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The YUKOS Affair

By Leon Aron

In the early morning of October 25, 2003, masked agents of the Russian security agency, the FSB, stormed the plane of Mikhail Khodorkovsky, CEO and principal owner of Russia's largest private oil company, YUKOS; arrested him; and conveyed him to a Moscow prison. He was charged with tax evasion, fraud, forgery, and embezzlement.

Khodorkovsky's arrest and imprisonment are only the latest of the Russian government's actions against YUKOS's executives and owners. On July 2, 2003, on a warrant from the prosecutor general of the Russian Federation, Moscow police arrested Platon Lebedev, a principal shareholder and director of the Menatep holding and investment company. Menatep owns 61 percent of YUKOS, and Khodorkovsky is the majority owner of Menatep.

Lebedev was charged with embezzling state assets in the 1994 privatization of Russia's largest phosphate extraction and enrichment plant, Apatit, on the Kola peninsula, 750 miles northeast of Moscow. Subsequently, the Russian government has issued additional charges against Lebedev, including "tax evasion," "abuse of trust," and "failure to comply with a court order." Lebedev's petitions for bail have been repeatedly denied, and he remains incarcerated.

Despite assurances by the government that the action against Menatep and YUKOS is nothing more than a "routine investigation," the choice of the target and the timing of the prosecution belie such claims. Instead, what has come to be known in Russia as the "YUKOS affair" is a reflection of a deep division among the elite, as well as the public at large, concerning the relationship between the state and the private sector, power and property, wealth and democracy.

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An Odd Scapegoat

A Product of the 1990s. The Russian government created YUKOS in April 1993 by integrating several state-owned production, refining, and distribution companies. The company's name is a combined acronym of the original constituent companies: Yuganskneftegaz, one of the largest oil producers in the Tyumen' region of Western Siberia, and KuybyshevnefteOrgSintez, a major refinery and petrochemical plant in Kuybyshev (now Samara), a city on the Volga.

Khodorkovsky's Menatep acquired YUKOS through a "loans-for-shares" auction in December 1995. Having inherited an empty treasury from the Soviet Union and being unable, as in any revolution, to collect taxes, the government was desperate to pay pensions to retirees and salaries to teachers and doctors. With presidential elections looming, the Kremlin sought huge instant loans from the top private banks. As collateral, the government offered controlling stakes in key industrial enterprises. When the state defaulted on the loans a year later, the companies became the property of the creditors.

In a country still clawing its way out of the Soviet economic collapse, the hundreds of millions of dollars raised at the auctions were an astronomic sum. At the time, barely two years had passed since the outbreak of a mini-civil-war in Moscow in October 1993. Within days after the auctions, the Communist-led "popular patriots" gained a plurality in the State Duma, and a Communist candidate was widely predicted to win the summer 1996 presidential election half a year later. (By the rules of the auctions, the owners of the collateral state shares were not to take possession of the properties until the fall of 1996. Had a Communist won, the lenders would have lost every kopeck.)

With political risks so high, no reputable foreign investor was willing to spend hundreds of millions of dollars for the privilege of owning potentially profitable but then mostly loss-making enterprises and face the sullen and technologically backward work-force, Communist-dominated unions, and additional hundreds of millions of dollars in technological overhauls. For the Russian privatizers, then, the choice in 1995 was not between pristinely clean foreign corporations and banks spoiling for direct investment in Russian industry on the one hand and the home-grown entrepreneurs with dubious connections and practices on the other. Instead, they had to choose between the latter and the thieving, corrupt, and incompetent Soviet functionaries in ministries and committees who had run most of these “crown jewels of the Soviet economy” (the obligatory journalistic cliché) deep into the ground.

Menatep “loaned” the government $159 million in exchange for 45 percent of YUKOS’s shares. Shortly thereafter, the company purchased another 33 percent for $150 million in an investment tender. The transactions were conducted through an intermediary company, Laguna, since Menatep was the organizer of the auction. Thus Menatep purchased YUKOS at an auction that it ran through a company it created.

Capitalism without Institutions. Uniquely in world history, private property and capitalism emerged simultaneously in post-Soviet Russia. At the time, the laws and mores that, in more fortunate lands, predated modern capitalism by centuries had to be created from scratch on a slate wiped clean by seventy years of totalitarian Marxism-Leninism and absolute state ownership of the economy. In what Russia’s leading liberal economist Evgeny Yasin called “the revolutionary chaos,”[1] no large business in Russia was “clean” by today’s standards—and the larger the company, the greater the violations it likely committed.

