ruined the government's plans of holding inflation within 8%.

It was also the rise in the price of grain that led to the Minister of Agriculture, Aleksey Gordeyev's statement that in 2007, only 76 million tons of grain will be collected, or 2.4 million tons fewer than in the previous year.

As a result, the main consumers of grain turned to the government with a request to ban the export of wheat and begin a government intervention, which would allow to cut down its price somewhat. Moreover, the rise in the price of grain became not only an economic, but a political issue as well. The rise in the price of wheat threatened to make bread more expensive and this was fraught with certain social risks in the run up to the parliamentary elections.

Under a lot of pressure, Gordeyev agreed to establish tariffs and intervene in the grain market. Moreover, the head of the Ministry of Agriculture began

¹⁷ Tatyana Zikova, Mikhail Chkanikov The right "to freeze". // Rossiskaya Gazetta (Moscow). - 11.15.2007.- 255.- C.1

¹⁸ Philip Sterkin Extreme measures in the fight against rising prices // Vedomosti (Moscow).- 09.07. 2007.- 168.- C.A3

preparing an agreement between the leading producers and retail chains on the establishment of a moratorium on the rising prices of food products. The agreement was signed at the end of January in 2008. The list of “regulated” products was made up those foodstuffs that whose price was rising the fastest.

Nevertheless, Aleksey Kudrin resolutely came out against “freezing” prices. He argued that the moratorium would exclusively have a short term effect and that later, the agricultural producers would compensate for the loss in revenues.

The interests of Aleksey Gordeyev himself are closely intertwined with this argument. His department has been executing policy for a while that is in the interests of the large agroholders. Besides that, the head of the Ministry of Agriculture is laying the groundwork to become the governor of the Ryazan province or of the Stavropol territory. The support of the largest businesses in these regions could be of great importance to him.

However, the sharp rise in inflation that could start in a few months after the lifting of the moratorium does not fit into the plans of the Ministry of Finance. So apart from not meeting the forecasted levels of inflation, the cabinet of ministers will have to fight the rise in consumer prices in the winter-spring of next year.

When taking into account the fact that Aleksey Kudrin is personally responsible for the level of inflation, the minister’s position in relation to limiting the increase in prices becomes quite clear.

Nevertheless, notwithstanding the resistance of the head of the Ministry of Finance, the moratorium was put into place. The agreement, which was in effect until the end of January 2008, stipulated for the fixation of the price for a number of foodstuffs – white and black bread, milk, kefir, sour cream, sunflower oil, eggs – to the level that they were on, on October 15, 2007. The retailer’s maximum mark-up could not exceed 10%. The document was signed with the collaboration of MEDT (the author of the project), the Ministry of Agriculture, and FAS (Federal Anti-monopoly service).

As a result, the rise in the price of consumer goods did in fact slow down.

However, the government wasn’t able to hold inflation to forecasted levels. The reason being was that instead of consumer goods, the main catalyst for the price rises was the increasing price of energy, bills, and transportation services.

Nevertheless, negotiations began in the middle of January, 2008 to extend the moratorium till May 1. The agreement involved some tough negotiation: according to the government’s project, food producers were supposed to push up prices by only 5-6% compared with October price levels, while the food producer’s demanded 10-15%. As a result they came to an agreement that staple goods would

rise by 6-9%. Moreover, the new agreement strengthened the positions of regional administrations, to whom the function of controlling prices was delegated.

As a result of the effort of the Ministry of Agriculture, the question of high inflation was no longer an election issue in the upcoming presidential race. Thus the opposition, and most of all, the leader of KPRF, Gennady Zuganov, lost their trump – the chance to criticize the government for rising prices. However, the inevitable rise in prices after May 1, 2008 could be a blow to the image of the new president, who, by all accounts, will be Dmitri Medvedev.

Moreover, besides the repeal of the moratorium, the first half of 2008 will include significant payouts for the national projects, also significant expenditures within the framework of the program to raise the salaries of government employees and the stipends of students. Payouts are being prepared for “housing certificates”, aid for new mothers, and other things. All the above stated will lead to a significant rise in consumer prices.

Vladimir Putin's energy project

In 2007, the leadership of the Russian Federation sped up the development of its main energy project – “gas pincers”.

Thus, in November, the CEO of Gazprom, Alexei Miller and the president of N. V. Nederlandse Gasunie, Marcel Kramer in the presence of the Russian president Vladimir Putin and the prime minister of the Netherlands, Yan Peter Balkenend, signed a comprehensive agreement on the joint participation of their companies in the Nord Stream and BBL gas pipeline projects, and also about using Gasunie gas transport facilities that are located on the territory of the Netherlands¹⁹.

N. V. Nederlandse Gasunie is a 100% government owned gas infrastructure and transport company which is located in the Netherlands. Gasunie owns one of the largest gas distribution networks in Europe. Its length is over 12000 km, and it transports over 100 billion cubic meters of gas yearly, which is a significant part of total European gas consumption. In October of 2006, the two sides signed a memorandum of understanding relating to cooperation in the Nord Stream and BBL projects. The Dutch company, BBL Company (Balgzand Bacton Line) is responsible for the construction and operation of the just finished BBL pipeline

¹⁹ Vasili Kashin VEDOMISTI The third one isn't extra. // Vedomisti (Moscow).- 11.06. 2007.- 209.- C.A3

(which connects the Netherlands and Great Britain). If the project goes through, Gazprom will own 9% of BBL while Gasunie will keep 51%, and E. ON Ruhrgas and Fluxys will each get 20%. The company Nord Stream AG (it was first called North European Gas Pipeline Company) was formed in December of 2005, for the designing, construction, and exploitation of the main gas pipeline Nord Stream.

With the signing of the agreements, the first stage in the formation of a “wide coalition” of partners in the EU gas monopoly was completed. However, the path to this strategic alliance with the leading energy companies was a long and thorny one²⁰.

The project to find European partners started a few years ago. Then, the basis of the agreement was the model of trading “resources for markets”, in which Russian companies (and Gazprom in particular) would give foreign companies access to domestic gas fields and infrastructure in exchange for an equivalent share in the downstream companies (that sell directly to the consumer). This model was first tried in the Northeastern gas pipeline project (Nord Stream). Then BASF and E. ON, in exchange for participation in the Russian project promised to provide Gazprom with shares in the European pipeline companies.

In 2005, Gazprom started the construction of the “North Stream” (Nord stream) gas pipeline from Russia to the countries of Western Europe through the waters of the Baltic Sea. The capacity of the pipeline will be 55 billion cubic meters per year. The land portion of the pipeline is 917 km long and spans the territory of the Russian Federation from Gryazov to Vyborg. The sea portion, which is 1198 km long, is planned to span the bottom of the Baltic Sea from Vyborg to Germany with a branch-off into Sweden. What makes the project unique is the lack of transit countries, which lowers the risk and cost of transporting the gas, at the same time increasing the reliability of gas deliveries. Gazprom’s partners in the Nord stream project are the German companies BASF AG and E. ON AG, with whom a fundamental agreement for the construction of the Nord stream gas pipeline was signed on September 8, 2005. In accordance with the agreement, the partners created a joint German-Russian company Nord Stream AG, where Gazprom owns 51% of the shares and BASF AG and E ON AG own 24.5% apiece. The agreement leaves the option of bringing third in parties into the project.

At the same time, the foreign companies were given access to Nord stream’s resource base – the Yuzhno-Russkii gas field, which is located in the

²⁰ They will figure it out so all three get a share. // Expert (Moscow).- 11.12. 2007.- 042.- C.6

Krasnoselkupskii district of the Yamalo-Nenetskii autonomous region. Its reserves are estimated at more than 1 trillion cubic meters, with more than 700 billion of those proven. The license for the geological survey and the development of the Yuzhno-Russkii gas field is in the possession of OAO Severneftegasprom, which is 100% owned by Gazprom. After achieving its projected capacity, the field should put out 25 billion cubic meters of gas per year. The investment needed for the Yuzhno-Russkii gas field project is estimated at 1 billion euros.

At that, if the agreement with BASF about exchanging assets was concluded relatively quickly, the negotiations with E. ON have dragged out. The issue at hand is that the foreign company offered assets that weren't equivalent to the shares in the Yuzhno-Russkii gas field. This however didn't get in the way of Gazprom and E. ON signing a contract for the delivery of gas by way of Nord Stream on August 29, 2007. The contract stipulated the transport of up to 4 billion cubic meters of the "light-blue gas" per year. At that, the overall volume of deliveries from 2010–2011 till 2036 is supposed to comprise up to 100 billion cubic meters of gas. Moreover, the two sides extended the current contracts for the delivery of natural gas through the city of Baidhouse for another 15 years (from 2020 to 2035). Gas deliveries will be about 20 billion cubic meters per year with an overall volume of 300 billion cubic meters.

Later, an analogous scheme of "trading markets for resources" was used for the Shtokmann gas-condensate field. Alexei Miller then began the search for a strategic partner that could provide an outlet for the gas monopoly to the end customer in Europe. At that, the political factor played a key role here. Thus, first of all, it became necessary to refuse the services of U. S. companies. This was connected with the worsening U. S.-Russia relationship, and also to a number of specific unfriendly moves by the American elites towards Russia. An example was the torpedoing of the agreements on joining the WTO. The Negotiations with Statoil, Hydro and Total were longer but also unsuccessful. The topic of discussion with the Norwegian companies was the possibility of giving Gazprom access to their transport infrastructure, while the topic of discussion with the French companies prospective of receiving shares of EU energy companies.

When Gazprom couldn't achieve what it wanted, it put out a statement saying that it was going to develop Shtokmann by itself, and prepared to close down the deposit until 2015. It was until this time that the main resource base for Nord stream was going to be the reserves of the Yuzhno-Russkii and Bovanenkovskii gas fields (Yamal).

Moreover, according to the calculations of the monopoly, in 8 years the tentative value of the Shtokmann field was going to triple. Also, the prices for

liquefied natural gas (LNG) technology were going to come down which would neutralize the main expenditures of the gas monopoly. This, in ones turn, would significantly strengthen Russia's position in European, American, and Chinese markets where by 2015 there is going to be a shortage of LNG.

However, subsequently in view of complications in the realization of the Nord stream project, the model of entering Shtokmann was changed: in exchange for political support and transport infrastructure, French Total and Norwegian StatoilHydro were allowed to join the Shtokmann project.

In this way, Gazprom, finally, was able to create strategic pressure groups on EU territory that would become the main lobbyists for the gas monopoly's infrastructure projects in Europe. Gazprom offered three assets in the tradeoff with its partners: besides shares in Nord stream (BASF, E. ON and Gasunie) and Shtokmann (Total, StatoilHydro), there was also the southern version of the Northeastern gas pipeline – "Blue stream 2" (Enel and Eni).

In addition to gaining effective lobbyists (foreign companies), Gazprom receives access to the infrastructure of Gasunie и StatoilHydro which allows "Miller's company" to enter the British energy market.

Pressure groups in the Russian economy in 2007

In 2007, there were 7 large active pressure groups on the federal level, which admittedly, were of different status and possessed diverse resources in bringing their strategic projects to life.

"Legal" pressure group (Gazprom)

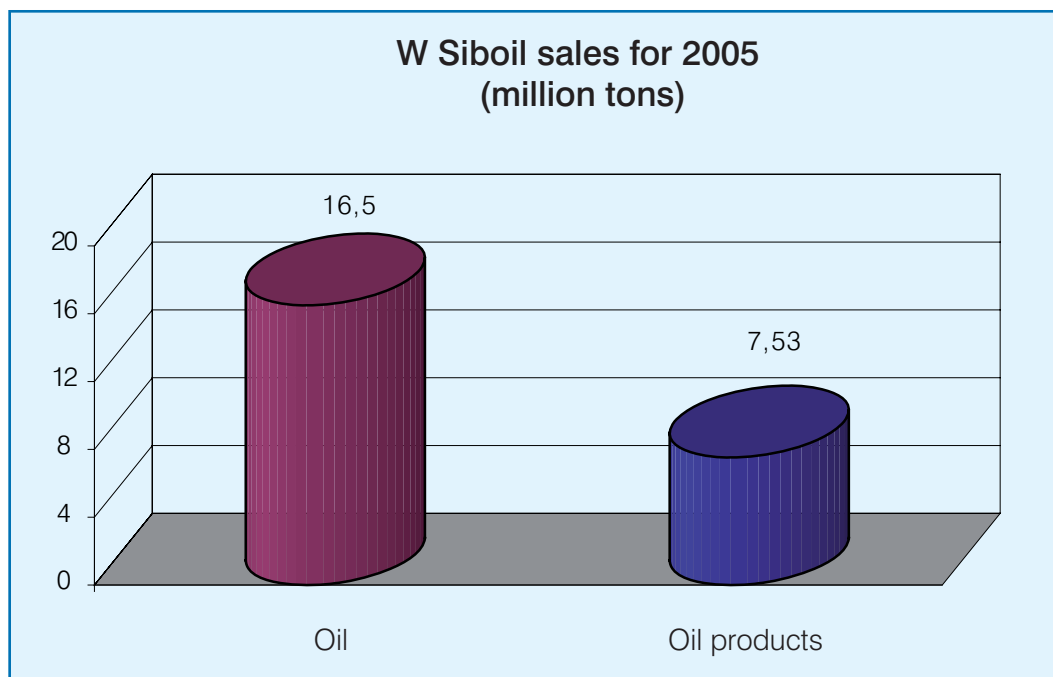
Its leaders were the chairman of the board of directors of the government monopoly, Dmitri Medvedev and the CEO of the company Alexei Miller. A number of advantages and disadvantages (risk factors) can be noted about the main asset of this group. A plus is the fact that the company is the exclusive supplier of Russian gas to international markets. This situation was cemented in the law "about exporting gas" that was signed in the summer of 2006 by the president of the Russian Federation. In the long term, gas prices are going to rise, which will bring about the significant increase in the Gazprom's financial figures (market capitalization, and profit). Moreover, Gazprom is diversifying its business and actively developing oil production – the integration of Sibneft was practically

painless – actively increasing output and refining in the domestic market. Besides that, the company is systematically absorbing its main competitors in the domestic gas market. It received a large amount of shares of the independent gas producer OAO NOVATEK (the main beneficiary of the company is its CEO, Leonid Mekhelson) and is planning on increasing its share there. Besides that, Miller is interested electricity: in particular, he lobbied through the supplemental emissions of OGK-5.

