



**“We will make Russia the kind of country that is seen in the eyes of the world as a normal, civilised, stable and reliable”**

**In a rare inside glimpse at the inner workings of the Kremlin, Jonti Small, Managing Editor, Russian Investment Review met with Igor Shuvalov, Aide to President Putin, on a recent visit to London. Shuvalov's responsibilities include providing support to the President in the development of domestic policy and supervising the Presidential Expert Directorate and the Presidential Commission on Federal Relations and Local Self-Administration. He is also in charge of the Protocol Department. In addition to his other functions, in July 2004, he was appointed to a Special Reform Commission tasked with overhauling the government structure to make it more efficient.**

"I am meeting people here in London who are making multi-billion investments in Russia. For them, the Yukos affair is not at all important."

Igor Shuvalov is in full flow. As we sit, overlooking Green Park, his ice-blue eyes lock in: "Do not tie Yukos and the investment climate in Russia into one bundle. People who are willing and ready to invest in Russia see the situation differently."

This is one of Shuvalov's few visits to London since becoming a member of the Kremlin inner-circle. He is considerably less well known in the West than many of Putin's ministers or other notable presidential aides. Shuvalov, however, is reputed to be highly influential; he is one of Putin's speech-writers and is one of the three key strategists appointed to monitor the formulation and enforcement of policy, especially economic policy and is considered to be a 'rising star'.

Kremlinology has out lived the Soviet Union: the business of guessing what really goes on behind the fortress walls and predicting whose star is waxing remains a fool's game, but after an hour with Shuvalov, there is little doubt that we should hope that he is indeed highly influential.

The impression of the Kremlin that Shuvalov provides is that of a world of "active consultations" and "vigorous internal debates". And while his answers are littered with references to "great dangers" faced by Russia, suggesting perhaps that he is not immune to a siege mentality, he is, undoubtedly, the urbane acceptable face of Putin's Kremlin: the very model of reasonableness and a man who talks the talk of the investment community in the

West. He understands their concerns and anticipates their criticisms. He knows the problems of modern Russia, and how they are misconceived in the West.

Though he does not need his translator to understand questions put to him in English, Shuvalov gives his answers through her ("to be more precise", he explains). That said, he has a habit of continually overrunning her translations, his answers being hurried, yet measured; thoughtful but urgent. At one point – in his urgency – he breaks into English.

Just before Shuvalov left Moscow, Putin had given his public blessing to the planned merger of Gazprom and Rosneft. Shuvalov keeps to the party line. The world's largest gas producer will become a "company which can compete with the majors on the world market" and so on. Does that mean that Gazprom's interests are in oil and gas, and not electricity?

"Oil and gas," confirms the translator.

But Gazprom would like to acquire some power assets?

"That is right" Shuvalov says, breaking into English, "but that is none of their business."

#### **Battlefield Gazprom**

"Gas and oil," Shuvalov asserts again, returning to Russian and the buffer provided by translation. "We would like Gazprom to form strategic alliances with the majors and to prove that we are a much more stable and reliable partner for hydrocarbon supplies than Middle Eastern countries. We would like to be the preferential – most reliable – partner for the US, Europe and Asia."

At the moment, the Gazprom board does not appear to be the most reliable partner of the Russian government. Board meetings are characterised by Shuvalov as "a battlefield where there are huge fights between those who support the government and those who support the management." In such a situation, the question must arise whether Alexei Miller, Gazprom's CEO, is strong enough to control the situation. "He is usually the source of all the battles, proposing something that we don't agree with. Finally through the battles we come to some kind of compromise – but sometimes he wins." Share liberalisation should play a part in improving the situation and also in improving corporate governance. "We hope that a number of investors will force Gazprom to move towards better corporate governance. The share-capital structure will be quite diverse and I envisage that there can be other foreign representatives on the board [Burckhard Bergmann of Ruhrgas already serves] – possibly including independent directors."

