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The YUKOS Affair: Protecting Democracy, Private Property, and the Rule of Law

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The Kremlin's attack on YUKOS, the major Russian oil company—including the arrest of Chairman and Chief Executive Officer Mikhail Khodorkovsky, seizure of his shares of YUKOS, and his subsequent resignation—is a watershed event in post-communist Russia. This development has negative implications on several levels, and its ripple effects are far from over. Obviously, President Vladimir Putin has been listening to those who do not care about Russian integration into the global economy and who are undermining his stated goal of doubling Russian gross domestic product by 2008.

The Kremlin's attempt to dismantle YUKOS will have several long-range consequences:

- Drying up domestic and foreign investment,
- Undermining the rule of law,
- Increasing the power of unelected bureaucrats from secret police and law enforcement,
- Withering sources of funding to democratic parties and charities, and
- Weakening civil society.

Seizing Complete Control. Through an orchestrated campaign of leaks and accusations, the Kremlin has accused Khodorkovsky of preparing for a constitutional coup by inundating the Duma with his loyalists, financially supporting opposition polit-

ical parties, and harboring presidential aspirations for 2008. The Kremlin was miffed that YUKOS supported several political parties but did not support the pro-Putin United Russia party. Furthermore, Khodorkovsky was considered a part of the Yeltsin-era “crony capitalism”—a freewheeling combination of politically active billionaire “oligarchs” and Boris Yeltsin's family members, who are now being purged. Alexander Voloshin, Yeltsin's chief of staff, whom Putin retained until his resignation on October 30, 2003, was a political leader of the Yeltsin “family.”

The St. Petersburg KGB men with whom Putin is siding (“chekists” or *siloviki*—men of force) and their associates from the business world differ with the Yeltsin “family” in their view of politics. While wrapping themselves in the flag and patriotic rhetoric, they do not hesitate to misuse law enforcement and the courts to achieve their goals. Their main goal is to translate power into wealth. To that end, some in the St. Petersburg faction want to chop up YUKOS.

- The attack on YUKOS has done multibillion-dollar damage to the Russian stock market and triggered a massive capital flight.
- It also signals that the Russian legal system can be subverted by unscrupulous bureaucrats, businessmen, prosecutors, and law enforcement officers.

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YUKOS has become Russia's most successful oil company. Just a month ago, it merged with Sibneft to form the world's fourth largest oil company. It introduced Western accounting standards and management, pioneered shipping Russian oil to the U.S. market, and launched a private consortium to build a pipeline from western Siberia to the arctic port of Murmansk. It has also bought hundreds of millions of dollars worth of U.S. oil equipment. Over the years, YUKOS paid billions of dollars in taxes and gave hundreds of millions to charity. It was also the company most independent from the government, and the attack on YUKOS suggests that other companies may soon be on the chopping block.

Abuse of the Legal System. Politically well-connected businessmen, associated with government-dominated oil companies and banks, have conspired to dismantle YUKOS by bringing apparently trumped-up charges of past irregularities against YUKOS's principal shareholders. In the 1990s, the Russian economy was plagued with lawlessness, and any consistent retroactive application of today's law would threaten a majority of Russia's current politicians, bureaucrats, and businesspeople with long jail terms. Such abuse of the law, however, causes irreparable damage to the Russian economy, its court system, and Western and Russian investors.

The attack on YUKOS has already done multibillion-dollar damage to the Russian stock market, causing the Moscow RTS index to plunge by over 20 percent and triggering a massive capital flight. YUKOS shares plunged 10 percent on the news of Khodorkovsky's arrest alone. Moreover, by jailing Khodorkovsky and his partner Platon Lebedev, Putin is sending a clear signal that the Russian state can be hijacked and its legal system subverted by unscrupulous bureaucrats, businessmen, prosecutors, and law enforcement officers. The positive investment climate that Russia had enjoyed since 1998 has evaporated overnight.

What the U.S. Should Do. The Bush Administration is facing a dilemma: It wants to keep Russia as a strategic partner in the war on terrorism and an

alternative source of oil. However, as Russia is moving toward the destruction of independent centers of power and increasing authoritarianism, and as the future of economic reform is at stake, decisive measures may be necessary. Specifically, the Bush Administration should:

- **Re-evaluate** its energy dialogue with Russia until Khodorkovsky is released and an impartial investigation examines the charges. U.S. companies should not endanger their stockholders by investing in an unstable Russia.
- **Temporarily suspend** U.S. Export-Import Bank and Overseas Private Investment Corporation financing of Russian oil and gas projects with state-owned entities, such as the oil monopoly Gazprom. This will send a signal that the state cannot abuse its power when dealing with private-sector competitors.
- **Issue** a joint statement by the U.S. Secretaries of Commerce, Energy, and State expressing concern over the crackdown on the private sector and abuse of the legal system.
- **Provide** U.S. government funding for democracy, free media, and rule of law projects through National Endowment for Democracy and U.S. Agency for International Development contractors—activities supported by YUKOS charities until now—and encourage private charitable giving to these programs. Support of democracy and an open society in Russia should not be allowed to die.

Conclusion. With the attack on YUKOS, the ex-KGB faction in the Kremlin has reverted to state-led repression against private capital and independent power centers. A crackdown on the independent media has been going on for three years. The U.S. should send a strong signal to President Putin that such policies may cost Moscow America's good will and cause damage in tens of billions of dollars.

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