In the case of approximately a dozen Menatep-like business empires in post-Soviet Russia, the list of violations is undoubtedly very long. During the 1990s, Russia’s fledgling entrepreneurs routinely trampled on the rights of minority shareholders, created shell companies for transfer payments, and leveraged their bribe-greased connections with government officials in a race against equally rough and aggressive competitors to snatch up the choicest pieces of state property. At the time, when full remittance of several dozen taxes would have absorbed well over 100 percent of a business’s profit, tax evasion was the only strategy allowing an entrepreneur to pay salaries and invest in his business.

While the detailed charges against Khodorkovsky have not been made public as of this writing, given the wide array of abuses committed by the vast majority of Russia’s capitalists during the 1990s, the case that state prosecutors have constructed against Lebedev is surprisingly, even insolently, flimsy. A front firm allegedly linked to Lebedev bought a 20-percent stake in Apatit in 1994 for $225,000 and pledged to invest $280 million.[2] In 1996, the Murmansk regional government sued the firm for reneging on the investment commitment. The case was settled in 2002, with the firm agreeing to pay $16 million in penalties. Ignoring the settlement, prosecutors have resurrected the case and charged Lebedev with embezzling $280 million.

The Flagship of “Civilized Capitalism.” Despite all its unsavory baggage, the choice of YUKOS as the scapegoat for the misdeeds of the 1990s makes little sense—unless one assumes that it has been picked not for what it was but for what it has become.

In the past five years, YUKOS has traveled the farthest of any post-Soviet industrial giant away from the mores and practices of the 1990s. In 1999, YUKOS became the first Russian mega-firm to switch to international accounting standards. Two years later it became the first Russian oil company to report its quarterly financial statements in accordance with U.S. Generally Accepted Accounting Principles (GAAP). The company has several dozen Western accountants permanently on staff. Its 2002 annual report has been audited by PriceWaterhouse-Coopers.[3] Independent directors constitute a majority of the company’s board.[4] Today, YUKOS is considered the most transparent of Russia’s largest industrial corporations. Meanwhile, as YUKOS started to be publicly traded, the company’s ownership has diversified considerably, with Menatep’s share falling from 85 percent to 61 percent.

When Menatep took over YUKOS in 1996, the company suffered from the same problems that were hobbling the rest of Russia’s energy sector. With salary arrears mounting and oil output declining precipitously, the company was on the brink of bankruptcy. Four years later, the firm had enough cash to become the first Russian oil company to pay dividends to its nearly 60,000 shareholders: the ruble equivalent of $300 million in 2000, $500 million in 2001, and $700 million in 2002.

By 2002, YUKOS accounted for 18 percent of Russia's total oil production, pumping an average of 1.4 million barrels a day. The company's output grew by 17 percent in 2001, by 19 percent in 2002, and is projected to increase by another 19 percent this year. Pursuing his dream of creating Russia's first global private economic player, Khodorkovsky engineered the purchase of another private Russian oil major, Sibneft. Approved by the Russian State Anti-Monopoly Committee and completed on October 4, 2003, the complex equity-and-cash transaction has created the world's fourth largest oil producer. Today Yukos-Sibneft pumps 2.3 million barrels a day, commands reserves of 19.4 billion barrels, and, prior to Khodorkovsky's arrest, was worth $43 billion.[5] Recently Exxon-Mobil has been reported interested in acquiring between 40 and 50 percent of YukosSibneft for an estimated $25 billion—the single largest direct foreign investment in Russian history.

Powered by YUKOS, Sibneft, and other privately owned companies and helped by their investing an estimated $5 billion in new technology, exploration, and drilling, Russia has increased its daily extraction of oil by 40 percent in the past five years, from an average of 5.9 million barrels in 1998 to 8.6 million barrels this past August.[6] On several occasions since 2001, Russia has pumped more oil in a given month than Saudi Arabia.

Since the 1998 financial crisis, the value of YUKOS's shares has increased more than tenfold, including 250 percent growth in 2001 alone.[7] In September 2002, Khodorkovsky, who owns 36 percent of the company's stock, was ranked first on *Fortune* magazine's "Global 40 Richest Under 40" list, with an estimated worth of $7.2 billion.[8] He was thirty-nine at the time.