The “lawyers” had a pretty strong political “cover”. This, first of all, is the first deputy premier, Dmitri Medvedev, who is the curator of the national projects in the government. Moreover, the head of the Ministry of Natural Resources, Yuri Trutnev, and the deputy head of Rosprirodnadzor, Oleg Mitvol, who are protecting the company’s interests in Sakhalin-2, are also close to this group. In the “economic block”, Miller periodically entered into tactical alliances with the former head of MEDT German Gref, who, nevertheless, wasn’t a direct “agent of influence” of this group. Moreover, periodically Gref would make statements about the high price of gas in the domestic market. In the “*siloviki*” block, the “lawyers” main collaborator is general prosecutor Yuri Chaika. For that short time that he has been the head of his department, Chaika took part in two key Gazprom projects – Kovytko and Sakhalin-2.

But the strongest resource that the group has is the fact that Miller and Medvedev are in the president’s “pool”. They both worked with him in St. Petersburg city hall. Miller worked in the committee for foreign dealings (CFD), and in the administration of foreign economic dealings. The head of the administration at that time was Alexander Anikin, the head of the committee – Vladimir Putin. In the spring of 1992, Anikin was dismissed and Miller took over his post. Later he became Putin’s deputy.

As far as political positioning is concerned, a serious advantage that Gazprom and the groups of elites who are oriented towards it have, is the fact that Gazprom is involved in a strategic project – the strengthening of Russian positions in Western Europe. Thus, in the summer of 2006, Miller announced the “Blue stream-2” construction project (Southern European Pipeline – SEP). Together with Nord stream, the new gas pipeline is supposed to create alternative routes for the export of Russian gas. At that, NEP directly hits the end consumer, while Blue stream-2 passes along the territories of pretty loyal countries (especially Bulgaria and Greece). Moreover, the central gas pipelines will be used less. The dependence on these central pipelines was used by the transit countries to exert political pressure on the Russian Federation. In addition to everything else, by cooperating with



large European companies (ENI, E. ON AG, BASF), Russia will receive major support from the leading EU business structures. The main ally within the framework of this project is Germany, who is going to be offered the role of the being the European gas distribution center.

The media escort to the group's activities is provided by Gazprom-Media. Its main and most influential assets are NTV, Ekho Moskva, Izvestia, and Itogi. The company's position is most actively represented by Izvestia, and Itogi.

However in 2007, Gazprom's business activities weren't "cloudless". Gazprom felt a certain pressure from its competitors in the first half of the year, when its patrons from the "lawyers" pressure group began having administrative problems (especially after Sergey Ivanov was put forth as the "main candidate" to be "successor").

In particular, this manifested itself in the resistance to a number of Gazprom's strategic projects. For example, on February 8, the CEO of OAO Gazprom Alexei Miller and the General director of OAO Sibirskaya oobshchestvennaya energoticheskaya kompaniya (OAO SYEK) Vladimir Rashevskii, signed a protocol of intent where the sides were supposed to create a joint venture company on the base of both of their electricity and coal assets. The new company's shares were supposed to be divided up as follows: OAO Gazprom 50% plus 1 share, OAO SYEK 50% minus 1 share.

The partners were planning on forging a strategy for the new company whose goal would be to become one of the Russian leaders in electricity production and also to take up a leading position in the world energy and coal mining industries. The joint company was oriented towards a significant increase in economic effectiveness with a more balanced approach to using coal and gas in electricity production which was supposed to save on gas deliveries in electricity production.

However, a number of government and business structures came out against the gas monopoly's plans. First of all, the traditional critic of Gazprom's offers to consolidate strategic assets in the electricity market is the head of PAO EES Russia. Anatoly Chubais' position is quite understandable. For the past 6 months he has been promoting increasing RAO's investment program. Chubais met serious resistance on this path. In the beginning, the former head of MEDT came out against him. In particular, German Gref removed Mikhail Abizov – the head of the commission for investments and a man close to Chubais – from his post. In the upshot, the key post went to a “compromise manager”, Andrei Zadernyuk.

Nevertheless, the head of RAO tied Gazprom to the significant problems in the realization of his plans. Anatoly Chubais' investment program was supposed to be financed by selling the shares of RAO subsidiaries, which were planned for this year. However, if Gazprom and SYEK were to create the joint venture company, then RAO wouldn't be able to sell OGK and TGK for a significant premium, because foreign companies won't enter a monopolized industry, and this is practically inevitable, since the positions of both companies in the market is pretty strong.

If the investment program is cutback, then business structures that are affiliated with RAO won't have access to these financial funds. These companies include Federalnaya setevaya kompaniya (FSK), HydroOGK, System operator (SO), Sevozapetrosetstroi and others. Nevertheless, Anatoly Chubais couldn't have torpedoed the joint venture deal by himself since the administrative resource of the “lawyers” who control Gazprom is much higher. However, here, the top manager received the unexpected support of German Gref, whose relationship with the head of RAO, to put it mildly, wasn't the friendliest. The position of the MEDT head was decisive in forming the opposition to the “lawyers” plans for the electricity industry. He is most likely the one behind the initiative to block the joint venture company between Gazprom and SYEK through government representatives on the board of directors of the monopoly. The activeness of the former head of MEDT in this case was determined by the risk to his image. He has the reputation of being “a moderate liberal economist” and in this role lobbied for joining the WTO, lowering the VAT, allowing foreign investment in the auto

industry and others. In order to preserve this reputation, the minister was forced to come out against the creation of the joint venture company.

It was the position of the head of the MEDT that was connected with the activization of another department – the Federal Anti-monopoly Service (FAS). Its head is traditionally reserved when it comes to the activities of state corporations. Nevertheless, Igor Artemev characterized the creation of the joint venture company as an “attempt to monopolize the electricity market”. FAS’ demarche is quite understandable. The department started collaborating with German Gref a long time ago and pretty keenly reacts to the minister’s initiatives. In fact, Artemev received the post as head of the service in large part thanks to Gref.

Gazprom is also vulnerable by the often “unfriendly” activities of its subsidiary companies. Here, Gazprombank should be especially noted. The head of this company is Andrei Akimov, and he and he has a pretty complex relationship with the leadership of the monopoly. At the end of 2004, Akimov wanted to increase his personal influence at Itera; however Miller practically took over the management of the holding. An analogous situation (till the end of 2006) could be observed at another subsidiary – Gazpromneft. The main initiator of the unfriendly activity towards the “mother company” was Alexander Ryazanov, who ended up in the Gazprom subsidiary because he was the head of Sibneft. During 2006 the top manager was involved in a whole slew of demarches against Miller. The most striking one was his participation in Bogdanchikov’s project with the famous “letter to Fradkov”.

Generally speaking, Gazprom was never an example of corporate unity. Key aspects of the business were controlled by various “subgroups”, which some times ended up being competitors. There are four such subgroups.

The first is “Medvedev’s subgroup” and it protects the interest of the “mother” company. Besides the first deputy premier, Alexei Miller is also in this group. The head of Gazprom has been trying for a long time to transfer under his control all aspects of the business of the monopoly; however he hasn’t been able to do so completely. The group’s strongest positions are in the specialized field of the company – gas. Moreover, “Miller’s man”, Kirril Seleznyov controls Mezhhregiongas, which recently has been given the function of consolidating electricity assets. First of all, this is the creation of the joint venture company with SYEK. Also on the menu is the acquisition of 13% of Mosenergo from Gazprombank. A block of shares in OGK-5 is also of interest. Besides this, regional companies are merging within the framework of Mezhhregiongas. A few months ago, the board of directors of Gazprom sanctioned the acquisition by

Mezhregiongas of shares in the authorized capital of 12 regional gas companies (Bryanskregiongas, Volgogradregiongas, Ingushregiongas, Kirovregiongas, Kostromaregiongas, Krasnodarregiongas, Kyzbasregiongas, Kurskregiongas, Lipetskregiongas, Mordovregiongas, Permregiongas, Peterburbregiongas, Pskovregiongas, Rostovregiongas, Ryazanregiongas, and Tambovregiongas).

The second subgroup represents the interests of Russia bank. It began its activity after gaining control of the finances of the monopoly. This happened in the fall of 2006 when the insurance group Sogaz acquired from Gazprom over 75% of the management company Leader, which manages the assets of the non-governmental pension fund (NPF) Gazfund (167.6 billion rubles) and owns 3% of the shares of Gazprom itself. Later it became known that Gazfund bought 49% of Gazprombank. This decision was made by the board of directors of Gazprom in the fall of 2006. Moreover, the group has a certain interest in petrochemicals. It seems that in light of this, Gazprombank will consolidate 100% of Sibura. OAO Sibirskaya-Uralskaya neftegazovaya kompaniya was formed by government decree on March 7, 1995 and includes 26 companies united in a single technological chain. The main shareholders of the company are – Gazprombank (75% minus 1 share) and Gazprom (25% plus one share). Sibura's earnings in 2004 were 85.055 billion rubles, in 2005 – 96.2, and in the first half of 2006 according to IFRS (international financial reporting standards) around 54 billion rubles.

The third subgroup can conditionally be called “Golubyov's subgroup”. The new deputy CEO of the monopoly Valerii Golubyov replaced Alexander Ryazanov. Like his predecessor, he began curating the export of gas to the CIS. Moreover, Golubyov is considered close to Vladimir Putin – that is, he represents the interests of the Kremlin in the monopoly.

The fourth subgroup is more of a tactical alliance between the head of Gazprom export, Alexander Medvedev and the owner of Gunvor, Gennady Timchenko. The first one controls the export of gas, while the second – the export of Gazprom's oil. In many respects, it was in the interest of this group that the export channels were transferred to Gazprom export. As a result, Timchenko will get control of exporting the oil, and Medvedev, the gas.

The “siloviki” pressure group (Rosneft)

The main opponent of the “lawyers” is the sub group which formed around the base of another state corporation – Rosneft. Its head is the deputy head of the presidential administration and also the chairman of the board of directors of the

company, Igor Sechin and also the president of the oil company Sergey Bogdanchikov. Another key representative of the group is the head of the FSB, Nikolai Patrushev. Conditionally the group can be called the “radical *siloviki*”. At the same time, one shouldn’t confuse this group with other groups of elites from the secret service community (they will be discussed below).

The advantages of the main asset of the “*siloviki*” are evident. After the absorption of the main production asset of Yuganskneftegaz, Rosneft focused on the subsequent assimilation of the “Yukos inheritance” (executing the project of bankrupting the company). In March of last year, Rosneft bought out the 482 million debt of the oil company from a consortium of banks, with Societe Generale at its head, and counted on acquiring the assets it wanted by paying off their credit liabilities. For this purpose, Eduard Rebgun was appointed to the post of bankruptcy commissioner. On the one hand, he was supposed to significantly quicken the bankruptcy procedure, and on the other, decrease, as much as possible, the price of the assets of the “disgraced” company. So Rebgun appraised the company at 477 billion rubles, that is, a little bit less than the total debt of the company (491 billion rubles). Yukos’ promising assets were its eastern Siberian lots and the Samara oil refineries. Rosneft then bought them out.