"Can he articulate the role of the state in the economy?" I ask, because, although the Gazprom announcement was greeted with near-euphoria by the investment community, there seems to be a real feeling of drift in the second term. One influential economist in a Moscow-based investment bank goes so far as to say that currently the government does not have an economic policy to speak of. Shuvalov doesn't falter.

"That's easy. We are finalising our tax reform; we lower taxes as much as we can. 24% corporate tax; the regions have the discretion to lower it to 20%. VAT is 18% - next year it will be dropped to 16%, if all →

goes well. The personal flat-rate tax is 13% - which is perhaps not liberal politically, but is very liberal economically. The way that the tax authorities work is very cumbersome. What we need to do is supply these very low rates with a very simple system of paying and administering them."

#### Khodorkovsky's problems

The inevitable question about Yukos is anticipated by Shuvalov. "We would like to see people's earnings legalising themselves. We did everything possible for business to come out, to become legal and for money to turn over legally."

Was the question of legality, then, really the driving force behind the Yukos affair? Does Shuvalov recognise that one of the consequences of the Yukos affair has been a growing perception in the West of increasing state control? "We don't want Yukos assets to somehow come under government control. Moreover, we see a great danger in that." In a matter of fact way he adds, "clearly, any tax payments that they owe us we will see out and they will pay - they have to pay, because for us, it is only the beginning of the road that we have to walk and other oil companies will have to pay as well. It just happened that Yukos was the first. We have to force major taxpayers to pay all their taxes until the end of Putin's term of office."

"When Khodorkovsky was arrested, it was clear that we would have problems with the stock market. We wanted a different story and wanted say to the world, Khodorkovsky is having problems, personal problems, but Yukos is developing and doing very well. That wasn't in the interests of Khodorkovsky and he was playing a very different game."

#### The personal is political

As a reliable partner - at least as a supplier of oil - Russia's credentials were damaged this summer as uncertainty surrounding Yukos contributed to pushing oil prices increasingly high. While the Yukos situation is widely believed in the West to be politically motivated, Shuvalov brushes aside the idea: "Of course there is a political aspect there, but it is to do with Khodorkovsky personally and can really be set aside. I have no idea how his personal destiny will develop. If you remember how it all started, it began

with Yukos experiencing difficulties, not Khodorkovsky. Then eventually it all led to him personally, but it did not begin with him. Investors understand that."

The Administration also wants investors to understand that the Yukos management has exacerbated the situation. "If only they had wanted to sort out the situation a few months ago, then it would have been resolved once and for all ... in a few years time they will say, they were forced to do this by the government."

**"And I know Khodorkovsky personally. I am on good terms with him. Personally I quite like him, so I can talk about it ad nauseam ..."**

They were first served with the notice to pay tax arrears to the tune of \$1.5b, but even for them \$10b would not ruin the company. From the figures that we read in the press, they have over \$5b cash in subsidiary accounts abroad. They are not doing anything to bring this situation to a peaceful conclusion."

As an easy, peaceful conclusion has always seemed unlikely, how exactly could the Yukos situation have been resolved? The surprising answer is with the aid of one Roman Abramovich. "Last autumn, I saw how the situation could be sorted out. It was absolutely clear that Khodorkovsky and his people could not influence the situation; nobody could talk to them at that time. Then we said 'OK. We will sort it out so that Abramovich and Shvidler will manage the company. They will sort it out and Khodorkovsky will remain one of the shareholders.' Khodorkovsky initially agreed and then said, 'No, I won't do it. It is all a plot for Abramovich to take my company away from me.'"

#### In the blood

Reform is not progressing as fast as Shuvalov personally wants. He identifies "huge resistance. We keep telling the people that this will bring you to the bright and glorious future - today is already better than yesterday. And they don't believe us! They say: 'It was much better in the Soviet Union. We were all poor - and now look at him: he has got Chelsea and I have nothing!'"