In December 2002, Standard & Poor's rated YUKOS "BB with stable outlook," and in January 2003, Moody's Investor Service assigned the oil company a rating of "Ba2." At the time, these were the highest long-term and foreign currency issuer ratings of any private Russian company.[9] Last year, YUKOS garnered awards for "Best Manager" (Khodorkovsky), "Best Investor Relations," "Best Website," and "Best Annual Report" from the Association for the Protection of Investors' Rights, which includes twenty-seven of the largest Russian and foreign institutional investors in the Russian market with an equivalent of $10 billion under management.[10]

Khodorkovsky also won the 2002 "Entrepreneur of the Year" prize, awarded annually by Russia's leading business daily *Vedomosti*, which is published jointly by the *Financial Times* and the *Wall Street Journal*. The same year, the Russian government named YUKOS the "Best Company for Compensation and Social Payments Programs," as well as for the "Implementation of Social Programs at Enterprises and Organizations."[11]

From Robber Baron to Philanthropist

Khodorkovsky likes to describe himself as three generations of Rockefellers rolled into one.[12] Having been a robber baron, a respectable industrialist, a leading philanthropist, and, perhaps, a national political figure—all in the span of ten years—he is not far from the truth.

Although the number of private Russian charities has skyrocketed from zero in 1988 to 70,000 today, with 2.5 million Russians actively helping an estimated 30 million of their fellow citizens,[13] YUKOS and Khodorkovsky's personal donations are beyond parallel in post-Soviet history. YUKOS gave the ruble equivalent of $45 million to charity in 2002 and is projected to donate an equivalent of $50 million this year.[14] According to Hugo Erikssen, the director of YUKOS's International Information Department, in addition to charitable disbursements by YUKOS, the company's core shareholders will donate between $100 million and $150 million in 2003. (Leonid Nevzlin, Menatep's second largest shareholder with 8 percent of the equity, is the leading contributor to Jewish charities in the territory of the former Soviet Union.)

In early 2002, $10 million went to establish the Open Russia Foundation for the support of educational and cultural projects in Russia and abroad. Its projects include the first permanent exhibition of artwork from St. Petersburg's Hermitage Museum to be held outside Russia, in the historic Somerset House in London.

In November 2001, YUKOS donated $500,000 to the U.S. Library of Congress for its Rule of Law Program, which brings Russian judges to American communities, where they are hosted by senior federal judges and observe firsthand the U.S. judicial system. At the same time, another half million dollars was given to the library to administer resident fellowships for Russian scholars and students.

When the billionaire investor and speculator George Soros decided last year to end a decade of charitable giving in Russia, YUKOS stepped in with a $1.15 million contribution to the U.S. nonprofit Eurasia Foundation for the support of "small business and community development."[15]

The corporation has instituted a home mortgage program for its employees and plans to spend up to

$15 million in 2003 to subsidize loans extended by participating banks at special low rates.[16] YUKOS purchases drugs and state-of-the art diagnostic equipment for hospitals in its "company towns": Nefteyugansk, Khanty-Mansiysk, Angarsk, Achinsk, and Tomsk. In the same cities, the company runs "social cafes" where anyone can get a free hot meal.

YUKOS also provides stipends to the children of its employees if the children are enrolled in college and receive straight A's two semesters in a row.[17] It also awards stipends to A-students in universities and institutes with oil-industry-related majors. [18]

Helping Raise the "Creative Minority." Khodorkovsky is convinced that the export of raw materials (Russia's major source of foreign earnings and tax revenue today) is incapable of turning the country into a world-class industrial power and securing a high standard of living for most Russians. To achieve these objectives Russia must transform itself from an industrial to a postindustrial society—a trajectory possible only in the presence of a progressive and modern home-grown scientific, managerial, and technological elite, which Khodorkovsky calls the "creative minority."[19]

It is to create such an elite that, in March 2000, YUKOS launched a nationwide program called "Pokolenie.ru" (or "Generation.ru") to provide Internet skills and access to Russian high school teachers and students. Managed by the Federation for Internet Education (FIE), Pokolenie.ru opens and equips regional Internet centers, where forty teachers at a time spend two weeks acquiring Internet skills to pass to their students. Their travel, room, and board are paid by YUKOS.[20] By last spring, there were Internet centers in thirty-four out of Russia's eighty-nine regions, and 56,600 Russian educators received FIE's diplomas after completing the course.