In 2007, this group actively “encouraged” Rosneft’s subsidiaries to move closer to the parent company. In the spring, the decision was taken to transfer the 12 main subsidiaries into a single stock. After the exchange procedure, these companies received 11.85% of Rosneft. According to the plan, Rosneft was supposed to conduct a limited IPO by the end of September and a conversion in October. This measure was directed at consolidating the main assets of the company prior to the administrative and business confrontation with the group of “lawyers”.

Traditionally this group relied on the support of the security services – first of all, the FSB. Previously, before the dismissal of Vladimir Ustinov, it also controlled the General prosecutor’s office, which it actively used to further its business interests and put pressure on competitors. However, after the transfer of Ustinov to the Ministry of Justice, the “radical *siloviki*” lost a key resource. Nevertheless, they still retain serious positions in the main security departments. First of all, they control the Federal Customs Service, which was removed from under the influence of MEDT in 2007. The leadership of the Federal Migration Service (FMS) and the Federal Tax Service (FTS) are also considered allies. Moreover, in the first half of 2007, the “*siloviki*” were able to strengthen their

positions in the economic block of the government by forcing through, via Aleksey Kudrin, at least 2 significant initiatives. The first was the repeated preparation of the law “about changing articles 20 and 40 in the first part of the tax code”. This document will give FTS significant levers of influence over large national companies. The second one is the introduction of a system of obligatory registration for VAT tax payers. This measure will allow the tax organs to control Russia’s main exporters.

The formal head of Rosneft, Bogdanchikov, is in the sphere of influence of Igor Sechin, and the latter, being the deputy head of the presidential administration, has many connections in the Russian elite and enjoys the personal trust of Vladimir Putin. Sechin has known the president since the beginning of the 1990s. In those years he worked in the St. Petersburg city hall; first as an assistant to the head, then as head of the administration of the deputy mayor and finally as the head of the administration of the first deputy mayor, the head of the committee on foreign dealings in the St. Petersburg city hall, Vladimir Putin. According to the president, he personally picked Sechin to be part of his team.

In 2007, the “radical *siloviki*” presented a project for the expansion of Rosneft in foreign markets (China) and also in the domestic market (Bashkiria). Thus, Bogdanchikov’s company intended to exchange shares in its oil fields for participating in Chinese oil refineries and gas stations. Moreover, Rosneft acquired the above mentioned Samara oil refinery (from Yukos) and may become the owner of a block of shares from Bashneft.

Practically, in all of 2006, the Sechin-Bogdanchikov group was “in the ring” and thus felt serious pressure from its political opponents. However, in February of 2007 it was able to counter-attack and mount a major administrative-business expansion that only came to a stop after Medvedev was named as Putin’s “successor”.

This strengthening off their position, allowed Sechin’s “*siloviki*” to intensify the lobbying of the Eastern Siberia – Pacific Ocean (ESPO) oil pipeline project. In March, the then prime minister Mikhail Fradkov took a working trip to Yakutiya. The main objective of this trip was to advance this project. The first part of the ESPO pipeline has a capacity of 30 million tons of oil per year and is supposed to connect Taishet with Skovorodino (Amurskaya region) and the special oil port at Kozmino. After the decision to move the route of the pipeline in April of 2006, the construction of the pipeline was divided up into two separate projects: the previously planned route and the increase in the capacity of ESPO, and the part of the pipeline that was moved 400 km north of Lake Baikal. Right now building

and installation work is taking place in the Taishet – Ust-kut, Tinda – Skovorodino, and Ust-kut – Talakanskii oil field (the first zone where the pipeline will be widened) zones. The overall length of the pipeline is around 2.8 thousand km.

The infrastructure project caused a battle among all the major pressure groups, with Rosneft finding itself in conflict with the former head of Transneft, Semen Vainshtok. In spite of the fact that Vainshtok used ESPO to increase his political capital, the construction of the pipeline didn't promise him large dividends. Moreover, the speeding up of the project had some risk for Transneft. Against the backdrop of the slow development of the eastern Siberian fields and the fall in output in western Siberia, the bringing on-line of new transport capacity would decrease the fill rate of the pipeline network which would significantly decrease the profitability of the state corporation. Moreover, in this case, Transneft wouldn't be able to meet its export contracts in full measure.

However, a slow rate of construction wasn't convenient for the “*siloviki*” who controlled Rosneft. Being under pressure for Gazprom, Rosneft's most prospective course for development was the export of oil from eastern Siberia to Asia. To solve this dilemma, the “*siloviki*” began prospecting the oilfields, from which the oil will flow via ESPO. This is, first of all, the Bankorsk oilfield.

The Verkhnechonsk oilfield is also being prospected. This field is located at the beginning of the new pipeline. The Verkhnechonsk oil and gas condensate field is located in eastern Siberia in the Katagansk district of the Irkutsk region, about 420 km to the north-west of the city of Ust-kut. The license for the search and exploration work as well as for the exploitation of the field belongs to the company Verkhnechonskneftegaz and is valid until 2017. Rosneft owns 25.94% of Verkhnechonskneftegaz. The majority shareholder (62.71%) is TNK-BP. The rest belongs to the administration of the Irkutsk region. So far, there have been over 100 bore-holes sunk. As a result, 3 fields were opened up – Osinskii (gas condensate), Preobrazhenskii (oil), and Verkhnechonskii (oil).

Taking into account everything stated above, the main aim of Fradkov's visit to Yakutiya was to speed up the construction of the ESPO pipeline. The former head of government was considered an ally of the “*siloviki*” pressure group and has participated in their strategic projects many times.

The weakest point of this group is their lack of a lobby in parliament. Thus, laws go through the specialized committees and commissions practically without the participation of the “*siloviki*”. Other competing groups (primarily the “lawyers” and the “*staromoskovskie*”) get their bills passed through parliament after three hearings. As a result, most of their laws end up passing and thus the

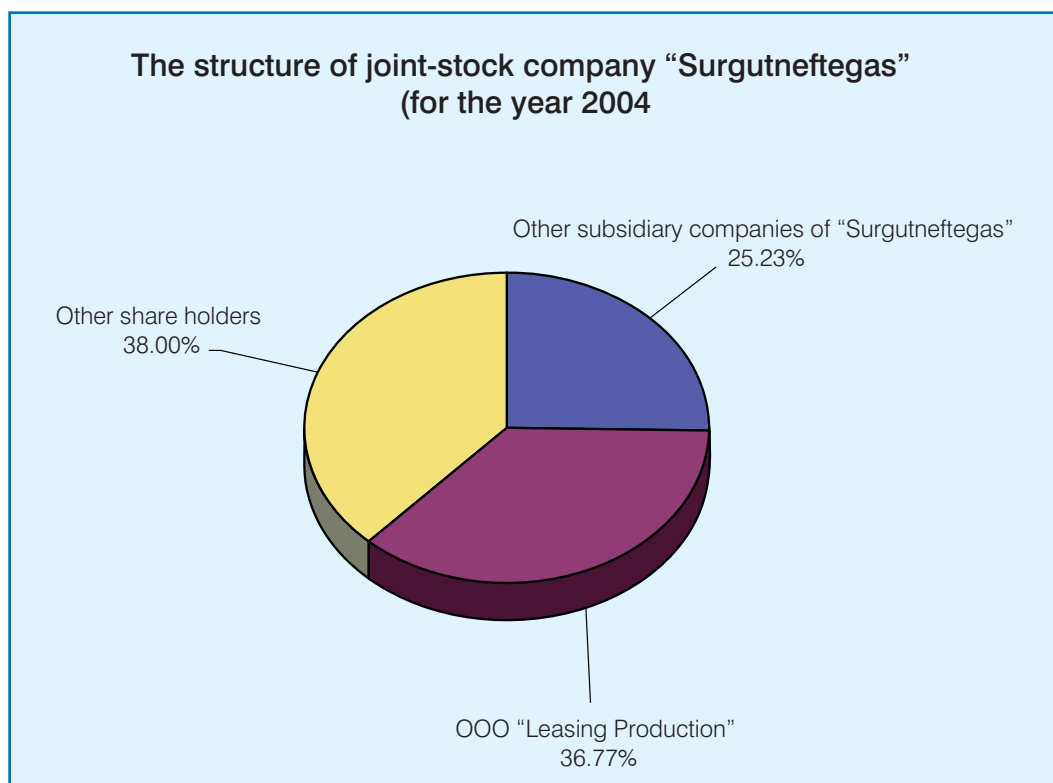
siloviki can only resist them at the department (government) level. Another vulnerable spot for the group is the lack of a strong media resource, without which it is pretty difficult to get large economic projects going. And after Vladimir Putin picked Dmitri Medvedev – the leader of Rosneft’s competitor – as his “successor”, the positions of the “*siloviki*” came under pressure and their main aim became not the pushing through of new initiatives, but rather attaining agreements on the retention of their accumulated assets.

The stock holders of Russia bank (Russia bank, Surgutneftegaz)

Besides the first two, in 2007, another pressure group became more active in asserting itself. According to a number of sources, its major resource asset is Surgutneftegaz, and its base structure is Russia bank. As of January 1, 2005, its largest shareholders were Yuri Kovalchuk (37.6%), Nikolai Shamalov (9.7%), Dmitri Gorolev (9.7%), and ZAO Severstal group (8.8%). According to the Center for Economic Analysis (CEA) Interfax, in 2004, the bank’s assets rose by 54% to 10.3 billion rubles (74th spot) and personal assets to 1.2 billion rubles (98th). The bank’s profit before taxes in 2004 was 264.4 million (73rd).

Among the main members of this group, Victor Myachin is the most noticeable. He is the largest shareholder of Russia bank (up until 2004, he was the second largest shareholder after Yuri Kovalchuk), and from 1995 till 2004, the CEO and the general director (with a break in 1998-1999) of the bank. Sergey Kovalchuk, as the largest shareholder of JSCB Russia (37.6% as of January 1, 2005), is the chairman of the board of directors. A key player of this elite group is Gennady Timchenko, the co-owner of the off-shore oil-raider companies of the Kinex group: the Finnish-Swiss International Petroleum Products and Gunvor International, which is registered on the British Virgin Islands. Moreover he is the main beneficiary of OOO Transoil CIS. The group the conditionally be called “the Russians”.

In the beginning, Surgutneftegaz was earmarked for the “*siloviki*” pressure group. There was an agreement that the head of the company Vladimir Bogdanov would leave CIS by 2008. The fact that there were large financial resources sitting on the company’s books testified to this fact. Right now this is more than 10 billion dollars. It was assumed that if Bogdanov were to sell the company, he would take all its cash. However, at the beginning of 2006, Surgutneftegaz began to be seen as the base of another pressure group. This, in ones turn, didn’t suit the Bogdanchikov-Sechin “conglomerate”, which increased the pressure on Bogdanov



via the labor unions. To all appearance, it was the representatives of Bogdanchikov who initiated the mass protests in the summer of 2006 at the Surgut factory.

Nevertheless, “the Russians” continue to accumulate significant financial assets. At the end of August in 2006, it became known that the insurance group Sogaz bought more than 75% of the company Leader (which manages the assets (167.6 billion rubles) of the NPF Gazfund) from Gazprom and 3% of Gazprom itself.

Moreover, Surgutneftegaz announced that it was planning to develop oil refinery capacity – which is the most problematic aspect of its business. There are two projects. The first is the building of its own oil refinery on the eastern branch of the ESPO pipeline. The second is connected with the purchase of Angarskaya neftekhimicheskaya kompaniya (ANK). The resource base for both oil refinery projects will be the Surgut oilfield in eastern Siberia. At that, Rosneft is beginning to actively resist Surgutneftegaz’ projects to expand its oil refinery capacity. The head of Rosneft, Sergey Bogdanchikov has noted on several occasions that he sees Yukos assets as the main line of development. For Rosneft, ANK was the most likely candidate for absorption. Moreover, Rosneft was planning to build an oil

refinery whose end point would be ESPO. The problem is that there may not be enough space in the pipeline for two additional oil refineries.

Besides that, “the Russians” are consolidating media assets. Right now they control the Tele-radio company (TRC) Petersburg. In November of last year, the TRC executed an additional issue of shares worth 25 million dollars. These shares were bought out, by all appearances, by structures close to this pressure group. As a result, 38% of TRC Petersburg is now under the control of the investment company Abros (a structure which is close to Russia bank), 25 % – OOO Volna (a structure that is affiliated with the head of Baltic media group Oleg Rudnov), 18.5 % – Severstal group and 18.5% – the St. Petersburg city administration. Later, on January 25, 2007, TRC Petersburg won the competitive tender for broadcasting frequencies in 41 cities. As a result, the channels audience increased on the average by 200 thousand people. Moreover, “the Russians” are exerting influence over the channel Ren-TV. The channel is the main asset of OOO Media-holding Ren-TV. It unites 354 television companies in Russia and the CIS. The average Russian viewing share of the channel is 4.5-5%. 30% of Ren-TV is owned by German RTL group, while Severstal group and Surgutneftegaz control 35% apiece. The possible merger between Ren-TV and Petersburg was already being looked at in 2007 with the aim of the latter acquiring Moscow frequencies.

