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EXECUTIVE SUMMARY

- When the Kremlin decided to attack Ukraine, it put its geopolitical objectives above the economic interests of Russia and Russian business. That decision engendered major financial consequences for the Russian Federation. President Putin's image as a skilful strategist was undermined in the aftermath when – contrary to expectations – the sanctions turned out to be a lasting problem. Their gradual tightening marked a failure of the president's policy. Therefore, restoring business as usual between Russia and the West, which was the Kremlin's priority, is far from coming true.

- The personal sanctions imposed after 2014 by the United States and the European Union targeted people in Vladimir Putin's inner circle, among others. They have directly affected the wealth of the Russian ruling elite, including the president himself. However, since Europe, where most of the Russian investments were located, adopted a much less strict sanctions policy than the United States, Russian oligarchs have managed to effectively mitigate the negative impacts of the sanctions. Still, in the initial period after the sanctions were imposed, members of the Russian business elite suffered major financial losses. They were also forced to scale down or close their business operations abroad, and were no longer free to travel internationally. For some of them, the restrictions meant an involuntary change of lifestyle, as they could no longer enjoy a life of luxury outside Russia and had to restrict their contacts with the international elite. The sanctions thus became a test of the Russian elite's loyalty to Vladimir Putin.

- The Kremlin made its first efforts to at least partly compensate a select group of businessmen for the losses suffered as a result of the sanctions as early as March 2014. The Russian state apparatus pursued a co-ordinated policy of supporting the oligarchs in the president's inner circle at the expense of the general public. The state's aid became particularly important as the sanctions continued for longer than originally expected. The financial operations undertaken by oligarchs from the president's inner circle in order to counter the sanctions, combined with assistance provided by the Russian state, which fostered the rapid growth of their businesses in Russia, helped the oligarchs to quickly make up for the losses. Within the last four years, the value of the assets owned by several of the president's insiders has almost returned to pre-sanctions levels. However, most of those assets now are under Russian jurisdiction, making the oligarchs even more dependent on the Kremlin.

- The sanctions have limited Russian business's opportunities to expand internationally, while the prospects for the Russian economy's growth in the coming years are not particularly optimistic. This is fuelling an intensifying rivalry over the remaining attractive business assets in Russia, while the group of potential beneficiaries who stand to profit from close relations with the Kremlin has been shrinking.

INTRODUCTION

Since March 2014, the Russian economy has been functioning under the impact of the sanctions imposed on Russia by the United States, the European Union and a number of other Western states in reaction to Moscow's aggression towards Ukraine and its annexation of Crimea. The sanctions have created many restrictions on economic co-operation between the Russian Federation and Western states. The diplomatic sanctions have been the least painful economically, although they have hit Russia's international prestige, with the exclusion of Moscow from the G8 grouping of the world's most influential states, the suspension of its accession negotiations with the Organisation for Economic Co-operation and Development, and the decision by Western leaders to refrain from official contacts with the Russian leadership during the initial period. The sanctions have also barred Russia's access to international finance; for example, the World Bank and all its agencies have suspended the financing of new projects in Russia, and the European Bank for Reconstruction and Development has taken a similar decision.

The Russian economy has also faced sectorial sanctions, such as limits on access to capital markets for the largest state-owned banks in Russia and several state-owned oil and defence companies. The ban also covered exports of arms and dual-purpose materials to Russia, as well as selected technologies and services in the oil extraction sector.

Moreover, personal sanctions have been imposed on selected officials, managers of state-owned companies, journalists, and private entrepreneurs from President Vladimir Putin's inner circle. The ensuing restrictions have also affected companies with links to persons and companies involved in economic relations with Crimea.[1]

[1] The United States, Canada, the European Union and Norway imposed their sanctions on Russia in several stages, starting on 20 March 2014. They have since been joined by Australia, New Zealand, Japan, Switzerland, Iceland, Albania, Macedonia and Liechtenstein among others. For more on the sanctions

The scope of sanctions imposed on Russia by the different Western states varies widely. The United States has imposed the most extensive restrictions on Russian entities. Moreover, the US sanctions have been enshrined in a congressional bill (CAATSA No 3364),[2] which means that lifting them will be a long and complex process. Moreover, the bill obligates the US president to further expand the sanctions on Russia. In the case of the European Union, the member states decide every six months to extend the current sanctions against Russia for another period.

Analysis of the Kremlin's reactions and the state aid offered to selected entrepreneurs in Vladimir Putin's inner circle indicates that while the Russian leadership has consistently played down the impact of the Western sanctions on the Russian economy, the sanctions have proven painful for the Kremlin, and have led to rising tensions within the Russian elite.

*

The present paper aims to show how the personal sanctions have affected entrepreneurs regarded as members of the Kremlin elite and the providers of its economic base, specifically Gennady Timchenko, the brothers Arkady and Boris Rotenberg, and Yuri Kovalchuk.