I cannot help thinking, is it any surprise that "the people" long for the Soviet Union when today's politicians still promise a "bright and glorious future"?

The reform process may not be moving fast enough, but it is moving on. "We need a completely different system of public healthcare. We need to introduce a different education system. We have implemented a huge affordable housing programme. There is also the reform of the military. And they are painful processes." It is a "difficult situation for us... there are some grounds on which to criticise the government. We don't count on total support for everything."

Bureaucracy is a force of resistance which he recognises - not only are there too many bureaucrats, many working inefficiently, but they also fail to understand that they are there to provide a service. Shuvalov, the dynamic reformer, is clearly frustrated by his fellow Russians and is willing to make a huge generalisation: "Russians lack whatever it is in the blood that makes you understand this concept of service! They think that they are bosses in life and that they rule and everyone else exists for them!"

A transformation of the state, society and mentality is in train. Shuvalov sees changing the mentality as "part of the economic agenda because this very cumbersome bureaucracy affects investment decisions." The economic agenda also includes completing the privatisation process by 2009. While 60% of the economy is now in private hands "there are still huge numbers of state assets that need to be privatised. Some companies we probably will not touch: they will remain in state hands." These companies are strategically important - or are part of others, such as the railways, where "anything that develops and grows alongside the rail will be privatised; the track and everything to do with making trains move

will remain with the state.”

Shuvalov even dangles the possibility that there may come a time for further privatisation of Gazprom. Most likely, for many years to come, the controlling share will be in the hands of the government, but all limitations on operations with Gazprom’s shares will be abolished and the ring-fence which limits foreign ownership will be removed “very quickly indeed ... it will take a year or two to sort out the question of ownership, but if the government has 50% plus one there is no concern as to who owns the rest.”

The important “task” for Russia is to turn this company into an asset for the country and to transform the country as part of that process. “We don’t really need Gazprom purely as a business – we want Gazprom to be an arm of the government, a huge corporation that, with other corporations and other states establishes the basic principles of this industry.”

Once Russia is that country – once Russia is a reliable partner with the west – the time for privatisation may come: “This is how long we need our controlling share in Gazprom for. Until then, we will keep it. Perhaps then we would drop our share to a quarter.”

This issue raises the interesting question of how influential Shuvalov is. He plots this scenario: “We can adopt a special law and I am advising the President to this extent. This law should envisage how Gazprom will develop in time – the tasks we see Gazprom facing and how Gazprom privatisation would take place.” We will have to wait to see whether this hypothesis is in fact realised and to what extent Shuvalov pulls the strings over such fundamental long term policies, and whether he can have a short term impact as well.

### A reliable partner?

Those who are quick to claim that Russia is descending into authoritarianism also assert frequently that the Kremlin looks enviously to China, with its mix of political authoritarianism, staggering growth and a level of foreign investment that dwarfs FDI figures for Russia. If Russia is going to achieve the coveted reputation as a “reliable partner”, in Shuvalov’s vision, it will do so through economic and democratic reform. “If we join the WTO, if we develop our dialogue with the EU, and if democratic processes are underway – in a few years we will make Russia a country that is seen in the eyes of the world as normal, civilised, stable and reliable.”

On the broader question of domestic politics, Shuvalov seems to recognise the need for “national parties”. He also realises that United Russia needs a rival, and, what is more, it needs to resemble more of a functioning political party, rather than a combination of people who came together to support Putin. The way he articulates what United Russia could or should become may offer reassurance to those who fear that Russia is slipping further away from their definition of democracy: “We would very much like to see United Russia give rise to a party that has moderately right wing views – in our meaning of right wing.”

Shuvalov’s explanations frequently come with such caveats. Quite correctly, he reserves the right to Russia’s distinctiveness; and perhaps is it unwise to unpick his translated answers too forensically, but his elaboration of what United Russia should stand for is worth reporting: “For traditional, moderately right-wing values ... family values, [and] for low taxes, private initiative, state support only to those

people who cannot look after themselves. We would like United Russia to give rise to a party that supports fundamental capitalist values – private property, the right of every family to live decently, the right of privacy – and that would cover the majority of the electorate.”