“The Russians” also have pretty strong positions in the government organs. For example, the head of OAO Rossiiskiy Zheleznii Dorogi, Vladimir Yakunin used to be a member of the board of directors of Russia bank. The Minister of Education and Science, Andrei Fursenko was a member of its auditing commission. And the former deputy CEO of Gazprom, the deputy minister for economic development, Vitalii Savelev used to head this financial organization.

This group is pretty close to the president and has a significant resource – his trust. However, “the Russians” also have their weak spots. In the beginning, this group wasn’t public, and it was built as a network. In 2008 it will be forced into the media spotlight, which could be bad for business for some of its members (for example Gennady Timchenko and Yuri Kovalchuk). Moreover, the “radical *siloviki*”, who have levers of influence in Bogdanov’s company, are actively working against this group.

Yakunin’s Group (OORZhD)

In spite of the fact that the head of the railroad monopoly is affiliated with the shareholders of Russia bank, in the domestic market, Vladimir Yakunin is furthering his own interests and pushing through his own projects.

They are mostly connected with OAO RZhD. This is one of the largest transport companies in the world and 100% of its shares are government owned. The company has 85,500 km of railroad track; in 2006 it transported 1.3 billion tons of freight and 1.35 billion passengers. The company's revenues (for 9 months of 2006) according to Russian Accounting Standards (RAS) were 623.23 billion rubles, while its profit was 27.57 billion rubles.

Vladimir Yakunin has four strategic initiatives.

The first is to complete a number of infrastructure projects on the territory of the Russian Federation. Here, the strategic direction is the expansion and modernization of the Trans Siberian Railway. This railway transports more than 50% of the total foreign trade and transport freight of the country. Currently OAO RZhD is ready to increase the volume of container shipping on this railway by 2-2.5 times. And if the fleet of specialized railway cars and the capacity of port terminals were to increase then RZhD would be able to increase it by 3-4 times. Since 1999, the volume of container shipping across the Trans Siberian Railway has increased by an average of 30-35% a year. For 2004, the total volume of transported containers was 386.95 thousand in twenty foot equivalent units, including transit – 155.4 thousand TEU, export – 118.6 thousand TEU, and import – 113 thousand TEU. During 2004, 3247 container trains participated in international connections. The total volume of cargo that was transported to Western Europe from APC (Asia-Pacific countries) was 155.7 thousand TEU containers compared with 117.2 in 2003 and 70.6 thousand in 2002. In 2005, the total volume of transport was 388.3 thousand TEU containers (including 139.2 thousand – import, 124.8 – export). Between Russia and China there were 134.9 thousand containers transported, while in 2004 this number was 121.1 thousand containers. More than 65% of them were transported through port Eastern, while 25% through the border crossing Zabaikalsk.

The development of this route holds significant economic dividends. In eastern Siberia and in the Far East a number of strategic projects are being sped up. This includes the development of Nizhniy Priangarya, which was lobbied by key pressure groups (RAO EES, Rusal, and others). This project is being intensely lobbied for by the head of the Krasnoyarsk region, Alexander Khloponin. Moreover, a number of transport infrastructure projects are being readied to be realized in Yakutiya (here it is being lobbied for by the head of the republic, Vyacheslav Shtirov, the Ministry of Finance, and the ALROSA company) and Chita region (offered by Norilsk Nickel). Moreover within the framework of the Federal Target Program of the development of the Far East, major investments are planned

in the development of the industrial complex of the region. Most of the named projects are going to be realized within the framework of a government-private business partnership. Within this framework, the government finances the infrastructure part of the project.

Yakunin's second initiative is strengthening the positions of RZhD in foreign markets. Here, the main line of development is Asia. South-east Asia interests the monopoly in terms of exporting Russian energy. Here Yakunin's main competitor is Transneft. After the bankruptcy of Yukos and the sale of Yuganskneftegaz, Rosneft took over the export of "black gold" to China. The oil company tried to significantly increase deliveries using the oil pipeline through Kazakhstan (Omsk – Pavlodar – Atasy – Alashankao). Bogdanchikov's company even presented a request to transport 1.2 million tons of oil in 2007. However, through the efforts of Yakunin, this project was torpedoed (the export schedule wasn't approved). As a result, Rosneft had to increase its deliveries by way of rail.

Yakunin's third initiative is the acquisition of contiguous assets. First of all, this project involves the purchase of Transmashholding, the leading producer of railway vehicles. A state corporation that builds transport vehicles may be built on its base. Vladimir Yakunin would then get control of this new state corporation.

Finally, Yakunin's last and main project is the creation of Gruzavaya Kompaniya (freight company) RZhD. It is hard to overestimate the significance of this project for the group. This business structure is supposed to become the key asset of the railway operator, becoming a major source of income for the whole group. Moreover, the realization of 49% of Gruzavaya Kompaniya RZhD is supposed to become the resource that will help finance the monopoly's investment program in the long-term. However, here, Vladimir Yakunin met some serious resistance from competing pressure groups in the person of the head of the Ministry of Transport.

Igor Levitin, in this conflict is lobbying for the interests of the private transport companies. First of all, this is OOO Nezavisimaya Transportnaya Kompaniya, OAO Novaya Perevozachnaya Kompaniya, OOO Firma Transgarant, and OOO Transoil. The representative of the latter is the head of Roszheldor. A collision between the head of the Ministry of Transport and the president of RZhD occurred on October 23, 2006 at an inter-department commission on questions concerning structural reform in railroad transportation. Then, the consolidated effort of Levitin and the private operators was able to stop the creation of Gruzavaya Kompaniya. However, subsequently Yakunin was able to realize a number of strategic projects that significantly strengthened his position in this conflict. The inter-department commission (IDC) of the Ministry of Transport

on the reformation of railroad transportation that occurred in March approved the specialized model for the railway transportation service market until 2010. In this way, the Gruzavaya Kompaniya RZhD project began.

Its authorized capital will include 260 thousand train cars – practically the entire specialized railway vehicle fleet and part of the universal train cars that can be used in the competitive segment of the market. OAO RZhD, apart from the universal railway vehicles, will retain all of its railway vehicles that are connected with securing the military and mobilization transport needs. In 2009-2010 part of the shares of the subsidiary company may be sold via IPO with the secured funds used to modernize infrastructure and renew the railway vehicle fleet. The second freight subsidiary will appear in 2008-2009, after the results of the activity of the first subsidiary company are analyzed. This will also be when the decision will be made about the Federal Passenger Company – also taken into account will be the experience of the Federal Passenger Directory and the OAO RZhD's management of the train stations.

Practically, the decision of the IDC is a strategic victory for Vladimir Yakunin since the creation of the freight companies according to the conditions set by RZhD with the subsequent IPO, on the one hand will allow the monopoly to retain its position in the domestic market, and on the other, provide a financial resource for its other strategic projects.

The group's advantage is Yakunin's close relationship with the president and in addition to this, his significant political resource (the head of RZhD for example, is the head of the board of trustees of the patriotic fund of Andrei Pervozvannovo). Of no small importance is the electoral potential of the group. OAO RZhD is one of the largest employers in the Russian Federation, and this makes Vladimir Yakunin an advantageous strategic ally for all the different groups of elites.

Among their main vulnerabilities is the conflict with the specialized department – The Ministry of Transportation – which is already pretty fierce. RZhD's positions are also weakened by the conflicts with the private transportation companies, the largest of which, Severstaltrans, has been waging a media and departmental battle with Yakunin for a long time.

Chemezov's group (FSUE Rosoboronexport)

For the past couple of years, the head of FSUE (federal state unitary enterprise) Rosoboronexport, has been lobbying for projects that are connected with the formation of large state corporations in the Russian economy. Sergey Chemezov is responsible for the realization of five of these specialized projects.

The first one is the consolidation of the helicopter holding created in 2002 on the base of MIC (military industrial complex) Oboronprom. Right now the FSUE is working on putting into place a single production chain and the specialization of the main enterprises of the business.

The second one is the consolidation of engine building companies. The core of the new state corporation will be the R&D company Saturn. The Ufimskoye engine construction production unit and the Permskii engine construction complex, will subsequently, in all likely hood, join the new company.

The third project is connected with the creation of an armor state corporation. This project was actively discussed in the middle of 2006, however there were no significant developments in this matter. Right now, under discussion are the possible participants in the business structure and also the possible base companies. To all appearance, FSUE PE (production enterprise) Uralvagonzavod is laying claim to this role.

The fourth project is supposed to unite the producers in the Russian metallurgical market. Here there are two trends: the consolidation of the titanium corporation VSMNO-Avisma and the creation of a state corporation that will produce specialized steel. The key event in the second trend was the purchase of ZAO Russpetsstal (a subsidiary of Rosobronexport) from Midland steel industries limited, and 100% of the shares of the metallurgical factory Krasnii Oktyaber, which is located in Volgograd.

The company ZAO Russpetsstal was founded in August of 2006. The strategic aim of the company was to create a metallurgical holding by consolidating and developing assets that produce specialized steel and alloys. 25.3% of the assets of ZAO Russpetsstal belong to ZAO Promimpex, the founder of which was FSUE Rosobronexport.

According to the agreement, ZAO Russpetsstal will acquire 49696953 shares of common stock and 2800 shares of preferred stock in OAO Mettallurgicheskii Zavod Krassnii Oktyaber (MZKO), which is 100% of the equity capital of OAO MZKO. OAO MZKO, in turn owns 99.99% of the shares of ZAO Volgogradskii Mettallurgicheskii Zavod Krassnii Oktyaber (VMZKO).

Finally, the fifth project is supposed to consolidate the military electronics industry. A few months ago, Sergey Ivanov (then still the Defense Minister) received an offer that supposed to create OAO Electronie Systemi on the base of Oboronprom, which is a subsidiary of Rosoborexport.

To all appearances, the following companies (with state capital) will be merged with the state corporation. OAO Litkarinskii zavod opticheskovo stekla

(38%), R&D company semi-conductor devices (Tomsk, 100%), R&D company electronic computing machines (Moscow, 60.26%), Institute for guided machines (Moscow, 38%), Schyotmash (Kursk, 30,38%), the Kalmikov Moscow factory of accounting machines (Moscow, 12,88%), FSUE Istok (city of Fryazino, Moscow region), FSUE SPE (Scientific and production enterprise) Topii (Moscow), FSUE R&D company M. F Stelmkha Polus (Moscow), FSUE R&D company Argon (Moscow), FSUE R&D company S. A Vekshinskii vacuum machinery (Moscow), FSUE R&D company micro-electric gear Progress (Moscow), FSUE FSE Pulsar (Moscow), FSUE Gosudarstvenii zavod pulsar (Moscow), FSUE Alpha (Moscow), FSUE R&D company Platan with an R&D factory (city of Fryazino, Moscow region), FSUE SPE Salut (Nizhninovgorod), FSUE PO Novosibirskii priborostroitel'nyi zavod (Novosibirsk), FSUE Tsentralnoye konstruktivnoye bureau tochnovo priborostroenie (Novosibirsk), FSUE SPE Polyot (Nizhninovgorod), FSUE Gosudarstvenii institute prikladnoi optiki (Kazan).

Judging from the composition, there isn't that much production continuity. However, just like the helicopter construction project, Chemezov is planning on making his presence felt in military electronics. Later on the structure of the state corporation will be significantly reformatted.

Chemezov, just like Yakunin, is pretty close to the president. At the same time, he has strong positions in the defense industry (DI) of the Russian Federation. Moreover, "Chemezov's people" are in all the specialized structures and departments: the Ministry of Industry and Energy, the Ministry of Defense, the Joint Staff, and others.

The group's weaknesses include traditional conflicts with the Defense Minister. This includes the former (Sergey Ivanov) and current (Anatoly Serdyukov) head of the Defense Ministry. Moreover, Chemezov had a problem with the corporate structure of the shares. In particular, the head of the FSUE had to coordinate with the owner any deals that exceeded 5 million rubles. In order to significantly increase his capabilities, Sergey Chemezov lobbied through the transformation of his FSUE into a state corporation. It became much easier to manage the company, and moreover Rosoboronexport got rid of the burden of coordinating the majority of its moves with the government.