The first part discusses the nature of the Kremlin elite and the position of selected businessmen within it, as well as the sanctions imposed on them and the impact on their assets. Part II looks into

imposed by the United States, see the US Department of State, 2018, https://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx; For more on the sanctions imposed by the EU, see the European Council, 2018, http://www.consilium.europa.eu/en/policies/sanctions/ukraine-crisis/

2 See the US Congress, https://www.congress.gov/bill/115th-congress/house-bill/3364/text; For more information, see I. Wiśniewska, S. Kardaś, 'Ustawa o amerykańskich sankcjach przeciwko Rosji', *Analizy OSW*, 4 August 2017, https://www.osw.waw.pl/pl/publikacje/analizy/2017-08-04/ustawa-o-amerykanskich-sankcjach-przeciwko-rosji

the mechanisms the oligarchs have exploited to evade the sanctions. Part III discusses the elaborate system of assistance offered by the Russian state to selected entrepreneurs, including awards of public contracts and tax breaks in Russia. Finally, part IV presents the consequences of the sanctions and reactions to them for the Russian economy and its economic governance model, as well as the relations within the Kremlin elite.

I. WESTERN SANCTIONS – A BLOW TO PRESIDENT PUTIN’S FRIENDS

1. The new private oligarchs in Russia

Since the beginning of Vladimir Putin’s rule in Russia, the state’s role in the economy has been expanding. The nationalisation of assets has progressed in parallel to consolidation, leading to the emergence of large-state owned corporations. Economic governance has become increasingly centralised, as a result of which competition has dwindled and corruption has been on the rise. According to estimates by the Federal Anti-Monopoly service of the Russian Federation, the state accounted for around 70% of the GDP in 2015, compared to only 35% of GDP a decade before.[3]

The process of nationalisation has been accompanied by measures to strengthen the Kremlin’s control over private business. The Yukos case was a turning point for the efficacy of that process,[4] as it was the moment where the Kremlin displayed the tools and mechanisms through which it would control the private sector, such as the full pliancy of state institutions. The end of Putin’s first term and the beginning of the second in particular marked a period when many private entrepreneurs lost their businesses and moved abroad. In the aftermath, big business in Russia became fully subordinated to the Kremlin. The Russian leadership also imposed new conditions for its co-operation with business: businessmen are banned from ‘meddling’ with political affairs and have to share their profits as part of their ‘corporate social responsibility’, for instance by supporting the implementation of

[3] See the Federal Anti-Monopoly Service of the Russian Federation, 2016, *Доклад о состоянии конкуренции в Российской Федерации за 2016 год,* https://fas.gov.ru/documents/596439

[4] For more information, see W. Konończuk, ‘The “Yukos Affair”, its Motives and Implications’, *OSW Studies*, 15 July 2006, https://www.osw.waw.pl/en/publikacje/2006-08-15/yukos-affair-its-motives-and-implications

important social programmes or infrastructural projects (such as the Olympic facilities for the 2014 Games in Sochi).

However, against the backdrop of those general trends, a small group of new private oligarchs has emerged in Russia, whose wealth has grown dynamically under Vladimir Putin's rule. In particular, this group includes four men with whom Putin built close relations back in St. Petersburg: Gennady Timchenko, Arkady and Boris Rotenberg, and Yuri Kovalchuk[5] (see Figure 1 ona page 15 for more information).

Yuri Kovalchuk is the man who created an elite summer house co-operative on Lake Komsomolskoye in the 1990s, together with Putin and a group of friends from St. Petersburg (which also included Nikolai Shamalov). The president's friendship with the Rotenberg brothers dates back to his teenage years when the three men practiced martial arts together in what was then Leningrad. And Gennady Timchenko, who first started dealing in oil exports in the 1980s in Leningrad, has co-operated with Vladimir Putin since the early 1990s, when the current president headed the International Co-operation Department of the city hall of Leningrad (subsequently renamed St. Petersburg).

President Putin reaffirmed his close acquaintance, and even friendly relations with Timchenko, Kovalchuk and the Rotenbergs during his 2014 televised conference with the public, when he was asked about the Western sanctions. He said: "Yes, these are my good acquaintances and friends [...]. I'm not ashamed of my friends."[6]

5 Two years ago, Kirill Shamalov joined this group. He is the son of Nikolai Shamalov, also considered to be a member of the president's closest circle of friends during this St. Petersburg time, and probably a former son-in-law of the president. In 2017, Kirill Shamalov made the Forbes rankings, for a second time, with assets worth US$1.3 billion, ranking 74th.

6 The president's televised conferences with the public are propaganda exercises carefully staged by the Kremlin. The question about sanctions imposed on businesspeople, asked in April 2014, was not accidental either. The way it

These businessmen have built their current wealth by doing business in sectors of strategic importance for the Kremlin, including energy, banking, the media and providing services to state-owned companies. Oil trade is the area where Timchenko, the wealthiest among them, has been the most successful (in 2018, according to Forbes, his assets were worth an estimated US$16.8 billion). His company Gunvor accounted for as much as 40% of Russia's oil trade in the 2000s.[7] Stroytransgaz, a construction company controlled by Timchenko became, alongside the Rotenberg brothers' Stroygazmontazh, one of the main contractors for the multi-billion infrastructure projects implemented by state-owned concerns including Gazprom and Rosneft. The Rotenberg brothers, like Kovalchuk, have also been very successful in banking. Their banks, SMP Bank and Bank Rossiya, are currently among the top thirty banks in Russia. Kovalchuk has furthermore managed to create one of the largest private media companies in Russia, in a market dominated by state-owned players.

