

Oligarchs and Western Sanctions

THE DILEMMAS FACING RUSSIA'S ULTRA WEALTHY

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The effects of Western sanctions on Russia have been much debated since they were first imposed in 2014. But their impact on Russia's economic elites remains little studied. This should be remedied. From the start, sanctions have affected elites. But in 2018, major private owners of wealth and their businesses were directly targeted for the first time. The CAATSA-mandated "Kremlin report" included all 96 Russian business people with a net worth of over \$1 billion and severe personal sanctions targeted Oleg Deripaska and Viktor Vekselberg. After the Salisbury nerve agent attack, the UK also began to tighten scrutiny of foreign wealth and its owners in Britain and the Overseas Territories. Other countries are also beginning to look more critically at the presence of potentially illicit foreign wealth. These higher standards complement harsher sanctions.

It is time consider afresh how important the oligarchs are in this era of domestic unease and external sanctions. Three questions arise: How do sanctions affect oligarchs? What responses are available to them? What are the implications for Russia's development? Russian oligarchs face unprecedented difficulties. For the first time, they have been encountering adverse attitudes from state, society, and the West simultaneously.

Russia's Economic Elite

To understand sanctions' impacts and assess their implications, we should reappraise the role of Russia's major private wealth owners ("oligarchs" in the convenient, if imperfect, shorthand). A focus of intense interest in the 1990s, they have been relatively neglected in recent study of Russia as their political influence has waned. Analysis of potential political change now more commonly focuses on mass opinion, protest, and mobilization. Yet change in almost any system takes place—and, especially, begins—among elites rather than from below. As Henry Hale at George Washington University [reminds](#) us, this has

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been consistently true of regime change across post-Soviet space. Elsewhere, major private wealth nearly always has the incentives and resources to protect its interests, and is a key part of the constitution of power. If Russia is an exception – a place where privately-held wealth is *not* politically consequential – this is a significant finding for the comparative study of regimes that requires explanation.

In the long tradition of Russia's patrimonial state, title to asset ownership, and contract sanctity, are merely conditional, secured by political loyalty rather than the rule of law. As in the 1990s, under Putin, oligarch privilege remains dependent on the state, but now from a position of weakness, not strength. The state largely kept its side of the bargain: with oligarchs as with officials, Putin rewarded loyalty with stability.² Oligarchs, in turn, invested, expanded their operations, and grew much richer. Just as they were losing influence, a new commodities super-cycle began to drive up oil and metals prices. Paradoxically, they became financially wealthier but politically weaker. The state, and state companies, resurged under Putin. "Silovarchs" [flourished](#) as security service personnel were recruited across institutions. The proportion of economic activity produced by nominally private businesses declined. But oligarchs themselves rarely lost out directly. They grew in number and diversity as other sectors beyond raw materials and banking, such as agro-industries and IT, developed.

Oligarchs were weak in relation to society as well as the state. In particular, a sizeable section of public opinion never came to terms with the loans-for-shares scheme. Under Putin, oligarchs lost ownership of the mass media, and thus the means of influencing popular attitudes. Weak with respect to state and society alike, oligarchic fortunes were relatively non-fungible, buying neither political nor social legitimacy.

Oligarchs responded to the adverse shift in their domestic position under Putin by transforming their relationship with the West. In the 1990s, they had traded with and borrowed from the West, but made little effort to cultivate deeper ties. Some, indeed, were vilified by Western investors for their behavior during the 1998 financial crisis. But in the following decade, oligarchs invested heavily to gain the influence and legitimacy in the West that they lacked at home. Four interwoven strands developed in the relationship of Russian private wealth to the West:

- 1) *Revenue*. Oligarchs sold output, mostly commodities, onto global markets, expanding 1990s practices on a larger scale and at higher prices.

² Fewer billionaires have lost this status than in many other countries. Most of those who have done so since the early 2000s appear to have suffered from the global financial crash rather than state pressure. For more, see: Daniel Treisman, "[Putin's Billionaires](#)," *American Economic Review*, 106 (5), 2016.

- 2) *Investment.* Oligarchs sought international financing for business expansion. Unlike the 1990s, this increasingly meant offering equity, not just taking out loans. A growing wave of companies were floated on the London Stock Exchange.
- 3) *Consumption.* Oligarchs increasingly spent their fortunes on foreign travel, homes, goods and services, and education for their children. Some became resident abroad. They discovered new tastes and [sought](#) to legitimize themselves in their own eyes and in those of Western interlocutors.
- 4) *Protection.* The most significant development: oligarchs sought access to Western financial and legal systems to secure their wealth and safety. This took many forms:
 - Sending a large share of revenues to offshore accounts.
 - Making large property purchases.
 - Acquiring EU citizenship or permanent residency.
 - Retaining top Western PR companies.
 - Using English libel law against critics.
 - Concluding deals (even among themselves) under English law and resolving legal disputes in London courts.