Launched in 1996 in the oil-producing regions of Russia, another of YUKOS's educational programs, "New Civilization," is designed to educate high school students in the principles of democracy, market economics, and civic responsibility. Classes participate in a role-playing activity, in which they "invent" their own country, determining its political system, electing its government, introducing a currency, even opening a stock exchange.[21] The students compete for the "most effectively governed" state, with the winners representing the school at a district competition. According to the program's website, each school is "transformed into an independent 'children's republic.' These 'republics' establish economic, political, cultural, and educational ties with the 'countries' in neighboring schools."[22] By 2003, over 200,000 Russian high school students had participated in New Civilization, and the number is expected to reach 500,000 by 2005.

Why YUKOS? Why Now?

The choice of YUKOS (among dozens of equally eligible candidates) as the whipping boy for the excesses of the early post-Soviet "primary accumulation" (in Marxist terminology) is hard to explain in terms of the core long-term interests of Russia's state and society, be they the diminution of corruption, greater transparency, social responsibility of large businesses, or foreign investment. As leading Russian political philosopher Igor Kliamkin put it, "If the war on the oligarchs is begun with one of the most successful, effective, and transparent companies, then success, effectiveness, and transparency are no longer the priorities of the state."[23]

Elections 2003. Those who engineered the assault on YUKOS were likely guided by another set of priorities. In the short run, they hoped to bolster the chances of the pro-government centrist party, United Russia, in the December 7 parliamentary elections. At the moment, United Russia is in serious trouble, running even or slightly behind the Communists in voter preference polls.

The attack on YUKOS was expected to help United Russia in two ways. First, it was to scare the top Russian entrepreneurs into giving more to United Russia and less to opposition parties. Khodorkovsky is reportedly concerned about the possibility of a two-thirds pro-government majority in the next Duma—the so-called "constitutional majority," required by the 1993 constitution to effect changes in the "foundation" of Russia's economic and political systems. Among the possible "federal constitutional laws" Khodorkovsky seems to be most wary about and determined to oppose are re-nationalization, the extension of the president's tenure to include a third four-year term, and the imposition of the "development fee," or "rent," for the use of natural resources.

To prevent any faction from gaining control of the Duma, Khodorkovsky has given amply to the major opposition parties since the beginning of this year: the Communists on the Left and the liberals of the Union of Rightist Forces and Yabloko on the Right. (He is reportedly underwriting Yabloko's entire campaign budget.) In exchange, YUKOS has placed more than a dozen people on these parties' national candidate lists. At the same time, Khodorkovsky has repeatedly refused the Kremlin's "requests" to finance United Russia.[24]

Capitalism, Equality, and Russian Public Opinion. The other reason for the YUKOS crackdown was an apparent belief that a sustained and well-publicized attack on a prominent "oligarch" would add voters to United Russia's count. Based on a selective reading of public opinion polls, this was not an unreasonable hope.

Tensions between democracy, which is institutionalized equality, and capitalism, which is institutionalized inequality, are a permanent feature in the public attitudes of countries that combine these systems. Wariness and resentment of "big business," private wealth, and the role they play in democratic politics are characteristic of all capitalist nations, but are especially acute in the younger "poor democracies"[25] of Eastern Europe, Asia, and Africa.

In Russia, suspicion of and hostility toward big business has been intensified by almost three-quarters of a century of socialist autarky and incessant anti-capitalist propaganda; the stresses of adjusting to the rapid transformation of most of the economy from state-owned to private; and the unsavory details of the "primary accumulation" reported daily in a press free from government censorship.

In July 2003, 77 percent of Russians viewed "big capitalists" somewhat or completely negatively.[26] In a country where for almost four generations private wealth (apart from carefully hidden Communist Party nomenklatura possessions) by definition could only be acquired by breaking the law, 88 percent of respondents in the same poll believed that large private fortunes have been earned "mostly" or "totally dishonestly."[27]

Perhaps most enticing to those behind Khodorkovsky and Lebedev's arrests was the less overwhelming but still solid support for the "need" to revise the results of privatization: 44 percent for privatization as a whole, and 33 percent for "parts" of privatization. Additionally, the prosecution of the "big capitalists" who benefited from privatization was approved unconditionally by 57 percent of those polled, while 31 percent supported criminal charges in "exceptional cases."[28]