The men have invested some of their proceeds from their Russian operations abroad. This has been a way to reduce costs, diversify businesses and boost their financial security by removing some of their capital from the jurisdiction of Russia, where property rights are not respected. However, there is very limited information available on the volume of capital expatriated from Russia by specific entrepreneurs. Many such operations were carried out via tax havens, and the real owners may be hiding behind

was phrased was very telling: "The sanctions [...] affected representatives of big business, such as Yuri Kovalchuk or Gennady Timchenko and the Rotenberg brothers; many of them are associated with yourself [Putin], are reportedly part of your inner circle and owe their wealth to their acquaintance with yourself. Now it turns out that they also owe the sanctions [...] to their acquaintance with you [...]. Don't you feel that you are the main target of the sanctions?". See the official Kremlin website: *Прямая линия с Владимиром Путиным*, 17 April 2014, http://kremlin.ru/events/president/news/20796

7 Timchenko has been a Swiss tax resident since 2002. In the period 1999–2001 he paid his taxes in Finland; according to the Finnish tax service his revenues rose ten-fold within those three years, to €4.9 billion (in declared taxable income) in 2002.

intermediaries.[8] The scale of the phenomenon was revealed by a journalistic investigation which looked into confidential documents of the financial operations (some of them illegal) carried out by public personalities from many countries, including Russia, leaked by the law firms handling those transactions (known as the Panama Papers[9] or Paradise Papers).

The entrepreneurs in question have often invested in real estate abroad, buying homes in which they themselves or members of their families would spend the better part of the year (as examples, Arkady Rotenberg owned several villas in Italy via companies incorporated in tax havens; his brother Boris had properties in Latvia, and Timchenko in France and Switzerland), they would adopt citizenship of Western states (Timchenko and Boris Rotenberg hold Finnish passports in addition to Russian citizenship), and sent their children to schools and universities in the West.[10]

The fact that Timchenko, the Rotenbergs and Kovalchuk have been able to build up their private business empires proves that they occupy strong positions within the Putinist power elite. That elite consists of Putin's close aides in the state administration, business and the defence and security sectors, most of whom hail from St. Petersburg and hold significant sway over Russia's policy.[11] Significantly, the group is covert and informal, with many

8 For more information, see OCCRP 2018, *How to Hide a Russian Fortune on the French Riviera*, 21 February 2018, https://www.occrp.org/en/about-us/28-ccwatch/cc-watch-indepth/7675-how-to-hide-a-russian-fortune-on-the-french-riviera

9 For more information, see M. Domańska, 'The Russian aspects of the "Panama scandal"', *OSW Analyses*, 6 June 2016, https://www.osw.waw.pl/en/publikacje/analyses/2016-04-06/russian-aspects-panama-scandal

10 For example, two children from Arkady Rotenberg's second marriage live with his former wife in London; Roman, the son of Boris Rotenberg, went to school in Helsinki and has studied in London; and Ksenia Frank, Gennady Timchenko's daughter, has graduated from the University of Edinburgh.

11 The main criterion for membership in the Kremlin elite is personal ties: most members of the power elite originate from Putin's milieu from the times when he worked at the KGB (the First Chief Directorate for intelligence)

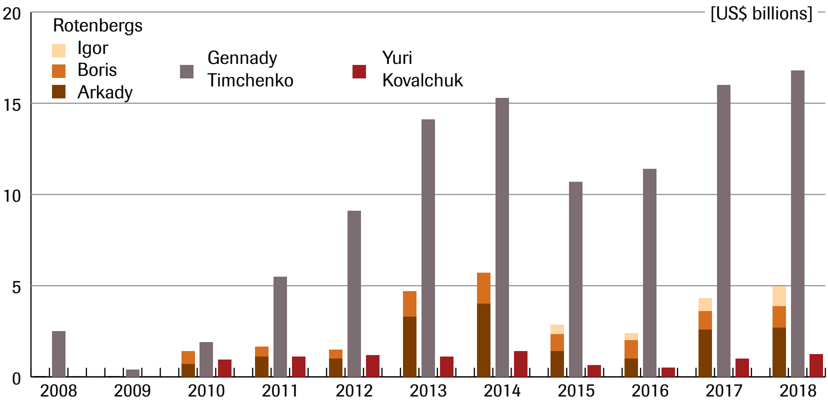
of its members holding no public functions. The Putinist establishment is not homogenous, and tensions and divisions exist between different interest groups. These conflicts mainly concern the division of spheres of influence, assets and means. As the available financial resources and opportunities to invest abroad have shrunk, so this rivalry has intensified, and the positions of some members of the elite have eroded. As a result, no member of the Russian establishment can rest assured as to the safety of their position, and all have to make constant efforts to build up their standing by demonstrating that they are still useful for the system. Putin, who has consolidated this narrow group around himself, acts as the arbiter, balancing the different interests within the ruling establishment. However, his role as an arbiter has been waning in recent years, as revealed by the ever fiercer and increasingly public conflicts within the highest tiers of leadership.[12] Paradoxically, Putin also depends on the elite, thanks to which the system functions and enables him to stay in power. This has forced the Russian president to take certain actions to demonstrate that he remains a strong leader and can still guarantee benefits to members of the establishment.

