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From the Archive: Making the Case for Putin

By William Browder

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There are a number of big problems facing Russia today, but the battle that President Vladimir Putin has been fighting to stop the oligarchs from taking over the country has to be one of the most important. And nowhere is this battle more emblematic than in the current fight between Putin and Mikhail Khodorkovsky. The way it is resolved will influence the country's development for the next decade.

One only needs to look at the record of the two men to see that Putin is doing what any leader would do to further his nation's interests.

On the one hand, we have Khodorkovsky; he may have become the poster child for corporate cleanups in the last two years, but his activities in the mid-1990s became synonymous with corporate governance abuse.

Perhaps his most infamous deal, and the one that made him fantastically rich, was his

acquisition of the oil company Yukos from the state. In a series of transactions with the government, Khodorkovsky successfully took control of a 78 percent stake in Yukos for a $310 million immediate cash payment, plus the promise of investing $200 million in the future. Eight months after he secured control, the same stake was worth $12.6 billion. Currently, it is worth $23.3 billion.

If that were his only questionable deal, perhaps one could make the argument that we should look beyond what he had done because he turned Yukos around. Unfortunately, there were too many other questionable deals to ignore his behavior. In 1998, when the banking system collapsed, Menatep, a leading bank controlled by Khodorkovsky, defaulted on its obligations to depositors. Khodorkovsky could have blamed external factors for the collapse of his bank, but those external factors certainly couldn't justify the asset transfers to another bank that he controlled, when Menatep depositors were receiving next to nothing.

Another example was in 1999, when Yukos attempted to divert between 66 percent and 80 percent of its major subsidiaries through dilutive share issues to offshore companies allegedly controlled by Khodorkovsky's associates, as a way of squeezing out minority shareholders. Most investors in either Yukos or its subsidiaries, including myself, believed that we were going to be left with nothing if the dilution plans were implemented. After buying out a significant portion of scared minority shareholders' stock, the dilution plans were dropped.

Khodorkovsky collected an enormous pile of cheap assets from the government and minority shareholders, and then embarked on an impressive charm and lobbying offensive to legitimize himself and his wealth. He has been very successful in getting people to forget his not-so-distant past.

Now let's look at Putin. When he came to power in 2000, everyone questioned his intentions in light of his KGB past and analysts made dire predictions about what he was going to do for Russia. The country was in a state of chaos. The expectation was that Putin was going to add to people's misery by maintaining the status quo of poverty and graft, but also adding some terrible KGB authoritarianism to the mix.

The reality of his actions surprised everybody. Instead of pushing the country back, Putin has implemented a reform program that is far more liberal than anything that could have been cooked up at the most radical think tank in Washington. In 2000, he changed the individual income tax rate from 35 percent to 13 percent, and in the process collected 49 percent more tax. He changed the Land Code, the Labor Code, the Customs Code and securities laws. Workers started receiving their salaries, companies paid their debts and the economy grew by 29 percent in his first four years. Perhaps most importantly, he is clearly not acting merely in his own financial interest in the way that we have seen government officials do in the past. When UES minority shareholders were facing the prospect of having their assets stripped by management of the company in a corrupt restructuring plan, it was only after Putin stepped in that the asset-stripping plans were scrapped.

To the extent that Putin had opposition to his economic reforms, it has come from two camps. One was the Communists. Fortunately, they have been gradually drifting into oblivion as their constituency has been lost to other parties. The other camp was made up of oligarchs, whose

influence had risen to dangerous levels. As the richest oligarch, Khodorkovsky was particularly vocal in his own self-interest. He went from being one of the sharpest-elbowed people in the corporate world to being the most zealous and influential in the world of politics and lawmaking.

In 2001, when the State Duma was considering taxing oil companies depending on the age of their fields, oil lobbyists successfully blocked that amendment, thereby giving Yukos and several other companies a big advantage over companies with older oil fields. In 2002, when the Duma was considering a new law on taxing oil products, the oil-lobbying machine again went to work in preventing the law and limited the rise in tariffs on oil product exports. As a result, tariffs on oil product exports remained capped until recently. When the Duma tried to close the tax loophole of onshore tax-free zones, at the same time setting up the lowest possible profit tax rate of 20 percent, somehow Yukos was able to keep an effective tax rate of 13 percent, while LUKoil was paying 32 percent and Surgutneftegaz 25 percent. Only Sibneft was able to squeeze out a lower tax rate of 12 percent.

It is not surprising that Putin stepped into the fray in 2003 when Khodorkovsky started actively financing the Duma campaigns of various political parties. Putin could not just sit back and watch one unelected person use his own wealth in a manner that had such potentially dire outcomes for the nation. So as all the controversy rages, we have to ask ourselves one key question: Who do we trust to act in the best interests of the country? Is it the oligarch who amassed a personal net worth of $8 billion from nothing, using almost every tool available to enhance his wealth and avoid sharing his good fortune with the people? Or is it the president who has a four-year track record of bringing the country back from the brink of collapse and creating a small degree of stability for his shocked and tired citizens?

Perhaps some observers of Russia have come out in favor of Khodorkovsky, but that is not where the people stand on this issue. At the moment, Putin has an 82 percent approval rating (it rose by 8 percent after the arrest of Khodorkovsky). The business world has also voted with its feet and its money. Under Putin's leadership, ruble interest rates have dropped from 38 percent to 7 percent, the stock market has gone up 144 percent and Moscow real estate prices have doubled.

The fear of economic disaster in the wake of the Yukos affair never materialized. There was no capital flight and Central Bank reserves grew by $14 billion in the weeks following Khodorkovsky's arrest, reaching a record $78.9 billion as of Jan. 9. Ruble interest rates have not risen and the ruble has strengthened against the U.S. dollar from 29.9 to 28.8.

Looking into the future, Putin still has enormous challenges facing him. Among the key ones are developing the real rule of law and a functioning judiciary, lifting the discriminatory ring-fence on ownership of Gazprom, and developing a sound banking system. But the one challenge he has successfully addressed is the challenge of the oligarchs.

Putin understood that the country would never succeed with seven oligarchs at the helm — particularly since their interests were so counter to those of the nation. He has set clear limits to the oligarchs' power and their meddling in the affairs of state. While there may be some things about Putin that we disagree with, we should give him the benefit of the doubt in this

area and fully support him in his task of taking back control of the country from the oligarchs.

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