Deripaska's group (Rusal)

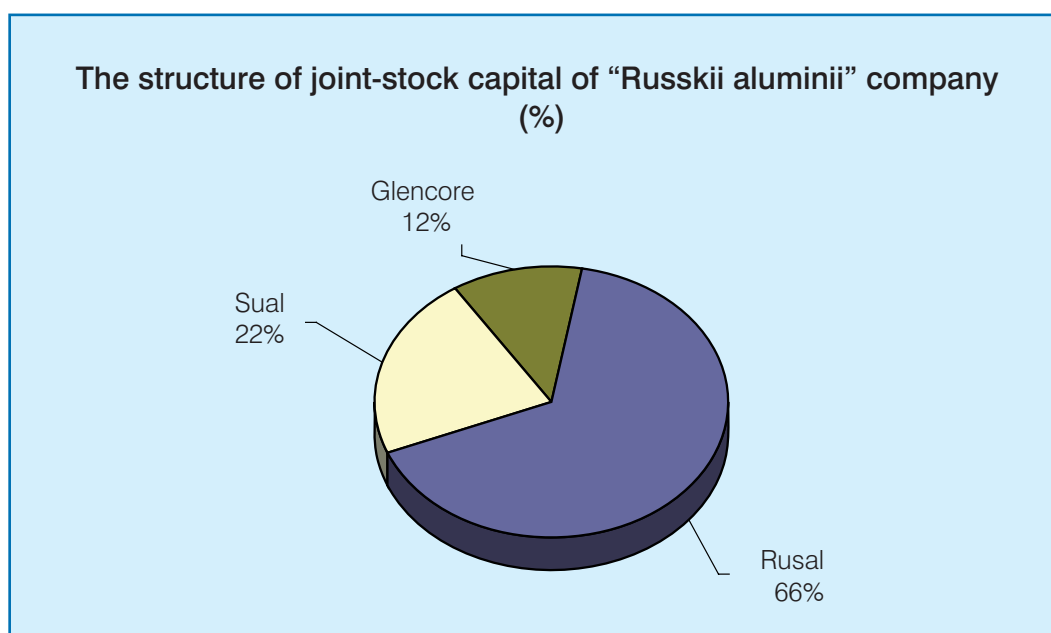
Oleg Deripaska has many strategic assets; however his key asset is Rossiiskii Aluminii. The creation of the integrated company occurred on March 27, 2007. As a result, the largest producer of Aluminum in the world appeared on the scene.

The integrated company Rossiiskii Aluminii (United Company RUSAL) is now made up of 4 companies that extract bauxite, 10 aluminous and 14 aluminum factories, and also 3 rolled aluminum foil plants. The company's assets are stretched out on 5 continents and 17 countries. Rusal's yearly turnover is around 12 billion dollars. More than 100,000 employees work at the factories and plants of the company. The production capacity of the integrated company allows the yearly production of 4 million tons of aluminum and 11 million tons of alumina. Moreover, the company has rich reserves of high-quality bauxite and also access to energy resources. The Chairman of the board of directors of the integrated company became Victor Vekselberg, who used to be the chairman of the board of directors of the company Sual. The general director became Alexander Buligin (previously he was the general director at Rusal). The shareholders of Rusal own 66% of the integrated company, while the shareholders of Sual own 22%. The shareholders of Swiss company Glencore now own 12% of Rossiiskii Aluminii. In the next three years, the company is planning on an IPO.

Officially, the process of integrating the assets of the company lasted 6 months. Thus the agreement on the unification between Rusal, Sual, and Glencore was signed on October 9, 2006. The majority of time was taken up by getting approval from the anti-monopoly organs of the countries where the assets were located. This process went through easiest of all in the Russian Federation. A preliminary agreement was already given in the beginning of the fall (by the Federal Anti-monopoly Service (FAS) while the application was only submitted on November 13, 2006. The European controlling organs put up more of a challenge. But they too agreed. They gave their permission on February 14, 2007. A major factor was the strong positions of Glencore in the European Commission.

Nevertheless, the main difficulties in putting Rossiiskii Aluminii together were connected with the battle between the shareholders in the company. All three sides had their own strategy for the development of the business structure. In many respects, the final parameters of the deal were a compromise between the partners.

In the beginning, the head of Renovo wasn't interested in the deal. In many respects Vekselberg had no other choice. He had been trying for a while to sell his share to a strategic investor, first of all, to a foreign company. Vekselberg had drawn out but very unsuccessful negotiations with the market leaders – Alcoa, Alcan, Hydro and Anglo American. Later, in the first half of 2006, a project was developed to conduct an IPO for Sual, where the businessman was planning to part with his majority share.



When it became clear that the merger was inevitable and that it had received the blessing of the Kremlin (to all appearance, the preliminary parameters of the deal were worked out at a meeting between Oleg Deripaska and Vladimir Putin in August of 2006), the head of Renovo concentrated on the maximization of his own profit and the withdrawal of part of the production capacity of the business out from under the control of the consolidated company.

Oleg Deripaska was forced to make serious concessions to Vekselberg in this deal. The head of Renovo was able to set a high dividend rate – 50% of the Rossiiskii Aluminii's profits will go to its shareholders. Vekselberg was also able to get the agreement of Deripaska on conducting an IPO of the consolidated holding, which was supposed to happen in the medium term. According to the agreements, the co-owners of Rossiiskii Aluminii would sell 20% of its shares on the market. At that, Glencore's share in the company was to remain above 10% and Deripaska was supposed to keep a majority stake. If for any reason the IPO cannot be conducted within three years, then the head of Rusal would be obligated to buy out the shares of his partners at the price stated in the agreement.

In return, Oleg Deripaska practically got full operation control of the company. Thus, of the 14 representatives on the board, only two come from Sual. Moreover neither of them took a key post – director of strategy, and sales director. Meanwhile, Deripaska's representatives headed up all of the divisions.

The strategy of the head of Basil in relation to the company was consolidating the main production facilities and speeding up the modernization of the company. Oleg Deripaska doesn't face any serious political risks. The businessman has a significant administrative resource, is taking part in strategic government projects (the Olympics in Sochi, Nizhnie Priangarye). Moreover, the property structure of the main assets that Basil's head owns are pretty well protected. Most of the assets are under the control of management companies abroad.

Vekselberg is in a different position. Lately the businessman has come under pressure from Gazprom about Kovytko and electric energy. That is why his main strategy is to sell his assets for a premium. Consequently, the head of Renovo will most likely realize his block of shares in Rusal.

Glencore has its own plans for the future of the company. Most of the assets of the business structure were broken up and had poor corporate protection. Moreover, Glencore's production assets were located pretty far from prospective markets (Southeast Asia and most of all China). It also should be noted that Glencore initially developed as trading company. That is why the main strategy for the company will become the strengthening of distribution of the integrated company through its own representatives.

The group's advantages are Rusal's strong regional positions in its base regions. The Krasnoyarsk region and the Krasnodar region should be noted separately. Moreover, Rusal is a classic example of a "national champion", the creation of which is supported by the Kremlin. Moreover, the status of industry leader (which was lost, however, due to the merger of Alcoa and Alcan) gave Deripaska added preferences.

The weaknesses of the group were partly mentioned above. This is the confrontation between Oleg Deripaska and Victor Vekselberg within the framework of Rusal. Moreover, the head of Basil has some friction with some regional heads. For example, the governor of the Irkutsk region, Alexander Tishanin, has on more than one occasion criticized the development strategy of the Bratskii aluminum factory, and has insisted upon a tax hike for Deripaska's business structures.

Abramovich's group (Evraz Group)

The key asset of the group in the Russian Federation is the metallurgical company Evraz, on the base of which Roman Abramovich planned to consolidate the Russian ferrous metallurgical industry. An announcement was made about this by

the head of Millhouse Yevgeni Shvidler in the beginning of September in 2006. The governor of Chukotka acquired 41% of the stock of Evraz Group making good use of favorable market conditions. As is well known, the former head of Evraz, Alexander Abramov had a strained relationship with the head of Metalloinvest, Alisher Usmanov. The reason for the conflict was the battle over the Mikhlovskii mining and beneficiation complex. Abramov tried to obtain the shares of this company through Oleg Kiselev. Consequently, Evraz acquired a very dangerous opponent. In this case, selling the company to Abramovich was a good way to get out of this situation.

The main Russian metallurgical companies reacted immediately to Abramovich's move. These business structures announced strategic development plans, which were supposed to protect them from any hostile moves from Evraz. MMK's strategy was to expand its business overseas. Thus "Magnitka" is planning on securing a spot in the North American market. At that, the chairman of the board of directors and the main shareholder Victor Rashnikov has the very weak support in the federal organs. NLMK is sticking to the opposite strategy. Its chairman of the board of directors, Vladimir Lisin began to develop extraction capability and modernize existing production facilities. Moreover, at the end of November in 2006, NLMK and Swiss Duferco announced the creation of a joint venture company.

Alisher Usmanov also began to show significant activity in the foreign markets. The main shareholder of Metalloinvest presented a project which would include the consolidation of the assets and the creation of a new transnational holding company on the base of the metallurgical plants of the CIS (First of all, Ukraine and Kazakhstan). Also, in the beginning of December of last year, Metalloinvest began the realization of a project to create a steel-rolling mill in the UAE, Hamriyah Steel. The new company will work within the framework of a joint venture that will be located in the free economic zone of the Sharjah emirate and will produce 1 million tons of reinforced steel per year. Severstal also announced a number of international projects, but none of them left the negotiating table.

However, Evraz was a step ahead of its competitors in acquiring foreign assets – namely the American Oregon Steel Mills. The result of this is that the Russian company may take control of 50% of the American rail market and get a "pass" to the American pipe market. Moreover, Abramovich has pretensions of taking over Magnitorskii metallurgicheskii kombinat (MMK) and Severstal.

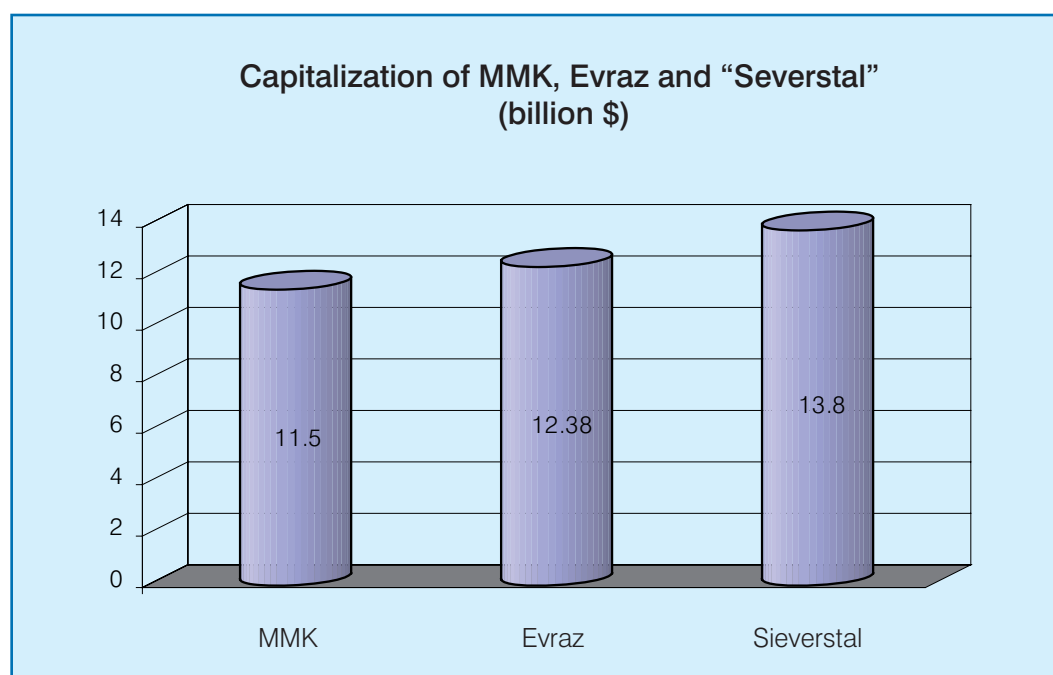
The group's advantage is the support that Abramovich's plans of consolidating the ferrous metallurgical industry have from the Kremlin. Moreover,

the governor of Chukotka maintains close ties with the “lawyers” pressure group.

Its weaknesses are the active resistance of its main competitors, first of all, from the head of NLMK, Vladimir Lisin, who has a strong lobby in the federal government structures.

State corporations as the foundation of Putin’s economy.

The key trend of 2007 was the strengthening of government business structures in the Russian economy. At that, their principle form became the state corporation.



As of the beginning of February, there were 9 state corporations (including the United Airplane Construction and Ship Construction Corporation (UAC and USC) in the Russian Federation. It should be noted that UAC and USC formally are not state corporations (SC): they were both formed as an OAO. Nevertheless they function similarly to the way that SC’s function, so they can be considered in this category.

The legal status of state corporations was first designated in changes made to the federal law “about non-commercial organizations” and assumed a pretty interesting format from the political-economic point of view²¹.