in the years 1975–1990, and in the St. Petersburg City Hall in the years 1991–1996. The key members of the elite are former Soviet intelligence functionaries (including Igor Sechin and Sergei Chemezov), entrepreneurs (Gennady Timchenko, Yuri Kovalchuk, the Rotenberg brothers) as well as lawyers, economists and researchers (Dmitri Medvedev, Alexey Kudrin). In recent years, several people including Sergei Ivanov, Vladimir Yakunin and the brothers Sergei and Andrei Fursenko have lost their positions in the Kremlin elite. See J. Rogoża, '"The power gained, we will never surrender": the Russian ruling elite versus the succession and economic crisis', *OSW Point of View*, 15 October 2009, https://www.osw.waw.pl/en/publikacje/point-view/2009-10-15/power-gained-we-will-never-surrender-russian-ruling-elite-versus For a description of the current model of governance in Russia and the positions of the individual establishment members, see the report *Politburo 2.0*, Minchenko Consulting, 23 August 2017, http://www.minchenko.ru/analitika/analitika_74.html

12 OSW team, 'Putin for the fourth time. The state of and prospects for Russia', *OSW Report*, 20 March 2018, https://www.osw.waw.pl/sites/default/files/report_putin-for-the-fourth_net.pdf

Timchenko, the Rotenbergs and Kovalchuk share sports interests with the president (hockey, martial arts) and enjoy friendly relations with Putin, which means they can often meet him and lobby for their interests; they are also able to influence decisions taken in the Kremlin, especially on economic issues including the distribution of public revenues. However, they owe their strong position largely to the role they have likely played in building up the personal wealth of the president and his close relations. The names of Kovalchuk and the Rotenbergs appear in the Panama Papers, among other dossiers. The journalists behind that investigation have suggested that Bank Rossiya was involved in money laundering and opaque transactions with people close to the president, of which Putin himself was the beneficiary.[13]

Figure 1. Assets of selected Russian businesspeople according to Forbes (US$ billions)



Source: Forbes 2017, http://www.forbes.ru/rating/342579-200-bogateyshih-biznesmenov-rossii-2017

* 2018 figures as of 6 June; figures for the remaining years as of February/March. As a result of the new sanctions imposed on Russia by the United States on 6 April 2018, the stock-exchange value of the companies owned by the entrepreneurs has declined, although in recent weeks the companies have been recovering. For instance, in March 2018, Forbes estimated the wealth of the Rotenberg family at US$5.45 billion.

[13] See OCCRP 2018, *Russia: Banking on Influence*, https://www.occrp.org/en/panamapapers/rossiya-putins-bank/

2. Western sanctions against Putin's friends

The United States has imposed more painful restrictions on Russia than any other Western state, putting the largest number of Russian nationals and their companies under restrictions. Gennady Timchenko, Yuri Kovalchuk and the brothers Arkady and Boris Rotenberg were put on the US sanctions list as soon as 20 March 2014.[14] All their assets in the United States were frozen, and US companies and companies doing business in the United States were prohibited from entering any transactions with those persons or companies they controlled. The sanctioned persons were also banned from entering the United States. Initially, the restrictions applied to legal persons in which any of the individuals facing sanctions controlled a stake of at least 50%. However, in August 2014 the restrictions were extended to include companies in which different persons under sanctions together held at least 50% of shares (for instance, shared assets in the US were held by Kovalchuk and Rotenberg, or by Rotenberg and Timchenko). In July 2015, the US sanctions were also extended to Roman Rotenberg (son of Boris), and in April 2018 to Igor Rotenberg (son of Arkady). Of this group, the European Union's sanctions were imposed only on Yuri Kovalchuk and Arkady Rotenberg[15] (in July 2014). The European restrictions envisaged a freeze on those persons' European assets and a prohibition on obtaining visas and travelling to Europe.

14 See US Department of State, 2018, https://www.treasury.gov/press-center/press-releases/Pages/jl23331.aspx

15 Arkady Rotenberg appealed the decision imposing sanctions on him. In autumn 2016 the European Court of Justice ruled that the sanctions imposed on him by the EU Council between July 2014 and March 2015 had been unjustified, but upheld the sanctions imposed later. According to the Court, the benefits which Rotenberg derived from his connections with Russian decision makers (including Putin) before early 2015 could not have affected the situation in Ukraine. However, it ruled that the sanctions imposed on Rotenberg after March 2015 were justified, because in that period Rotenberg was among the people responsible for Russia's actions or policy against Ukraine (for example, as a shareholder of Giprotransmost or as a member of the board of the Prosveshcheniye publishing house). For more information, see General Court of the European Union, https://curia.europa.eu/jcms/upload/docs/application/pdf/2016-11/cp160131en.pdf

Timchenko, who held extensive assets outside Russia, was the most exposed to the impact of the sanctions. In the case of the Rotenberg brothers and Kovalchuk, the sanctions were painful because the banks they controlled were dependent on the international financial markets and Western technologies. In addition to the direct consequences of being under personal sanctions, these men's assets were also hit indirectly by other Western sanctions, including sectorial restrictions and restrictions on access to Western capital.[16] Many Western companies, including banks, changed their attitudes towards their erstwhile Russian partners and withdrew from co-operation. In addition, uncertainty over future developments regarding Russia, especially the US bill on sanctions against Russia and the extension of US restrictions in April 2018, as well as pledges to take further action, discouraged potential business partners from making deals with Russian entrepreneurs, and adversely affected the capitalisation of their business assets.[17]