Support for Private Enterprise. Of course, like anyone else, Russians are perfectly capable of holding contradictory opinions simultaneously. When asked last year if the liberal economic reforms (with privatization as their centerpiece) should have been started, the share of those who said "yes" was almost three times larger than those who responded negatively: 62 percent versus 22 percent.[29] In 2002, 84 percent of those polled wished to work at a private firm or enterprise, as compared to 19 percent in 1990.[30] This past summer, 53 percent of those surveyed felt that their country should "create favorable conditions" for the development of big business, and only 22 percent thought that it should not.[31]

The public is almost evenly divided on whether private businessmen have been "good" for Russia: 45 percent consider their activity "useful for the country," and 40 percent, harmful.[32] (Commenting on these numbers, the dean of Russian sociologists and pollsters, Yuri Levada, said: "45 percent is not at all bad, not at all. With our poverty and our [Soviet] upbringing, the number could have been much lower.")[33]

Directly bearing on the attack on YUKOS, a strong plurality of 48 percent believed that "re-division" (*peredel*) of large properties today would "harm" Russia, and only 12 percent felt that their country would benefit from such an act; the rest were uncertain.[34] Furthermore, smaller pluralities in a mostly undecided population thought that the YUKOS affair would "worsen the political situation" in Russia (30 percent); "damage Russia's image in the West" (36 percent);[35] or "diminish Putin's prestige" (41 percent).[36]

Putin's Response. The selective reading of public attitudes may explain not only the eagerness of the anti-YUKOS plotters but also Putin's silence for almost three months, between Lebedev and Khodorkovsky's arrests. During this time, the Russian president said nothing to domestic audiences about YUKOS—and his responses to foreign reporters' queries about the case were omitted in transcripts on government websites and television. When Putin finally spoke, two days after Khodorkovsky's arrest, he warned against "hysteria and speculations" and expressed confidence that the court "had a reason" to order the arrest.

Putin's reluctance to interfere likely stems not only from United Russia's weakness at the polls and popular resentment of the "oligarchs" but also from surveys of voter preferences in the March 2004 presidential elections. While in all polls Putin is far more popular than all other potential candidates, he slipped last spring to just below the 50 percent mark for the first time since his election in 2000.[37] If Putin were to receive less than half of the vote, the Russian constitution would require a second-round runoff election. For someone accustomed to approval ratings in excess of 70 percent and addicted to popular adulation, the possibility of carrying less than half the electorate is an affront. Reportedly near-obsessive about his daily poll numbers and often hesitant and indecisive to the point of paralysis, Putin may hope that the attack on YUKOS will add just enough popularity for him to avoid the humiliation of a runoff.

Power and Property: Russian Capitalism at a Crossroads

Yet the YUKOS affair extends well beyond proximate political battles. In the end, it is about competing visions of Russia's fledgling capitalism and its relations with the state.

The institutional and normative void inherited from the Soviet collapse is still far from filled, and both the elites and society at large are sharply divided on what to fill it with. Among the key contested issues are the relationship between the state and the privatized economy, in which over 70 percent of the country's GDP is now produced; the competing claims on the enormous wealth that the privatized economy has generated and continues to generate daily; and the role of "big capital" in Russian politics and society.

Russia's economic revolution was also the largest denationalization of property in history. With no other source of "primary accumulation" inside the country—foreign investors having prudently stayed out for fear of a Communist comeback, and no Marshall Plan–like massive assistance from the West ever having materialized—Russian large capital could and did originate only through the privatization of the Soviet state, which owned everything.

Born out of decaying Soviet socialism, with corrupt Communist Party functionaries and thieving bureaucrats as its midwives, Russian capitalism continues to be bound to the state by the myriad of "deals," outdated regulations, and nefarious connections between businessmen and local and federal officials. Yet it was inevitable that sooner or later the most advanced, export-oriented, and cosmopolitan segment of the Russian business elite would come to resent the status quo and attempt to claim more independence as well as a presence in civil society and politics unmediated by the state.