As a last resort, it meant seeking asylum in the West. Oligarchs sought to compensate for their domestic weakness by outsourcing material, and even personal, security to the West. To some degree, oligarch wealth was more convertible into influence, more fungible, in the West than in Russia.

The result was a new set of relations between the Russian state, its elites, and the West from which all parties gained. Elites outsourced to the West some of the security no longer available in Russia, at least partly compensating for their now-subordinate position at home. This access to Western systems made the new status quo in Russia more tolerable to private wealth, thereby stabilizing Russia's authoritarian political economy. The Russian state in turn could tolerate and [even support](#) elite activity abroad, while monitoring it carefully. The state's approval was needed for any major initiative, such as selling a company stake to foreign investors (Khodorkovsky's failure to seek this for Yukos was one cause of his undoing). And for Russian businesses, cultivating influence abroad while remaining answerable at home, could be helpful to the Russian state seeking to use its deepening relationship with the global economy as an instrument of foreign policy.

Western interests, too, benefited from the inflow of Russian money. This was especially true of the financial, legal, property, and public relations sectors that serviced oligarch needs. Domestically influential, especially in the UK and its Overseas Territories, these

sectors lobbied for “light-touch regulation” before the 2008 crash era, and have since resisted efforts to tighten scrutiny and compliance standards.

There were three tensions in these arrangements. First, the two parts of oligarchic arbitrage—making money in Russia’s rule-of-power system and protecting it in the West’s rule-of-law system—required very different practices. Despite their successful engagement in the West, oligarchs never quite shook off “McMafia” suspicions. Second, debates took place within the West between providers of profitable “oligarch valet services” and security officials concerned about Russian influence. Third, after his return to the presidency in 2012, Putin began to see Russia’s engagement with the global economy as a source of risk as well as opportunity. But his calls for oligarchs to “de-offshore” their assets to Russia were ignored. This showed both that keeping wealth overseas was a core oligarch interest, worth defying the Kremlin to maintain, and that there were limits to the state’s power over oligarchs.

Overall, these frictions were contained by the mutually-profitable alignments of Russian state-oligarch-Western sectoral interests until the 2014 crisis. Russia’s wealthiest private businessmen became more dependent on the West even as Russia’s relationship with the West deteriorated.

Sanctions and Oligarchs

Sanctions disrupt these alignments by limiting oligarch access to Western systems in three ways:

- 1) *Revenue.* Some oligarchs have become even wealthier as a weaker ruble has lowered dollar costs of primary production. Agriculture has benefited from Russia’s food import sanctions. But for others, slower growth has hit domestic earnings. More striking, the United States has demonstrated its ability to target individual oligarchs, and, in the case of Oleg Deripaska, to cut off a target substantially from the global financial system (although he personally remains sanctioned, the U.S. Treasury lifted sanctions on companies he formerly controlled in January 2019).
- 2) *Investment.* Tighter regulation and scrutiny are restricting Russian investment. Some companies have delisted from the London Stock Exchange. Delay in the renewal of Roman Abramovich’s UK visa led him to take out Israeli citizenship. Petr Aven and Mikhail Fridman’s LetterOne Group was forced to sell its recently-acquired North Sea assets.
- 3) *Protection.* Western countries are tightening regulation of oligarch activity. Variants of the U.S. Magnitsky Act have been passed, or are being considered, in several EU countries (for example, recently [in Romania](#)). Investigation of the

Danske Bank scandal exemplifies the new climate of concern. These measures have so far been modest: oligarchs continue to reside, buy and invest, educate their children, and resolve legal disputes in the West. However, it is becoming harder for them to do so.³ No less important, the new climate of critical scrutiny is undoing two decades of oligarch investment in reputation. The prospect of further, more stringent measures creates more uncertainty.

Oligarchs face a more uncertain position in Russia too. Putin has stepped up calls to repatriate capital. The state's role in the economy has grown still further since 2014 because of defensive measures taken against sanctions. Oligarchs have publicly criticized proposals by the Presidential Administration to raise taxes on commodity profits. The struggle for assets in a stagnant economy is intensifying. High-profile cases instigated by "silovarchs" have alarmed oligarchs and economic reformers alike.⁴

In sum, Russian oligarchs face unparalleled difficulties due to adverse attitudes from state, society, and the West simultaneously. As the West comes to see Russian business through the prism of security rather than globalization, it is restricting access and tightening standards. As the Russian state comes under pressure from the West, it is behaving in less predictable ways at home.

Oligarch Choices and Dilemmas

Oligarchs have innovated boldly in their strategies before – within Russia in the 1990s, and abroad the following decade. They are proven risk-takers. How might they respond to these new and adverse circumstances?