The impact of economic sanctions was compounded by the sudden decline in oil prices in late 2014, which exacerbated the economic crisis in Russia and drove down the revenues and stock exchange values of Russian businesses. The economic slump in Russia initially brought the implementation of many infrastructural projects in Russia to a halt, including projects carried out jointly by the companies owned by Timchenko and the Rotenbergs, such as Gazprom's Power of Siberia gas pipeline connecting Russian gas

16 For more information, see E. Fiszer, J. Rogoża, 'Further EU sanctions against Russia', *OSW Analyses*, 6 August 2014, https://www.osw.waw.pl/en/publikacje/analyses/2014-08-06/further-eu-sanctions-against-russia

17 The imposition in April 2018 of US sanctions on Oleg Deripaska, one of Russia's richest entrepreneurs, and his companies including Rusal, one of the world's largest aluminium producers, caused the Russian currency to dive by 15% and the Russian stock exchanges to decline considerably. For more information, see M. Menkiszak, 'A test of strength. The escalation of the crisis in Russian-American relations', *OSW Commentary*, 11 April 2018, https://www.osw.waw.pl/en/publikacje/osw-commentary/2018-04-11/a-test-strength-escalation-crisis-russian-american-relations

fields with China. However, as the prices of oil, and hence also export revenues, increased again, most of the projects were resumed.

In **Timchenko's** case, the direct cost of sanctions imposed on his foreign assets proved limited. The Visa and MasterCard payment card systems blocked his private credit cards, but his assets were not frozen as they were concentrated in Europe, where he did not face sanctions. Such of his Russian assets that were sanctioned could no longer do business with US partners; this applies, inter alia, to the Volga Group via which Timchenko controls all his business assets, the infrastructure contractor Stroytransgaz, as well as Transoil, the rail company servicing mainly the Ust-Luga terminal, and Sakhatrans (a Yakutia transport company), and especially Novatek, Russia's second largest gas producer after Gazprom, in which Timchenko holds 23% of the shares.

The sanctions imposed on Timchenko's companies hindered their access to capital and technology, leading to problems with the construction of the transport and reloading coal terminal in the port of Vanino in Yakutia[18] and a nearly two-year delay to the Yamal LNG terminal, a priority project for Novatek which has been strongly supported by the Kremlin.[19] An agreement with Russian and Chinese banks to finance the project was only signed in 2016.

Timchenko also suffered some losses when the United States imposed separate sanctions on the Rossiya Bank in which he is a minority shareholder (more information on this below).

[18] For more information, see 'Сахатранс испытывает трудности со строительством угольного терминала из-за санкций к Volga Group Тимченко', *Морские вести России*, 2 March 2015, http://www.morvesti.ru/detail.php?ID=32056

[19] For more information, see И. Гладышева, 'Льгота на газ: как государство помогло построить Ямал СПГ', *РБК*, 11 December 2017, https://www.rbc.ru/opinions/business/11/12/2017/5a2e37599a79476b576c3f91

Timchenko had previously downsized his stake to safe levels (below 50%) or sold his foreign companies altogether. By doing so he shielded them from the US sanctions, so they could continue to do business with US partners. The hasty sale undoubtedly had a negative impact on Timchenko's wealth, but as the value of most of the deals was not disclosed (as a trade secret), it is difficult to estimate the scale of his losses. At the same time the sanctions did undermine the repute, credibility and ratings of his companies, which affected their stock exchange value.

The sanctions initially delivered a heavy blow to the business of the **Rotenberg** brothers. Even though they had no assets in the United States, the sanctions hit the SMP Bank (one of Russia's top thirty banks in terms of assets) which they own. When the first sanctions were imposed on Russia and on the Rotenbergs personally (in March 2014), the Bank, even though it was not sanctioned itself, stopped being serviced by Visa and MasterCard for several days, triggering panic among its customers and a bank run. When the bank was included in the sanctions list in late April 2014, it was permanently disconnected from the international payment card systems. On top of that, all American IT companies discontinued their business relations with the bank, including Microsoft, Oracle and the anti-virus system provider Symantec. The bank also lost the ability to communicate with its customers via the Bloomberg and Reuters systems. It lost access to the London stock exchange and the Chicago commodity exchange; its dollar account with JPMorgan Chase was frozen, and Bank of America and the US-based broker FXCM discontinued co-operation (the frozen assets are estimated at around US$65 million[20]). Deposits by individual customers fell by nearly 15% between March and May 2014 (to 70 billion roubles, i.e. US$2 billion), while deposits of legal persons increased by more than 20% to 51 billion

20 For more information, see 'Банкам друзей Путина разрешат оперировать деньгами бюджета', *РБК*, 1 April 2016, http://www.rbc.ru/economics/01/04/2016/56fe92989a7947340040e8af

roubles (US$1.5 billion).[21] The Owental Stock Investments hedge fund registered in Cyprus, which had links to the Rotenbergs (according to the register, it was owned by Denis Pospelov, a former deputy CEO of SMP Bank) also lost the ability to make deals in US stock exchanges.[22] After Arkady Rotenberg was put on the EU sanctions list in July 2014 (as the only member of the family to face European sanctions), the following September the Italian fiscal police blocked those of his properties (villa and hotels) in Italy which were formerly owned by the Cypriot company Olpon Investments Ltd.