The Legacy of Patrimonialism. To secure such a modus vivendi, however, Russian business must overcome very tall obstacles. The steepest among them may be the confluence of political authority and property. This is not just a Russian predicament. Perhaps more than anything else, the blending of power and property distinguishes poor democracies from the older capitalist nations. In the West, from the end of the Middle Ages onward, the unity between power and property steadily eroded until the king "was the lord in the political sense but not in the sense of an owner," as two lawyers reportedly explained to Frederick II of Prussia in the mid-eighteenth century.[38] In poor democracies, which mostly came into being in the last twenty years of the twentieth century, political power still tends to translate, directly or indirectly, into ownership or at least control by the elder, the factory director, the tribal chief, the mayor, or the governor.

The difficulty in breaking up the unity of power and ownership, which is the source of some of poor democracies' most recalcitrant problems (corruption first among them), is much aggravated by Russia's legacy of patrimonialism: a political system in which the ruler or rulers are "both sovereigns of the realm and its proprietors," and "political authority is exercised as an extension of the rights of ownership."[39]

Between the fifteenth and the middle of the seventeenth centuries, Russia was a full-fledged patrimonial state. For the local functionaries, patrimonialism translated into a rule that was to become the perpetual motto of successive Russian bureaucracies: "That which I manage, on it I feed."(Indeed, *kormlenie*, or "feeding," was the official designation of the means by which tsars' district prefects were expected to support themselves and their families during their time in office.)

After gradually receding over the course of a hundred years, patrimonialism was further diminished under Catherine the Great. The noblemen were no longer automatically the conscripts of the state, and the crown began to surrender its monopoly on the land by giving the nobles titles to their estates. The state's grip on the economy weakened gradually throughout the nineteenth century, particularly after the liberal reforms of Tsar Alexander II (1861–1865). Patrimonialism continued to erode in the first decade-and-a-half of the twentieth century when Russia's was among the fastest growing economies in the world.

Yet patrimonialism returned with vengeance in the Soviet state. For sixty years, from 1929 to 1989, it owned everything and employed everyone. Anyone who lived or traveled in the Soviet Union—with its underground trade in automobile parts, records, jeans, or books—will instantly recognize the description of private economic activity written by Giles Fletcher, an Englishman who traveled to Russia in the sixteenth century:

> And if [the Russian people] have any thing, they conceale it all they can, sometimes conveying it to

> Monasteries, sometimes hiding it under the ground, and in woods, as men are woont to doo where they are in feare of forreine invasion. In so much that many times you shall see them afraid to be knowen to any [Boyar] or Gentleman of such commodities as they have to sell. I have seen them sometimes when they have layed open their commodities for [sale] (as their principall furres & such like) to looke still behind them, and towards every doore: as men in some fear, that looked to be set upon, & surprised by some enimie. Whereof asking the cause, I found it to be this, that they [feared lest] some Nobleman or [Boyars' sons] had been [present], & so layed a traine for the prey upon their comodities perforce. This maketh the people (though otherwise hardened to beare any toile) to give themselves much to idlenes and drinking; as passing for no more, then from hand to mouth.[40]

Today, the boyar and the nobleman have been replaced by the bureaucrat and the policeman, and robbery by bribery, but the idea of the ultimate dependence of private business on the state's good graces persists. After four generations of limitless power, many in the still largely Soviet-era Russian bureaucracy, which easily survived the 1991 "velvet revolution," are still incapable of accepting an economic system in which property and wealth are not directly conferred (or withdrawn) by the state or, at least, controlled by it.

"If we don't like you, how can you be rich?" is the message that the state bureaucracy intends to send to Khodorkovsky, other "oligarchs," and hundreds of thousands of owners of small and middle-sized businesses.

YUKOS versus the Bureaucratic "Great Game." YUKOS's first offense was its increased transparency, as well as its newfound but stubborn respect for Russian and international laws. International accounting standards and audits by top Western accounting firms leave little, if any, "slush" funds for bribery. YUKOS was attacked, many Russian analysts believe, because it began to set an example of a big business determined to operate "by the book." "Our bureaucracy cannot stand clean and legal business," observed three leading Russian political experts in a long commentary on the YUKOS affair. "They are interested in keeping businesses in the 'shadows'. . . [and] in pushing them into an illegal, criminal space. Because an 'oligarch' who is the subject of a thick dossier in the prosecutor's office is much easier to command and to use as a money bag."[41]

YUKOS broke another cardinal rule of the bureaucratic "great game" by openly contributing to opposition political parties to advance its interests and shape the laws—instead of following the age-old Russian and Soviet tradition of ignoring the laws and bribing those who implement and enforce them. In a country where long-term planning—economic, financial, and political—has been all but extirpated by 400 years of brutal authoritarianism and totalitarian ownership of the economy, YUKOS dared plan for decades ahead without consulting state ministers and committee chairmen.