Just as interesting is Shuvalov’s explanation of what United Russia is not: it is not “trying to fill the niche of liberal values – the freedom of the press, etc – as the Union Right Forces or Yabloko were.” When Western admirers bracket Shuvalov with liberals it should be remembered that the he considers liberal values as a “niche”.

### A traditional defence

Nevertheless, during the interview, it is Shuvalov who supplies a spirited account of the need for an independent media: “Whatever happens, I support the idea that the press should be free.” He describes how on the state-controlled television channels “it is quite discernable that they present everything in a light that is favourable to the authorities” and that “sometimes it is sufficient to just hint to an editor and he will do twice as much as you wished.”

It is “dangerous” not to have an independent source of information, yet he adds that it would “be quite bizarre if the state-owned channels criticised the government.” Readily he agrees that this is exactly what happens in the UK, but in Russia’s defence explains that “the tradition here is entirely different”.

Tradition – or rather a lack of a democratic tradition – is invoked again to explain the relationship between the authorities and the people. His is a candid account: “If President Putin were to stand up and offer a very different programme, ➔





"The second term of the president will try to change public perceptions, which as you know, is very difficult."

[the public] would still vote for him." To change this is "very complicated ...there is no democratic tradition in Russia."

**Challenges ahead**

Building a democratic tradition and an independent media ("we need it but how it will appear is difficult to answer") are complex issues. Establishing a "reliable Russia" may prove the most complicated question of all.

United Russia is a void that must be filled. Crunch time will be the 2007 Duma elections, by which time Shuvalov promises that the party will have a "well-thought-out ideological platform." Whether, and in what form, such a platform will exist will be one useful measure of the current influence that Shuvalov wields in the Presidential Administration. (If he is then prime minister, as has been suggested, we may

know even more.) Shuvalov claims that the interests of United Russia's platform would "cover the majority of the electorate". But he knows that getting there will be difficult: "We have to be frank. The majority of the population does not support everything that the government and the authorities do. The second term of the president will try to change public perceptions, which as you know, is very difficult." And then, astoundingly, "So we will say what they want to hear and we will do exactly different things."

Does hope for Russia rest then with this Janus-faced 'liberal' adviser – a liberal by Western standards, yet one who describes liberal values as a "niche"? The adviser who admits, albeit to the Western media, that they will tell the population one thing while doing the exact opposite? Listening to Shuvalov, it is not the possible contra-

dictions in his answers that are striking, but how coherent and honest he is in describing the contradictions that face policy makers in Russia today, and the struggle they have in explaining Russia to the world. He identifies, for example, the contradiction of having "to tell the majority of the people that President Putin represents strong, central authority – which is what the majority of people want" while at the same time wanting to "bring multi-party democracy to the country".

As the chaperon is eager to move him on – on to meet those investing billions in Russia – Shuvalov is still in full-flow. "And I know Khodorkovsky personally. I am on good terms with him. Personally I quite like him, so I can talk about it ad nauseam ..." And I actually do want him to go on ad infinitum, I want him to expand more on the United Russia political project and to try and unpick some of the honest contradictions, which he is evidently alert to. And I want to know, who is the "we" exactly which he speaks for. Shuvalov presents a face of Putin's Russia that will be more acceptable to the western political and business establishment than other factions within the Kremlin. His is a 'reassuring' vision of the country's future, but that brings us no closer to answering which group truly holds sway in the Administration. When he says "we", who is he referring to? We may never know the answer, since other factions are less likely to make publicity-friendly tours to the UK.

As we move to pose for photographs he moves into English once more, refusing to let his point drop: "So that is not that easy concerning Yukos. So for them – we understand that they had their problems..." **rir**