US sanctions were also imposed on the Rotenbergs' Stroygazmontazh company, one of the largest infrastructure contractors in Russia. The company co-owns SGM-Most (also under US sanctions), which had been building the bridge across the Kerch Strait that connects Russia with Crimea. While these companies mainly operate on the Russian market, the sanctions deprived them of access to technology, which made it more difficult for them to implement their projects. Because of the sanctions, no Western financial institutions agreed to insure the construction of the Kerch Bridge. Russian financial institutions (especially state-owned banks) were also wary of the potential consequences of getting involved in the project, for fear of the possible imposition of US sanctions. Stroygazmontazh finally managed to sign an insurance contract with an anonymous company from Crimea in April 2016,[23] after a Turkish ship had damaged the bridge pylons in March that year.[24] The road bridge across the Kerch Strait was

21 Banki.ru, http://www.banki.ru/banks/ratings/

22 А. Вержбицкий, 'Плата за дружбу: как банк Ротенбергов переживает санкции', *Forbes*, 13 April 2015, http://www.forbes.ru/finansy/igroki/285505-plata-za-druzhbu-kak-bank-rotenbergov-perezhivaet-sanktsii

23 For more information, see М. Каверина, Е. Мереминская, 'Керченский мост застраховала неизвестная крымская компания', *Ведомости*, 9 June 21016, https://www.vedomosti.ru/finance/articles/2016/06/09/644725-kerchenskii-most

24 For more information, see *Турецкий сухогруз снес опоры строящегося моста через Керченский пролив,* Lenta.ru, 22 March 2016, https://lenta.ru/news/2016/03/22/bridge/

put into operation six months before the scheduled opening date (May 2018), but the railway bridge will be opened after a year's delay (in December 2019). Moreover, an investigation is underway in the Netherlands against Dutch companies accused of illegally supplying heavy equipment for the purposes of the project.[25]

Like Timchenko, the Rotenbergs have probably also suffered losses as a result of the fire sale of their foreign assets. However, most of those transactions are treated as trade secrets.

The sanctions also hit the assets of **Yuri Kovalchuk**, who was included in the US sanctions lists in March 2014, and the EU lists in July 2014. The sanctions imposed on Rossiya Bank, in which Kovalchuk is the largest shareholder (37.5%), were particularly painful for him. The bank's other shareholders were also hit by the US sanctions, including Gennady Timchenko (who held a 9.8% stake via the Transoil company) and Nikolai Shamalov (9.6%).

As a result of the sanctions, Rossiya Bank was cut off from its accounts with US banks. The Wall Street Journal estimated in March 2015 that American financial institutions had frozen assets of the bank worth nearly US$600 million. Bank Rossiya also ceased to be serviced by the international Visa and MasterCard payment systems. Moreover, between March and May 2014 the volume of deposits of individual customers fell by nearly 30% (to 27 billion roubles, i.e. around US$0.7 billion), while the deposits of legal persons decreased by 13% (to around 300 billion roubles, i.e. around US$9 billion).[26]

Initially Kovalchuk's media businesses were also hit by the sanctions. The operations of his Cypriot company Telcrest were blocked.

[25] For more information, see *Dutch companies investigated for supplying equipment for Russian bridge*, Dutch News.nl, https://www.dutchnews.nl/news/2017/09/dutch-companies-investigated-for-supplying-equipment-for-crimean-bridge/

[26] Banki.ru 2018, *op.cit.*

Via Telcrest (controlled by shareholders of Rossiya Bank and its associated companies: ABR Management, founded in 2011 by the bank's managers to manage its assets, and the Abros investment company) Kovalchuk owned a 25.3% stake in the CTC Media holding registered in the United States. As a result of the sanctions, Kovalchuk's representatives on CTC Media's board of directors lost their voting rights, and their dividends started to be deposited in blocked accounts in US banks.

It is difficult to estimate the volume of losses suffered by the Russian oligarchs as a result of the Western sanctions, as much of the data is not public; moreover, the impact of the sanctions has been compounded by the economic crisis in Russia, which also affected the oligarchs. However, based on the Forbes rankings, the cumulative effects of the sanctions and the economic slump have considerably dented the wealth of the entrepreneurs in question. According to Forbes, between February 2014 and April 2015 the value of Timchenko's assets decreased by 30% to US$10.7 billion, the wealth of the Rotenbergs shrunk by 50% to US$2.85 billion, and Kovalchuk's assets decreased by more than 50% to US$650 million (see Figure 1 on page 15).

II. THE OLIGARCHS' STRATEGIES TO COUNTERACT THE SANCTIONS

The Russian oligarchs have largely managed to minimise the damage and protect their assets from the impact of sanctions. They have done so by using various financial mechanisms to prevent the freezing of assets, which has allowed them to continue doing business. The mechanisms they used have proven quite effective, because most of the assets of the entrepreneurs in question were held in Europe, whose sanctions policy has been much less strict than that of the United States. Because the EU sanctions did not cover Timchenko or Boris, Roman and Igor Rotenberg, they could continue doing business in the European market. For those entrepreneurs who were covered by sanctions, their main strategy has been to scale down their stake in Western assets to below 50%, or severe their formal ties with such assets altogether by selling them to business partners, relatives, trusted managers or Russian state-owned companies. Another important strategy was to remove capital from under Western jurisdictions and repatriate it to Russia. As a result of those efforts, most of the foreign assets owned by Timchenko and the Rotenbergs changed owners and avoided freezing, or saw the restrictions lifted relatively quickly.