The Battle of Economic Cultures. The YUKOS affair is a major battle in a war of two economic cultures. One is labeled by Russian observers "great-power statist" (*derzhavno-etatistskaya*), and the other, "liberal-oligarchic."[42] Though hardly perfect from the Western point of view, the latter nevertheless has shown the ability for change and progress since its inception a decade ago. It has produced fiscal discipline, low inflation, lower corporate and income taxes, the extension of private property rights to urban real estate and agricultural land, the diminution of bureaucratic interference in the private sector, continuing privatization of state assets, improvements in corporate governance, and greater transparency.

By contrast, the "great-power statists" seek to increase the government's control over the economy and, inevitably, civil society. Concentrated among federal and local elected authorities and bureaucrats, they are supported by a significant segment of the Russian public, including the one-quarter to one-third of the electorate that votes Communist. Added to the "statist" constituency in the last three years have been many retired and still serving secret service officers who under Putin came to occupy an unprecedented multitude of executive positions in the federal and regional governments. (The alleged masterminds of the YUKOS affair are veterans of the KGB/FSB, deputy heads of presidential administration Igor Sechin and General Viktor Ivanov.)

Their campaign is said to be bankrolled by partially privatized companies with controlling or significant state ownership like the natural gas monopoly Gazprom, Russia's largest oil company Lukoil, and another oil major, Rosneft. Notoriously wasteful and corrupt, they have contributed obediently and generously to the Kremlin bureaucrats' favorite parties and are said to be behind the newly formed People's Party, a left-populist entity with dangerous nationalist overtones.

Another reportedly key underwriter of the attack on YUKOS is Russia's third largest bank, Mezhprombank. Although private, this institution is as close to the ideal of "state capitalism" as any Russian enterprise. The bank's principal shareholder and former CEO, Sergei Pugachev, began his career in the Kremlin's Presidential Property Administration, which manages the huge tracts of real estate inherited from the tsars and general secretaries. Later Mezhprombank was rewarded with the government accounts that brought billions of rubles in state revenues. Rumored to be very close both to the hierarchy of the Russian Orthodox Church and to the Putin-led St. Petersburg political machine, Pugachev's bank has recently extended a $100-million credit line to the perennially struggling Gazprom. Lately, the bank is rumored to be considering entering Russia's very lucrative arms exports.

"Statists" in a Hurry. Yet even with this heavy artillery behind them, the "statists" do not have much time. Following the largest denationalization in history during the 1990s, Russia has made long strides in the past three years toward further freeing the entrepreneur and the consumer from state control. In the legislative pipeline are measures aimed at further de-bureaucratization and reduction of state ownership or control over the nodal points of Russia's economy and society: housing and utilities, pensions, banking, as well as a civil service reform and the breakup of the two remaining state monopolies in railroads and natural gas. The on-and-off military reform is aimed at cutting in half the size of the Russian armed forces (already reduced to one-fourth of their strength in the Soviet Union) and will abolish perhaps the most hated manifestation of state power over society: the three-century-old conscription.

The "statists" need a decisive victory over not just a giant private conglomerate but a symbol of a more open, rapidly modernizing Russian capitalism. As likely the best known private Russian company inside and outside the country, YUKOS fits the bill. If successful, the attack on YUKOS may presage the scaling down or even the abandonment of liberal reforms, a shift in the Kremlin's priorities, and the rewriting of Putin's 2004 electoral platform. Some Russian observers foresee an increasing reliance by the state on the "power bureaucracies" (*siloviki*), that is, the secret services, police, and the military. Another serious danger is the adoption of the left populism of the People's Party as a state ideology based on Orthodox Christianity and the mobilization of the electorate for "class warfare."[43]

While stopping short of across-the-board renationalization, new policies may include a massive "redistribution" (*pereraspredelenie*) of the privatized economy, with key industrial sectors and the most profitable mega-companies reverting to state control or being taken away from the current owners and given to more "loyal" entrepreneurs.