According to the federal law “about non—commercial organizations”, a state corporation is a memberless non-commercial organization that was founded by the Russian Federation on the base of an asset contribution, and for the purpose of fulfilling a social, managerial, or other socially beneficial function. The state corporation is founded on the basis of federal law. The property that was given to the state corporation by the Russian Federation belongs to the state corporation. The state corporation isn’t liable for the debts of the Russian Federation, and the Russian Federation isn’t liable for the debts of the state corporation unless otherwise stated in the law that founded the corporation. The state corporation uses the property for the purpose determined by the law that created the state corporation. The state corporation can conduct business only insofar as it serves

The name of the SC	When it was founded (passage of the necessary law)	CEO	Chairman of the supervisory board (of directors)
Deposit Insurance Agency	December 23, 2004	Alexander Turbanov	Aleksey Kudrin
United Airplane Construction Corporation	February 20, 2006	Aleksey Federov	Sergey Ivanov
United Ship Construction Corporation	March 21, 2007	Yuri Yarov	Sergey Narishkin
Development Bank	May 17, 2007	Vladimir Dmitriev	Victor Zubkov
Rosnanotech	June 23, 2007	Leonid Melamed	Andrei Fursenko
Rosatom	December 12, 2007	Sergey Kirienko	Sergey Sobyenin
Olympstroi	October 31, 2007	Semen Vainshtok	Dmitri Kozak
Rostechonology	November 23, 2007	Sergey Chaemezov	Anatoly Serdyukov
Fund for the reform of housing and public utilities	July 21, 2007	Konstantin Tsitsin	Dmitri Kozak

²¹ Non-commercial economy // Vedomosti (Moscow).- 06.21.2007.- 112.- C.A1, A4

the attainment of the goals that it was formed to achieve. The state corporation is obligated to give a yearly account of how it used the property that was given to it, according to the law that created it. The legal status of the corporation is determined by the law that created it. A charter document, as is stipulated in article 52 of the Civil Code of the Russian Federation is not needed for the creation of a state corporation. The law that created the state corporation must include the name of the state corporation, the aims of its activity, its location, the manner in which it will be managed (including the management organs of the state corporation and the manner in which they are formed, the manner in which officials are appointed and dismissed in the state corporation), the manner in which it may be reorganized or liquidated, and the way the property of the state corporation will be used if it does get liquidated. 4. the regulations of this Federal law apply to the state corporation, unless it is otherwise stated in the this article or the law which created the state corporation.

However, notwithstanding the fact that this document (the changes to the law) was passed July 8, 1999, up until the present there hasn't been any need to create any state corporations (in view of the economic and political situation in the Russian Federation). In 2001-2005, FSUEs OAOs were successfully used in their place. Both of these formats allowed the authorities to control strategic assets with a high degree of effectiveness. At the same time these formats also had their own specificities.

The main advantage of the FSUE was the complete nominal control over the assets. Hence, the owner of the commercial organization will always be the government. The general director of the unitary enterprise is appointed by the government of the Russian Federation – to whom the business structure is also accountable to, within the framework of its business activities and its personnel moves.

Another advantage of the FSUE is its characteristic secrecy: the company is not obligated to publish an account. This enables it to hide key aspects of its business from its strategic competitors. Well known examples of large Russian FSUEs are Rosoboronexport, Pochta Rossiya, and others.

As a reminder, a unitary enterprise is a commercial organization which doesn't have ownership rights over the property that was attached to it by the owner. Unitary enterprises may be created only in the form of state or municipal companies. The property of the unitary enterprise belongs to the Russian Federation, a constituent territory of the Russian Federation, or to a municipality. On behalf of the Russian Federation or the constituent territory of the Russian

Federation, the rights to the property of the unitary enterprise are exercised by the organs of the Russian Federation or the organs of the constituent territory of the Russian Federation within the framework of their jurisdiction established by acts that determine the status of these organs. The property of the unitary enterprise can be used by the unitary enterprise to conduct business, and is indivisible, and cannot be distributed (shares), including to the workers of the unitary enterprise. The unitary enterprise does not have the right to create in the form of a corporate body another unitary enterprise by way of transferring part of its property to it (its subsidiary). The unitary enterprise can (on behalf of itself) acquire property and exercise property rights, incur an obligation, be a plaintiff and defendant in court. The unitary enterprise must have an independent account.

Nevertheless, this organizational-legal format has its shortcomings. Full governmental control didn't give the pressure groups that controlled the FSUE any freedom of maneuver. Moreover, by not having the right of ownership over property (government owned), the unitary enterprise has difficulties in organizing subsidiary business structures.

The opposite (in format) to a unitary enterprise is an open joint stock company (OAO). At that, during the past few years the stake has been placed on vertically integrated corporations. These include Gazprom, Rosneft, RZhD, Transneft, Aeroflot, and others.

OAOs also have their many advantages. First of all, OAOs are less dependent on the decisions made by the "whole" government. Here, the significant players are Rosimushchestva (manages government shares in companies) and the specialized departments (The Ministry of Industry and Energy, MEDT, the Ministry of Finance and others, depending on the company).

Moreover, OAOs receive significant preferences since they are public companies. The pressure groups which control these asserts receive a large degree of autonomy because they are able to play off the contradictions of the main shareholders. A classic example of this is Aeroflot, where the president of the company, Valerii Okulov maneuvers between NPK (30%) and Victor Ivanov (represents the interests of the government of the Russian Federation).

It also should be noted that these pressure groups, as a rule, own shares in the OAO that they control (Which is impossible in the FSUEs). This is insurance against the risk of a change in the political situation.

However, OAOs have their shortcomings too. For example, this is the already mentioned fact that they are public companies – a large portion of the company's shares are owned by minority shareholders. Some of them are foreigners and this

puts some obligations on the top management and complicates the activity of the pressure groups.

A classic example is Gazprom, where the minority shareholders own 49% of the stock.

One of the private shareholders of the monopoly, the Hermitage Capital Management fund, in 2005, started a media campaign against the management of the company. As a result, the business structure suffered a significant image and reputational blow²².

A separate “headache” for OAOs is the fact that they have to account for their finances according to IFRS (or RAS). This requires using auditors and outside companies, which increases the risk of insider trading and numerous informational leaks.

The process of creating state corporations was sped up in Russia starting in 2006 when the United Airplane Construction company (UAC) got off its feet. Subsequently, analogous business structures were founded in the ship construction (USC), atomic energy (Atomprom), and financial market (FEB) industries. Finally, information surfaced about the state corporation Rostechtechnology, which will consolidate the assets of FSUE Rosoboronexport.

This organizational form is the most effective when it comes to running the strategic industries of the Russian Federation. It combines the advantages of OAOs and FSUEs. First of all, state corporations have the legal structure of an NCO which allows it to pretty effectively side-step many barriers in the domestic and foreign markets.

Examples of this are the trade representatives of FSUE Rosoboronexport. The majority of them are located on the territory of Russian diplomatic missions. At that, according to international regulations, commercial organizations cannot be located on the territory of diplomatic missions. This situation significantly holds back the expansion of FSUEs in foreign markets, first of all, in the Middle East and South East Asia. The non-commercial status of a state corporation allows it to side-step these restrictions.

Moreover, state corporations inherited a certain secrecy from the FSUE. They are not obligated to account for their finances according to IFRS or RAS and at the same time they have the right to create subsidiary business structures and not be under the direct control of the government. Practically, the oversight over its top management is done by a supervisory committee which is only partly formed by

²² Gazprom like Yukos. // Vedomosti (Moscow).- 12.07.2005.- 230.- C.A4

the executive branch. Finally, the general director of the state corporation is appointed by the president without the approval of any subordinate organs for a pretty long term.

Another important aspect of the state corporation is the rights it has to the property that is under its management. Under the FSUE format the property belongs to the government and the top management is severely restricted in what it can do with it (sell, rent, liquidate, etc.). The opposite is true at an OAO, where the property is private. To be sure, here too the top management is somewhat limited in its rights (which are set in the charter), though much less so. The assets of the state corporation are practically no longer government property (certain property rights take effect). But at that, it doesn't fully become private property.

Thus the legal-organizational format of the state corporation is more likely more convenient for the pressure groups that control the strategic assets than for the government or the future president of the Russian Federation. A natural question comes to mind – why is the government at this time speeding up the creation of business structures that they know in advance are going to be hard to control and will have a significant degree of independence and more over will require long-term financing from the federal budget?

The reason for this is the start of project “dispersion”. The point of this project is to disperse the main strategic assets among the main pressure groups and to weaken the successor. Moreover, taking into account the possible resignation of the president in March of 2008, Putin began appointing people that were personally loyal to him to strategic posts in departments and state corporations. This will allow the current head of state to control key assets after the “reformatting of authority”. At the same time, the different pressure groups will get a certain degree of autonomy which will also complicate any attempt by the successor to consolidate economic and political resources around him.

Five large state corporations whose active development began in 2007 should be singled out.

United Ship Construction Corporation

Above all this is the United Ship Construction Corporation (USC). The authorized capital of USC is made up of 60% of the shares of OAO Nevskoe Proektnoekonstrukorskoye bureau (St. Petersburg), which are controlled by the government and 25 million rubles in cash. The authorized capital OAO Zapadni Tsentri Sudostroyeniya is formed on the basis of (again owned by the government)

100% minus one share of OAO Svetlovskoe predpriyatiya ERA (The city of Svetlii, Kaliningrad region) and 25 million rubles in cash. The authorized capital of OAO Severnii Tsentri Sudostroenie is formed on the basis of the government owned 100% minus one share of OAO Konstruktorskoe Bureau Rubin Sever (the city of Severodvinsk, Arkhangelsk region) and 25 million rubles in cash. The authorized capital of OAO Dalnevostochnii Tsentri Sudostroenie i Sudoremonta is formed on the basis of the government owned 100% minus one share of OAO Nauchno-issledovatel'skii Institute Bepeg (Vladivostok) and 25 million rubles in cash.

This project was sped up because of the appearance of two new players in the battle over the ship construction industry in 2007.

First of all, this is Sergey Ivanov. The first deputy premier, as is well known, heads the Maritime collegium, where a year ago he announced plans to create three state steamship companies – in the north-west (Sovcomflot), in the south (Novoship) and in the east (Dalnevostochnoe morskoe parokhodstvo). And not withstanding the fact that the supervisory board is headed by Sergey Narishkin, the first deputy premier continues to curate ship construction.

The second player is the United Industrial Company (UIC), which is owned by Sergey Pugachev. This group has two key assets – Severnaya Verf and Baltiiskii Zavod. Both companies expect significant government investment. Within the framework of the ship construction development project there will be money distributed for the organization of the construction of large-tonnage tankers in the Russian Federation. It is more likely than not that the base for this will be Severnaya Verf.

Both pressure groups put forth their representatives for the post of head of the USC. A fierce battle ensued for this post, because it is the head of this new monopoly that will be responsible for spending the government funds that will be distributed within the framework of the Federal Target Program, the Development of Civil Maritime Machinery, between 2009-2016. The size of this program is 140 billion rubles.

For a long time, the main candidate for this post was the advisor to the president on military-technical policy, Alexander Burutin²³. However, in the beginning of the fall, this official took up the post of first deputy head of the Joint Staff of the Russian Federation, which provoked the continuation of the battle for this strategic asset.

²³ Makienko K. Russian ships have run aground // Expert (Moscow).- 11.12. 2007.- 042.- C.108-110,112

After Burutin was transferred to the Joint Staff, the position of Sergey Pugachev in the battle for the post of head of the USC significantly strengthened. It was precisely his representative, Andrei Dutov that was supposed to be designated for the post. Previously this top manager headed two “friendly” business structures – Severnaya Verf and Severozapadnoe Parokhodstvo. Nevertheless Dutov also went to an “adjacent” post becoming the head of the Federal Agency for Industry (Rosprom).

As a result, a third pressure group (in the person of Victor Zubkov) entered the fray over the USC post. The new prime minister began to actively lobby his man – Yuri Yarov²⁴, who was Zubkov’s colleague in the Leningrad region executive committee – for the position. He in fact became the new head of the USC.

Rostechology

Finally in 2007, one of the most highly anticipated state corporations, Rostechology was formed. The main lobbyist for the project is the former head of Rosoboronexport, Sergey Chemezov.

In the summer of 2007, the project was given final approval in the presidential administration. On November 9, the law “about the state corporation Rostechology” was passed by parliament and on November 24 it was signed into law by the president. According to the law, the state corporation was created to aid in the “development, production and export of high-tech industrial goods” and “the attraction of investment for the organization of various fields of industry including the defense industry”. It is expected that Rostechology will receive blocks of shares that are currently under the control of FSUE Rosoboronexport (shares in auto and helicopter manufacturing, metallurgy and a number of other fields). Rostechology’s executive organs are its supervisory committee (4 members each from the president and the government and a general director), an executive committee (11 members appointed by the supervisory committee) and a general director who is appointed by the president. Currently, the assets of Rosoboronexport and its subsidiaries are valued at \$25 billion and another \$5.5 billion goes through its coffers yearly in the form of export contracts. Its stock of orders is currently valued at \$23 billion.