Reacting to the steps taken by the Russian businessmen, the West has tried to tighten and extend the sanctions lists. As a result, over the last four years sanctions have been extended to the sons of the Rotenberg brothers, i.e. Roman and Igor, as well as their business partners Kai Paananen, Petr Kolbin and Sven Olsson, as well as many companies associated with Timchenko or the Rotenbergs. However, because of the high dynamics and opacity of the transactions, tracing business ties has been very difficult, which has effectively allowed the sanctioned businessmen to continue doing business, both domestically and abroad (for more information, see the case studies below).

GENNADY TIMCHENKO'S ASSETS (VOLGA GROUP)

US sanctions April 2014

US sanctions March 2014

Foreign assets sold by Timchenko shortly before the imposition of US sanctions

Gunvor → Torbjörn Törnqvist (19 March 2014, 43.59% of shares)

IPP Oil Products (US sanctions July 2015) → Petr Kolbin (US sanctions July 2015) (19 March 2014, 50% of shares)

AirFix Aviation Oy (US sanctions July 2015) → Kai Paananen (US sanctions July 2015) (19 March 2014)

Rorvik Timber → Gunvor (April 2014, 50% of shares)

Arena Events Oy → Roman Rotenberg (US sanctions July 2015) (April 2014, 0.5% of shares)

Russian assets sold by Timchenko

Sogaz → Ksenia Frank (daughter) (12.5% of shares)

Gunvor divests from assets in Russia

Ust-Luga Oil → Andrei Bokarev (74% of shares)

Colmar → Andrei Bokarev (30% of shares)

Nevskaya Truboprovodnaya Kompania → Gazprombank subsidiary Tradescan (50% of shares)

December 2015 Volga Group removed from registers in tax havens and registered in Russia

Volga Group currently manages all of Timchenko's assets

Foreign assets held by Timchenko

US sanctions July 2015

- Arena Event Oy (49.5%)
  - Hartwall Arena Helsinki (100%)
  - Jokerit Hockey Club (49%)
- Sovag, insurance company (24.8%)

Russian assets held by Timchenko

US sanctions March 2014

- Rossiya Bank (10%)
- Sibur (15%)

US sanctions July 2014

- Novatek, gas holding (23%)
- Colmar, coal extraction company (30%)

US sanctions April 2014

- Sakhatrans, transport company (89%)

US sanctions April 2014

- Transoil, rail cargo company (80%)

US sanctions April 2014

- Stroytransgaz, construction company (63%)
- Stroytransneftgaz (around 50%)
- Yuzhnye Zemli, fruit producer (35%)

US sanctions April 2014

- Aquanika, beverage manufacturer (100%)
- Alma, agri-food business – apple producer (40%)

Case study: Timchenko separates his Russian and foreign assets

On hearing about the possibility of sanctions against Russia, Timchenko started selling his foreign assets to business partners. Shortly before he was put on the US sanctions list, Timchenko sold his stake in the Swiss oil trade company Gunvor to the Swedish billionaire Torbjörn Törnqvist.[27] He also divested from companies co-operating with Gunvor, including the Cypriot oil company IPP Oil Products,[28] which was most probably acquired by the Russian billionaire Petr Kolbin. Timchenko also reduced his stake in Arena Events Oy (the owner of the Hartwall Arena stadium in Helsinki and the Jokerit hockey club) to below 50% by selling 0.5% to Roman Rotenberg (son of Boris). However, most of those transactions (with the exception of the transactions involving Gunvor) were identified by the US government as attempts at circumventing sanctions, and as a consequence, the companies and persons involved were also put on the sanctions list in July 2015.[29] As a result, they could no longer do business with US partners or carry out operations on US territory.

27 The transaction was concluded on 19 March 2014. The Swedish billionaire Torbjörn Törnqvist had been a shareholder in Gunvor; after the deal with Timchenko, he came to control 80% of shares in the company. Gunvor is one of the largest oil traders in the world; before 2012 it accounted for nearly 40% of Russian oil sales, currently it sells negligible quantities of Russian oil, focusing instead on oil from other sources.

28 The value of Timchenko's shares in Gunvor was estimated at US$ 1.5 billion, and his stake in the Cypriot IPP Oil Products at US$ 220 million. For more information, see *Volga Group Геннадия Тимченко 19 марта продала 50%-ную долю в кипрской IPP Oil Products*, Интернет газета „Знак", 17 April 2014, https://www.znak.com/2014-04-17/volga_group_gennadiya_timchenko_19_marta_prodala_50__nuyu_dolyu_v_kiprskoy_ipp_oil_products

29 For more information, see US Department of State, 30 July 2017, https://www.treasury.gov/press-center/press-releases/Pages/jl0133.aspx; and 22 December 2015, https://www.treasury.gov/press-center/press-releases/Pages/jl0314.aspx

At the same time Timchenko tried to limit the influence of foreign entities on his Russian companies. In particular, he re-registered the Volga Group company, moving it from tax havens to Russian jurisdiction and becoming its direct owner.[30] Volga Group subsequently took control over all of Timchenko's assets. Timchenko himself stepped up his activities on the Russian market, entering new sectors such as the agri-foods industry (especially horticulture). He also protected some of his assets by transferring ownership of them to family members, namely his son-in-law Gleb Frank and his daughter Ksenia Frank.[31]