1991 and 1996. More optimistic Russian analysts, however, have compared the attack on YUKOS to the hard-line putsch of August 19, 1991, which led to the collapse of the Communist Party and dissolution of the Soviet Union. Another parallel is the battle joined in 1996 by the chief of staff of Yeltsin's reelection campaign, Anatoly Chubais, and Yeltsin's daughter, Tatiana Diachenko, on the one hand, and the head of presidential security, Alexander Korzhakov, and the head of the Federal Security Service, Mikhail Barsukov, on the other. The latter opposed a presidential election, advocating the dissolution of the parliament and a deal with the Communists. Yeltsin sided with Chubais and Diachenko, however, fired Korzhakov and Barsukov, and Russia had the first free election of its chief executive.

In both 1991 and 1996, the plotters precipitated the very development they were trying to prevent. In the current scenario, the release of Lebedev and Khodorkovsky and the closing of the "investigations" ought to lead to the firing of the Kremlin aides responsible for the affair; the resignation of Procurator General Vladimir Ustinov; and the beginning of impeachment procedures by the Judicial Qualification Collegium (the Russian judges' elected self-policing body) against the judges of the Basmanniy District Court and the three-judge panel of the Moscow Municipal Court for violations of the criminal-procedural code.

More important still, the defeat of the "statists" is likely to lead to the swift passage of the last batch of key structural liberal reforms and the establishment of a statute of limitations on charges arising from the privatizations of the 1990s—a measure advocated by many Russian economists and politicians. If passed, such a law will put an end to bureaucratic blackmail, significantly thin out the endless stream of "protection money" paid by businessmen to government officials and law enforcement agencies, and reduce the practice of "buying" local and federal legislators.

Finally confident in their property rights, Russian entrepreneurs will be encouraged to spend less on bribing local and federal authorities and legislators, and more on investments in their enterprises and charitable projects.

New laws on lobbying, campaign finance, and deductions for charitable contributions will permit Russian business to advance their interests in Russian politics openly.

The Damage Already Done. Yet the longer Lebedev and Khodorkovsky are in jail, the more the traditional Russian ailments that had begun to recede are likely to surface again: the lack of responsibility for oneself, one's business, and one's country; the inability to make long-term work and personal plans; bribery and tax evasion.

Like innumerable generations of Russians before them, today's Russian entrepreneurs are again made to feel like guests in their own country at the sufferance of the powers-that-be. Leading businessmen are bound to resume, or to increase, investing money abroad, stashing it in Swiss banks—or buying foreign soccer clubs, like Sibneft's principal owner Roman Abramovich, who in August purchased London's Chelsea club for $94 million. Abramovich's decision in October to unload half of his stake in Russian Aluminum, the world's third largest aluminum producer, for $2 billion, coupled with his sell-off of Sibneft, could be a harbinger of things to come.

Since Lebedev's arrest, currency reserves in the Russian Central Bank have declined by $2.5 billion, as Russian exporters delayed repatriating their profits. In addition, preliminary figures indicate that, from July to September of this year, private-sector net capital outflow from Russia totaled $7.7 billion—in the absence of a diminution in the price of oil, a striking turnaround from the previous quarter's *inflow* of $3.7 billion. The impact of Khodorkovsky's arrest has been even more devastating. On the Monday after his detention, the Russian stock market plunged 10 percent, losing $14.5 billion in market value in seven hours.

Another Fateful Choice. No matter who wins, the outcome of the YUKOS affair will represent a major choice among the many Russia and the Russians must make today. This is a judgment about the nature and the extent of state control over the economy and about the role of big business and personal wealth in what is still a very poor and state-bound society.

The stakes perhaps are the highest where the evolution of individual rights, including the right to own property, are concerned. Throughout history, such rights have "trickled down" from barons protected from arbitrary arrests and confiscations by the crown, to towns and cities autonomous from the feudal lord, to universities and guilds free from outside interference, to individuals getting their day in court.

It may be politically incorrect to say so in this proud and victorious republic of ours steeped in democratic chauvinism, but the historical record is unambiguous: where the barons (including oil ones) are safe from state despotism, and where the rich can get a fair court hearing in their disputes with the government (or one another), there eventually will be impartial justice for the ordinary citizen seeking to protect his or her rights or property.

Where an arbitrary and patently subverted judicial process against some of the country's most successful, civic-minded, and progressive entrepreneurs is deployed with impunity, the rights of everyone are uncertain at best. On Russia's long and rocky road to dignity and prosperity, the YUKOS affair may signal a costly and frustrating detour.

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