- *Exit.* Oligarchs could choose the West over Russia by emigrating. Few oligarchs in [any country](#) do this. It incurs the great personal cost of cutting most ties with native business and culture. Nor does it guarantee safety: a displeased Kremlin will still have means of monitoring and possibly punishing. With rare exceptions, exit will be chosen only by those for whom staying in Russia has become intolerably risky.
- *Loyalty.* They could choose Russia over the West by returning. This is also risky and unlikely. It would mean giving up most of the protection available in the West, making oligarchs and their wealth even more vulnerable to an increasingly unpredictable state. There is little sign of oligarchs heeding Putin's call to repatriate capital, or themselves.⁵

³ Russian property purchases in London have fallen sharply.

⁴ Notably the cases of Vladimir Yevtushenkov (Sistema), Alexei Ulyukaev (former economic minister), and Ziyavudin Magomdeov (Summa Group).

⁵ As an example, Putin sent his representative, Boris Titov, to the West in order to persuade exiles to return to Russia. The first one to do so had a criminal case against him reopened soon after his return.

- *Voice*. Oligarchs could influence Russian policy. The Russian Union of Industrialists and Entrepreneurs has actively lobbied for protection and compensation against sanctions effects. The government's July 2018 package of anti-sanctions policies reflects some of its proposals. But this is an uncertain course. With oligarchs lacking national popularity, it is not clear how much help they can expect. A draft law to compensate Russian citizens for property lost to sanctions, the so-called "Rotenberg law," was withdrawn after public criticism.

Could oligarchs go further, and seek greater influence over policy or even governance? It is generally assumed (though not argued in detail) that Russia's oligarchs are far too weak to consider this. But their taming after 2000 was unexpected. Is this forever, or could it be reversed, in whole or part, and if so under what conditions? Russia's development has been highly unpredictable. Few countries have shown such variation in governance since the mid-1980s. The looming shadow of the "2024 question" suggests this is well understood in Russia. Across the former Soviet Union, apparently strong regimes have suddenly proven weak when elite networks cease to rally around them, especially in periods of uncertainty induced by elections (even imperfect ones) and succession. Will Russia follow or defy this regional pattern?

If the domestic and international circumstances facing oligarchs continue to deteriorate, their incentives to seek change will grow. It would be surprising if some were not at least thinking about this now. Less clear is whether they would have the opportunity and resources to do so even if they wished to. There are three reasons why it might be especially hard for oligarchs to bring about major change even if the regime's mishandling of the "2024 question" creates conditions for this.

First, other, stronger networks may play a bigger role in shaping the future. In particular, the "silovarchs" may possess preponderant coercive and economic resources to dominate or resist change. Second, oligarchs may be too divided to overcome the collective action problem of coordinating risky action. When they were strong in the late 1990s they engaged in a fiercely rivalrous "bankers' war." They may find it even harder to concert their efforts in more difficult conditions.

Third, oligarchs' lack of popular support hinders their ability to mobilize support from below, as elites typically do when seeking major change. The Communist Party, which performed well in recent gubernatorial elections, is no ally of oligarchs. Alexei Navalny recently excoriated Anatoly Chubais for complaining that Russians were "ungrateful" to oligarchs.⁶ Oligarchs may conclude that, since some alternatives to Putin are less attractive, it may be safer to muddle through with the devil they know.

⁶ @navalny tweet: December 8, 2018: "Vile, ungrateful, infantile Russians. They do not want to thank the oligarchs. And even Chubais himself doesn't want to say thanks..." ("*Мерзкие, неблагодарные, инфантильные россияне. Не хотят благодарить олигархов. И даже самому Чубайсу спасибо не хотят сказать...*").

Conclusions

Oligarch access to Western systems has played a key role in stabilizing the political economy that Putin built in Russia. Sanctions on oligarchs and their companies, and higher standards of regulatory scrutiny, challenge these arrangements. If, as widely expected, such measures escalate, their effects could disrupt the alignments that have sustained an increasingly assertive Russia.

Russia's economic elite faces an unprecedentedly discomfiting set of domestic and international pressures. It is now more incentivized than at any previous point in the Putin presidency to consider how it can influence the country's course. Its interests, calculations, and resources merit close attention. This has important implications for Western policy. Change begins from within, not below. The effects of sanctions will depend on elite choices and capacities. Oligarchs may seek domestic change to protect their interests. They face major obstacles in doing so. Nevertheless, it is rare for the largest holders of private wealth to play no significant role in their country's governance, or for their interests to be systematically overridden. How sanctions impact Russia may hold wider lessons for policy toward other authoritarian countries, notably China, whose elites benefit from access to the West.

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