

Business Basing Risk Ruin Russia

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Populism and power are running rampant in Russia, no one and nothing is safe.

Yesterday prosecutors seized a controlling stake in Yukos, the Russian oil giant, comprising of shares belonging to Mikhail Khodorkovsky, the company's jailed chief executive. Mr Khodorkovsky was arrested at gunpoint over the weekend and charged on seven counts of tax evasion and massive fraud.

After the arrest, Anatoly Chubais, the head of UES, the country's electricity monopoly, made a public statement on behalf of Russian business leaders condemning what had happened.

Defending Mr Khodorkovsky is unlikely to have been the driving force behind the group's stance. They felt that if Mr Khodorkovsky could be arbitrarily arrested, they, too, were vulnerable.

Moscow now is a curious combination of hothouse of political speculation and whispering discussions. The fear of microphones is creeping back, and most observers feel that the heavy-handed crackdown against Yukos and Mr Khodorkovsky are politically motivated.

Indeed, Russia today is as lacking in transparency as it is lacking in the rule of law.

The powerful general procurator is charging Mr Khodorkovsky with fraud in connection with the privatisations of 1994. Mr Khodorkovsky is unlikely to qualify as a saint, but then again, it was hardly the era of saints, and if authorities wish to question what happened back then, there is no end to what can be done.

During his first presidential bid, Vladimir Putin unleashed a vigorous populist campaign on the issue of Chechnya which contributed to his success. Now, some brutal business bashing might serve a similar purpose.

But the cost could be very high. Russia is struggling to create conditions for sustainable and strong economic growth. Mr Putin wants to double the country's gross domestic product within a decade, which requires a sustained 8 per cent growth rate in the years ahead.

This will not be possible unless there are further substantial liberal economic reforms, a marked increase in foreign direct investment and the creation of a climate conducive to small and medium-sized Russian

enterprises.

All three of these conditions are under mortal threat from the growing influence of the siloviki faction of old-style security oriented individuals gaining ascendancy in Moscow. Indeed, it is the power ministries, not the reform ministries, who are starting to call the shots.

After an impressive start, Mr Putin has already put reforms on hold. He was widely expected to relaunch reforms after the Duma and presidential elections; after the Yukos affair, however, this is uncertain. Those in the ascendancy will clearly try to block it.

FDI in Russia has been limited so far. For the period from 1990 to 2002 FDI to Russia was equal to the amount to China in 2002. Moreover, FDI in Russia has been a fifth of what has gone to the countries of Central Europe.

There was a slight possibility of reversing this trend. Big US oil companies were courting Yukos after BP moved in. But if the very creation of the companies that the US was intending to do business with is under scrutiny, everything will change.

Domestic investment will suffer. When the Yukos affair began several months ago, capital flight accelerated dramatically. In the third quarter of 2003 capital outflows were more than all of 2002.

And if the general procurator a strong-armed Russian institution can send the increasingly powerful FSB internal security service after Mr Khodorkovsky, any local satrap will be inclined to do the same against alleged local oligarchs. Instincts from the anti-kulak campaigns of the past are much too easily revived.

Fewer reforms, less investments and fewer entrepreneurs will have a negative effect on Russia's growth potential in the years ahead. The siloviki might not complain, but everyone else will pay the price.

The impact goes well beyond just economics. Two days before the dramatic arrest, security spent eight hours searching a consultancy planning the election campaign of the Yabloko party, confiscating all its computers. This should have caused an outcry, but the incident was drowned out by the even more dramatic news.

On Tuesday Mr Putin will travel to Rome to attend the European Union-Russia Summit to discuss, among other things, the future development of a common economic space. But if we want to move from an economic relationship towards an evolving economic integration there must be a common understanding of the primacy of the rule of the law.

The EU must be clearly on the side of reforms, the rule of the law and

democracy in all of Europe.

The writer was prime minister of Sweden 1991-1994