²⁴ Victor Zubkov’s former boss may become head of the Ship Construction state Corporation
// Opec.ru (Moscow).- 10.11. 2007

The first information that came out about the creation of the new state corporation was at the end of 2005. Sergey Chemezov ordered Aleksey Aleshin to develop the plan. The effort of the deputy head of the FSUE led to a law that was sent to the government for approval. According to the document, the general director of the state corporation was supposed to become Sergey Chemezov, and the supervisory committee was to be headed by Sergey Ivanov. The first deputy premier, who held an analogous position in the USC, showed himself to be a good lobbyist, who nevertheless, practically didn't take part in running the company. Aleksey Aleshin was supposed to take over Sergey Chemezov's post. Aleksey Aleshin was a top manager who thoroughly knew the mechanisms of the creation of Rostechtechnology and could effectively organize the activity of its main asset.

Nevertheless, the project came up against direct resistance from a whole slew of pressure groups. This changed Chemezov's original plans.

Chemezov had four opponents. First, the former prime minister Mikhail Fradkov and the head of the Ministry of Industry and Energy, Victor Khristenko came out against the "expansion" of the state corporation. However, after the cabinet reshuffle in the fall, their resistance was minimized – Fradkov left his post, while Khristenko's deputy became Dennis Manturov, a representative of Chemezov. Andrei Dutoy, a man close to Rosoboronexport, was also placed in the Ministry of Industry and Energy.

The third threat came during passage of the legislation in parliament. Chemezov's next opponents were all the committees controlled by United Russia. The parliamentarians demanded that the functions of the controlling organs and the scope of the business of the state corporation be defined more clearly. Here, the representatives of Rosoboronexport with the support at the highest levels were again able to come to an agreement.

Sergey Chemezov's most serious opponent was the new head of the government, Victor Zubkov. In October a letter arrived in the prime minister's office from the general director of the FSUE. It was an offer to significantly expand the scope of business of Rostechtechnology by transferring the functions of Rosoboronpostavka (the Federal Agency for the supply of military equipment and goods) to it. The latter structure is responsible for supplying the Russian army.

There was definitely something to fight over: In 2007 Rosoboronexport plans on supplying \$5.5 billion worth of arms. Expenditures in the same period for the purchase, development, and repair of arms for the Ministry of Defense are equal to \$12.4 billion (at current exchange rates). All in all, the government program for supplying weapons to the Russian army till 2015 amounts to 4.93 trillion rubles (or

\$202.5 billion at current exchange rates). Victor Zubkov agreed to transfer the functions of Rosoboronpostavka to the state corporation, but in return the prime minister wanted his son-in-law, Anatoly Serdyukov to become the general director of Rostechnology²⁵. Chemezov was offered to head up the Defense Ministry.

Realizing that he was risking losing control of this strategic project, the general director of the FSUE activated all available resources to keep control over Rostechnology. First of all, he scratched the plan of getting the functions of Rosoboronpostavka. Moreover, he began preparing a more loyal figure to head up Rosoboronexport – Anatoly Isaikin. The latter was supposed to keep safe the main asset of the state corporation from Zubkov's people.

However, in spite of Chemezov's effort, the prime minister was able to get his man through into Rostechnology – the supervisory committee will be headed not by Sergey Ivanov but by Anatoly Serdyukov.

At the same time, Victor Zubkov was able to strike at Chemezov's adjacent assets. The head of the government harshly criticized the program in support of the auto industry which was put together by Dennis Martunov. The program included \$6 billion of government investments, a large portion of which was going to the development of Avtovaz.

Rosnanotech

Also in 2007, a state corporation for nanotechnology was founded (Rosnanotech).

This project began a year ago and one of its initiators was the head of the Kurchatov Institute. In many ways this project was able to get off the ground and receive the necessary financing thanks to the efforts of Mikhail Kovalchuk and his brother Yuri.

The Kovalchuk brothers control one of the more secretive pressure groups – the one which formed around Russia bank. Moreover, recently this financial organization has been buying up key assets inside the country.

Thus, in August of 2006, Russia bank bought the insurance group Sogaz, more than 75% of Leader (which manages the assets of the nongovernmental pension fund – Gazfund) and 3% of Gazprom itself. To all appearances this deal went down in the second quarter of last year. Previously, in 2004, Russia bank bought Sogaz from Gazprom. The government monopoly held on to only 20% of the shares of Sogaz and Leader.

²⁵ Kiseleva E. Special purpose corporation. // Kommersant-Dengi (Moscow).- 12.03. 2007.- 047.- C.18

The “Russia” group has a pretty strong administrative resource, which allowed it to force through the creation Rosnanotech. The head of OAO RZhD, Vladimir Yakunin was previously on the board of directors of the bank. The former deputy head of the executive committee of Gazprom, the current deputy minister for economic development Vitalii Savelev was the head of the whole group. And the Minister of Education and Science Andrei Fursenko was a member of its auditing committee. The latter, by the way, became the head of the supervisory committee of Rosnanotech.

Taking into account the abovementioned, it was widely predicted that Mikhail Kovalchuk was going to become the head of Rosnanotech. Nevertheless, Leonid Melamed got this post²⁶. The appointment of the latter to this position didn’t significantly alter the balance of power at the state corporation: civil nanotechnology remained under the control of the director of the Kurchatov institute.

The advancement of Leonid Melamed was a “bonus” to the head of RAO EES Russia. The new general director of the state corporation is considered “Chubais’ man”. Even after the former left RAO, the head of the electricity monopoly continued to help his protégé. For example RAO invested a significant amount of cash into Melamed’s mutual funds. His main asset is the investment company (IC) Alemar of which he owns 78%. Another 17% belongs to a different manager in the electricity monopoly, Dmitri Zhurbe. According to the accounts of RAO, it invested more than 3 billion rubles into the mutual fund Reforma, which was managed by Alemar. Also, Alemar was entrusted with the management of the assets of the electricity monopoly for a few months. These services cost the monopoly 100 million rubles.

The federal leadership’s goodwill towards “Chubais’ team” is connected with the forthcoming liquidation of the electricity monopoly. It will cease to exist in the summer of 2008.

Throughout this year, Anatoly Chubais’ key project was trying to change the reorganization scheme of the company. Generally speaking, the recommendations of the top manager are as follows: the blocks of shares from the 5 thermal OGKs and the 13 TGKs that are owned by the government will be transferred to “intermediate” companies – Gosudarstvenii Kholding Holding and Gosudarstvenii Kholding HidroOGK, which at the time of their creation will be incorporated into Federalnyi Setviyi kompaniyi (FSK) and HidroOGK correspondingly. Thus, the

²⁶ Kazmin D. and others. A beach head for Chubais. // *Vedomosti* (Moscow).- 09.10. 2007.- 169.- C.A1, A4

government shares of RAO's subsidiaries will be given to two companies who will be controlled by the government. Later on OGK and TGK securities will be sold and the funds raised will be used for the investment programs of FSK and GidroOGK. Anatoly Chubais is tying his administrative future to the development of these two companies.

Taking into account that the top manager of RAO EES has a political lever (the party SPS), the federal leadership, with the goal of avoiding extra conflicts on the eve of the elections, strove to find job placements for "valuable" people.

Rosatom

Furthermore, in 2007, the creation of the state corporation Rosatom was sped up.

It will be formed within the framework of a non-commercial organization that will manage 100% of the shares of Atomenergoprom and its assets on behalf of the government. All the key decisions of the head company and all its subsidiaries must receive the preliminary approval of the president. The president also gets to appoint the general director of Atomenergoprom. Later on, this function will be transferred to the board of directors of the corporation. The government must approve the charter, the amount of authorized capital and also form the board of directors of the new company. A number of legal entities, again with the approval of the president, will be allowed to own atomic materials, installations and storage facilities. Atomenergoprom should include the corporation that produces atomic fuel TVEL, the builder of nuclear power plants (abroad), Atomstroieexport, the company that runs Russia's nuclear power plants, Rosenergoatom, and other companies. The value of the assets consolidated under Atomenergoprom will be worth at least 40-50 billion dollars.

Rosatom is Sergey Kirienko's strategic project. As soon as he became the head of the Federal Agency for Atomic Energy (Rosatom), Sergey Kirienko made a few moves to significantly increase the weight of his department. The main one was a project to create a single state corporation that would unify all the key assets of the atomic energy market.

The idea of forming a unified company was proposed by the former head of Rosatom, Yevgeni Adamov. The original plan was to make it an OAO. The project was reanimated in the beginning of 2006, when Sergey Kirienko offered to form a vertically integrated holding company in civil atomic energy. In the beginning it was assumed that the new natural monopoly would be named Atomprom. However, the name was subsequently changed to Atomenergoprom.

To consolidate the main extraction and processing assets, the head of Rosatom needed significant financial resources and support on the federal level. To accomplish this, Kirienko made a proposal to Vladimir Putin to build 40 nuclear power plants over the next 25 years. The total investment was supposed to be to the tune of 60-70 billion dollars. However, the project met significant resistance from various market participants. This included the largest producer of atomic fuel TVEL. The chairman of the board of directors of TVEL is the head of the presidential administration, Sergey Sobyenin. In many respects it was his resistance that held up the project²⁷. Nevertheless Kirienko was able to get the backing of the Kremlin and force through the creation of the government holding.

As a result, in July of 2007, the government approved the charter, the general director and the board of directors of the business structure. The chairman of the board, as expected, became Sergey Kirienko.

Later on, Kirienko was offered to build a superstructure in the form of a state corporation which would manage the atomic assets of the government. This became Rosatom. At that, at the end of 2007, Kirienko received a guarantee from the president that he would head the state corporation.

The acceleration of the process of the creation of the state corporations embodies certain risks. These risks are connected with their autonomy. The point is that the assets of these business structures aren't the property of the Russian Federation, and hence the government doesn't have many legal means of limiting their sale. As a result, ***the top management of the state corporations can sell off the subsidiary companies to friendly businesses thus forcing through the privatization of strategic assets.*** As a result, the main companies of the strategic branches of the economy may become concentrated in monopoly business-structures.

In the next few years the main trend in the development of state corporations will become the consolidation of key assets and the formation of their inner-structures. The creation of new state corporations will cease.

Four projects have good chances of gaining this legal status. These are the state corporation in the sphere of Additional Pharmacological Support (APS), Avtodor, the corporation for improving Russia's image in foreign markets, and Rosribflot.

Out of all the four projects the state corporation APS, and Avtodor have the strongest positions.

²⁷ Alena Kornisheva "Atomenergoprom" received its managers. // Kommersant (Moscow).- 07.10. 2007.- 119.- C.10

In essence, *the project to create a state Pharmaceutical logistical complex (FLC) which will become the main distributor of the APS program became known in the fall of 20007.*

The APS market has always been pretty problematic in the Russian Federation. The program for Additional Pharmacological Support has been in effect in Russia since January 1, 2005 and is part of the government reform program aimed at monetizing benefits. The mechanism under which the program functions looks like this: government structures make a list of medicines that are vital for the socially unprotected layers of society (veterans, the handicapped, poor people and others). These “beneficiaries” can then go to the pharmacy and with a doctor’s prescription receive these medicines for free. Citizens who don’t wish to take part in the program have the right to receive compensation in the form of cash (in 2006 – 350 rubles per month, in 2007 – 477 rubles per month) and buy these medicines themselves. The government, represented by the Federal Fund of Mandatory Medical Insurance, picks, on a competitive basis, the suppliers of the “free” medicine and then at the end of the year compensates their costs. In 2005 the federal budget gave 50.8 billion rubles to finance the program, in 2006, 29 billion, and in 2007, 34.9 billion

A conflict arose over the APS in the fall of 2006 when government officials from the Federal Fund of Mandatory Medical Insurance (FFMMI is the main operator of the program) were arrested and charged with corruption. The head of the FFMMI, Andrei Taranov and his subordinates were indicted for using government funds not for the purpose that they were distributed for by the General Prosecutor.

At first it was assumed that this attack was initiated by the “*siloviki*” pressure group. However, the leading role of the General Prosecutor’s office makes one conclude the opposite. The thing was, was that Yuri Chaika’s department until the spring of 2007 was under the influence of the “lawyers” group which controlled Gazprom. Later, information surfaced that the large pharmaceutical distributors were behind this move. Subsequently this information was corroborated. Thus in the beginning of August in 2007, Yuri Chaika’s department indicted the president of the company Protek within the framework of the FFMI case.

ZAO Tsentr Vnedrenie Protek was created in 1990 by a pair of graduates from the Moscow applied-physics institute, Vadim Yakunin and Grigori Khachaturov. At first it played the middleman in commerce then in 1993 it entered the pharmaceutical market. Currently it is the largest distributor of medicine in Russia with a 23% market share in 2006. In the commercial segment of the market, Protek

was in 2nd place with 18.9%. It delivers medicines and other pharmaceutical products from 900 producers to 18 thousand Russian pharmacies, clinics and hospitals. 80% of Russia's pharmacies are clients of Protek. It has 40 branches and 39 representative offices throughout Russia. It owns the pharmacy chains Rigla and O3. Earnings in 2006 (according to its own figures) were \$2.38 billion and from that \$247 million was from the retail segment. According to data from the system SPARK, net profit was 2.6 billion rubles. Protek supplied 19 billion rubles worth of medicines to 32 regions of the Russian Federation within the framework of the APS program. According to DSM group, Protek's share of the APS market in 2006 was 30%. Currently it is 18%. The main shareholders are Yakunin and Khachaturov. 4% of the shares belong to the Hungarian pharmaceutical company Gedeon Richter. The president of the company was Vitalii Smerdov.

As is well known, Protek was one of the more active participants in the APS program – its share was about 40%. Moreover, the distributor was known to be close to the former head of the Ministry of Health and Social Development, Mikhail Zurabov.

The aim of the attack on the company was to weaken the role of private distributors in the APS program who were affiliated with the minister. Now their place will be taken by the state corporation FLK. The government distributor can be built on the base of Farmimex. To all appearances, the president of the latter, Aleksey Apazov was one of the initiators of the campaign against the officials from FFMMI and the head of Protek.

The top manager of Farmimex previously headed the pharmacy complex CCCP. From that time, Apazov retained business connections in the specialized departments. This allowed the president of the distributor to become the deputy head of the interdepartmental commission of the Security Council of the Russian Federation for public health. It was this government structure that became the main critic of Mikhail Zurabov generally and of FFMMI in particular. In January of 2008, Sergey Chemezov endorsed the idea of creating a state corporation in the APS market.

The second state corporation that could be created in 2008 is Avtodor.

The main lobbyist for the project is the head of the Ministry of Transportation, Igor Levitin. Presumably, the creation of this business structure got the preliminary approval of the president.

The Ministry is supposed to come up with the legislation and get the approval of all the necessary departments for the law on the creation of Avtodor by the fall

session (2008) of parliament. Prior to this, a list of federal roads must be made that are then going to be transferred to the state corporation (after the passage of the law). At the same time, the authorized capital of the company will be determined. The Ministry of Transport is lobbying for the whole federal auto track to be transferred to the new business structure, while the Government wants only the toll roads to be transferred. The final list of assets will be determined by 2009.

Avtodor will also receive the functions of the Federal Road Agency (Rosavtodor) for the Management of Federal Roads, which are about 5% of the road total in the country. Besides conducting competitive tenders for the construction of toll roads the state corporation is also planning to receive the advertising profit from billboards on the federal roads. The Ministry of Transportation project is analogous to Rosatom – after its creation the specialized departments will be liquidated.

The remaining two projects don't have that much of a chance to come to fruition.

The Rosribflot project belongs to Andrei Krainey. The head of Rosriblovstva presented his plan for the creation of the state corporation in the fall of 2007. This state corporation is supposed to fish in the world's oceans. However, Krainey wasn't able to get direct support from "the guys upstairs".

The idea to create a state corporation that would optimize Russia's image in the foreign markets belonged to German Gref. The idea first surfaced in the fall of 2006 within the framework of the MEDT recommendations on supporting domestic exporters. The project moved along pretty quickly and even received the support of some of the largest business structures: Sberbank and VTB. However, after German Gref left his post the project "hit the breaks".

Stability risks: social-economic factors

The strategy of maintaining stability – what is widely known in society as "Putin's stability" – led to the creation of a silent pact between the elites and society. The sole guarantee that this situation will last is the current president. According to the priorities of this policy, the standard of living of the majority of the population must continuously rise in exchange for its support for the current president (even if the support is passive) and that it doesn't get actively involved in politics. The situation in the country is stable for now, but more and more there are indirect signs of the challenges (mainly social-economic ones) that the

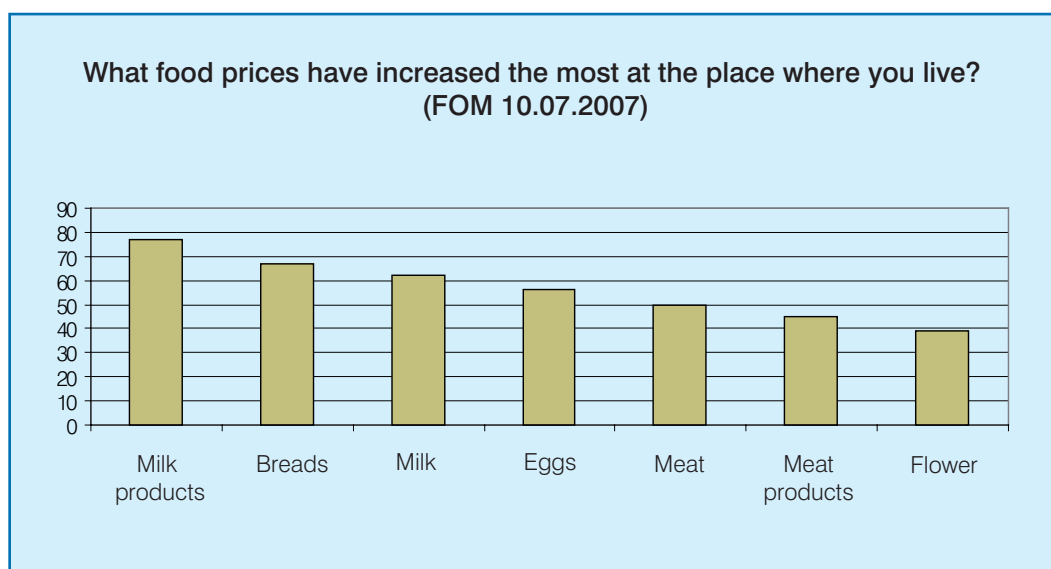
“successor” will face. Inflation, which already surfaced in the fall of last year, is only one of them.

In the beginning of October, for a whole week, the main issue in the domestic media was the rise in the price of staple goods. The rise in prices practically started in June/July and mainly hit bread and the products that come from it (for example spaghetti). However, in September, when there was a sharp increase in the price of other products – in particular, milk and the products that come from it (cheese, butter, mayonnaise), the authorities were forced to act. A sluggish response could hit the electoral prospects of United Russia and could also shake the population’s trust in government institutions overall. Staple products are the main products for the most disciplined category of voter – pensioners and other layers of society with a low income level, who for the most part participate in elections.

At that, *the government apparatus demonstrated a high degree of sluggishness* – instead of quick action, the immediate response was limited to slogans about the necessity to control prices and the need to find those responsible for the price rise. The situation was aggravated by the fact that the official statistics didn’t fully reflect the real increase in prices. According to Rosstat, the price of milk rose by 7.2%, butter by 9.4%, sunflower oil by 13.5%, and bread by 1.6%. At the same time the price of eggs rose from an average of 30-35 rubles to 50 rubles (close to 40%) and a number of the cheaper brands of domestic cheese rose from 120-130 to 200+ rubles (around 80%). The discrepancy between the official statistics and what people see everyday aggravates the sense of mistrust that the electorate feels towards government institutions. It should be noted that on the whole, those that are unhappy channel their feelings against officials on the ministerial level and below. Overall, they continue to support the president and the head of government. Some feel that the rise in prices was economic “sabotage” aimed against Victor Zubkov and Vladimir Putin.

According to surveys conducted in the fall by FOM, three-quarters of those polled stated that the rise in the price of food products had a large effect on the material well being of their families. 13% categorized this effect as insignificant. The latter position is taken by people who represent the “resourceful” groups of society: those with a relatively high level of income (24%), respondents with a college education (22%), people under 35 (22%) and Moscow residents (20%).

Two-thirds of the respondents (64%) stated that in order to save money they had to cut back purchases of everyday food products. Among these, the most often mentioned include meat (40%), and also milk products (37%). The following were



mentioned less often: fresh fruit (27%), fish (22%) and fish deli (19%). Less than 15% of the respondents saved on other products.

The legislative as well as the executive branches reacted to the rise in prices.

The first one tried to use this fact in their parliamentary campaign, while the second one began looking for those who were responsible for this inflation. “The ruling party“, to everyone’s surprise, reacted pretty quickly – one would have expected this from KPRF. Boris Grislov’s statement about the need for government intervention and also the reanimation of Elena Panina’s (a parliamentarian from United Russia) initiative about the government regulation of prices is rooted in the soviet planned economy. If these initiatives are accepted in 2008 as part of the main program, then there is the potential that part of the “nostalgic” part of the KPRF electorate will break off in favor of United Russia. Indeed, the authorities’ measures will most likely be a fiasco because the increase in inflation was to a large degree provoked by the pre-election increase in social pay-outs.

SPS was the second political party after United Russia that decided to use the rise in prices as part of their election campaign. At that, a pretty professional approach was chosen. Against the backdrop of the total domination of the ruling party in the media and the loss in initiative, when everything that needed to be said was already said, SPS chose a “flash mob” tactic by organizing acts of protest directly in supermarkets. This looks like a winning tactic for at least for two reasons. First of all, the original way in which these protests were held was guaranteed to get the attention of the media. Secondly, since these actions weren’t

technically illegal, they didn't have to get approval from the government to conduct them.

The executive branch also tried to demonstrate quick action. At a meeting with Vladimir Putin, the prime minister promised to take all necessary measures to correct the situation, while the head of MEDT, Elvira Nabyullina proposed to restrict the export of grain and lower the import tariffs on milk and cheese. The baton was then picked up by the head of FAS, Igor Artemev and the Minister of Agriculture, Aleksey Gordeyev. Artemev's department started actively looking for collusion in the market among the owners of retail chains in the regions and almost immediately stated that in fact they had found such evidence. Gordeyev concentrated on the necessity of establishing export tariffs on grains, although in the summer he came out against such measures when the rise in the price of bread products was at its peak.

The initiative of the regional authorities, lacking any other instruments, concentrated on using administrative methods, should also be noted. In particular, the governor of St. Petersburg, Valentina Matvienko summoned the representatives of the largest retail chains for a "prophylactic conversation". In the summer, the same methods were able to bring a stop to the rise in the price of bread. The administration of the Krasnodar region established the maximum mark-up level for retail chains – 25%. An accent was made on the undesirability of violating the "recommendations".

All of the above mentioned measures brought quick results. However they were of a short term nature and not more than a month later, the rise in prices resumed. These measures will be sufficient enough to assuage the electorate during the parliamentary campaign but are fraught with a new more serious crisis during the culmination of "transition-2008" in the beginning of next year.

The situation is being aggravated by the liquidity pump-up into the economy. This is thanks to the pre-election payouts to state employees and the promised increase in social pay-outs. Moreover, the speeding up of the formation of the state corporations and also in a number of cases, the increase of their budget (after only 6 months) will have a very negative effect on inflation and create problems for the successor. It is quite possible that the worsening situation next year will serve as the background for Putin's return to the presidency "at the request of the working people".

In the immediate future the authorities are going to rely on purely administrative methods since the customs and tariff restrictions won't help that much. This will help win some time until the presidential elections. But after that

the problem will resurface. After that, the head of state will have to make a choice: either sterilize the excessive liquidity by lowering the living standards of the population or continue using harsh administrative methods to control prices. The last scenario is more optimal; however in this case it will become necessary to significantly widen the authority of the security services.

Another serious social-economic risk is the onset and piling up of different unpopular reforms that will be needed to be put in place almost simultaneously (that is, within a year or two). Vladimir Putin already made it clear that it is essential to freeze all unpopular (from a social point of view) reforms and initiatives in the pre-election year. This pre-election tactic includes the multiple delays of the housing and public utility (HPU) reform (especially the deadline for picking the apartment management company), the freeze in the HPU rate rise (2005 – 32.7%, 2006 – 17.9%), the delay in establishing market prices for domestic gas and beginning the pay-out of the “maternal capital” starting from January 1, 2010. The same logic is behind keeping the regulation of HPU rates on the federal level only until 2010 after which they will be handed over to the municipal level. This was proposed last week by the head of the Federal Rate Service, Sergey Novikov.

The tactic of a “temporary freeze” is only justified in the short term (until 2009-2010), however, afterwards its positives will inevitably turn into negatives. The future successor, after steeping into his post, may face a significant number of problems that will threaten the stability of the government system as a whole.

First of all, he will be forced to start a whole series of infrastructure projects that will require significant capital investment. Secondly, it will be during his term that the payouts will begin on different government obligations (mortgage and maternity aid certificates, the increase in pensions, etc.). For example, only in 2007 there were around 600 thousand children born whose parents will be eligible to receive the maternal capital. If all of them file the necessary paperwork then already in the current year government obligations will total 6 billion dollars and by 2010 will total around 20 billion (this doesn't take into account the planned increase in the birth rate). Making such huge payouts will be problematic even with high energy prices. Moreover, the population could face a sharp increase in the cost of living due to the liberalization of energy prices in the domestic market and health and education sectors becoming fee-based. These two factors at the same time could lead to the significant worsening of the social situation in the medium term.