In parallel to Timchenko's actions refocusing his business on the Russian market, Gunvor took steps to severe ties not only with Timchenko but also with Russia in order to avoid being exposed to the US sanctions. The Swiss oil trader sold its shares in Russian companies to Gazprombank[32] and the billionaire Andrei Bokarev, who has long been Timchenko's business partner[33] and is currently co-operating closely with Igor Sechin, the CEO of the state-owned Rosneft.[34]

30 Before, shares in Volga Group had belonged to the Cypriot company Volga Resources Ltd. and the Luxembourg-based VRN Sarl. Timchenko owns 99.9% of the shares in Volga Group; the remaining 0.1% is controlled by Volga Group Holding.

31 For more information, see Р. Шлейнов, 'Акции СОГАЗа достались дочке', *Новая газета*, 10 November 2016, https://www.novayagazeta.ru/articles/2016/11/10/70486-aktsii-sogaza-dostalis-dochke

32 The Cypriot company Tradescan Consultants Ltd., which is owned by Gazprombank, purchased 50% of the shares in Nevskaya Truboprovodnaya Kompania (which co-owns the oil terminal in Ust-Luga) from Gunvor, thus increasing its stake in that company to 74%; the remaining 26% is controlled by the state-owned Transneft. The terminal mostly handles oil for the state-owned Rosneft.

33 In 2012, Bokaryov and his business partner Iskander Makhmudov acquired 13% of the shares in the transport company Transoil, in which Volga Resources owns the remaining 80%. For more information, see А. Темкин, 'Берег олигархов: как «Усть-Луга Ойл» за 3 года увеличила выручку вчетверо', *РБК*, 7 December 2015, http://www.rbc.ru/ins/business/07/12/2015/565f4f6e9a7947084d937c79

34 For more information, see А. Горшкова, *Ольга речной сборки*, ЦУРреализм, Medium, 17 March 2017, https://medium.com/@tzurrealism/knyagini-olgi-eafa34fc4cfc

As he put his assets under Russian jurisdiction, Gennady Timchenko and his wife also moved to Russia and stopped using their foreign properties.[35] Since 2014, Timchenko has ostentatiously remained in Russia. Most of these actions have been preventative in nature; Timchenko was not put on the EU sanctions list, and is able to continue doing business in Europe. His decisions were probably motivated by concerns about his security in the West and the possibility of further sanctions. Presumably, it was also a gesture towards President Putin and the rest of the Russian elite (especially Rotenberg and Kovalchuk), and an element of political manoeuvring to preserve Timchenko's position within that elite. Moving assets to Russia was an important gesture to the president, who had called on Russian oligarchs to stop using tax havens and concentrate their assets under Russian jurisdiction. The sanctions imposed on Russian officials and businessmen, in addition to creating real problems for the persons affected, paradoxically also tightened their relationships with the president who was responsible for the sanctions in the first place, as they were imposed on Russia in the aftermath of his decisions. They deepened the co-dependence of the president and his 'court'. Timchenko's ostentatious cutting of his ties with the West and his demonstration of loyalty to the president was therefore an important step, intended to highlight his place within the Putinist elite. (For more information about the transactions, see Diagram on page 24 and 25).

[35] The Russian media reported that he owned villas in Geneva and Cote d'Azur, an apartment in Paris and two hotels in France. For more information, see 'Дома и отели супругов Тимченко', *Ведомости*, 21 January 2013, https://www.vedomosti.ru/politics/gallery/2013/01/21/timchenko_real_estate#/galleries/140737489132611/normal/2 and Alexey Navalny's investigative piece of 6 August 2014, *Где бывала эта сука*, https://navalny.com/p/3717/

ASSETS OF THE ROTENBERG BROTHERS – EVERYTHING STAYS WITHIN THE FAMILY

Arkady Rotenberg

US sanctions March 2014
EU sanctions July 2014

Boris Rotenberg

US sanctions March 2014

RUSSIA

Stroygazmontazh

US sanctions April 2014

July 2014 the company was removed from registers in Cyprus and registered in Russia

December 2014 Arkady bought 17% of shares in Stroygazmontazh from Boris and since then controls 100% of the company

Volgogradneftemash

US sanctions December 2015

2016 Boris bought 79.1% of shares in Volgogradneftemash from Arkady

ABROAD

SMP Bank Latvia owned by the Rotenberg brothers' SMP Bank Russia

In May 2014, SMP Bank Latvia was sold to its managers and renamed as Meridian Trade Bank

US sanctions July 2015

Långvik Capital Ltd owned jointly by the Rotenberg brothers (50/50); it controls:

– the Långvik conference centre and hotel near Helsinki (100%)

– the Tanskarlan Centrum developer (100%)

– Arena Event Oy (50%)* [owner of the Hartwall Arena Helsinki and 49% of shares in the Jokerit Hockey Club (KHL)]

US sanctions July 2015

October 2015 **Roman Rotenberg**, son of Boris, took over 100% of shares in Långvik Capital Ltd

*April 2014 0.5% stake in Arena Event Oy was sold by Gennady Timchenko to Boris Rotenberg

Case study: A new generation of the Rotenbergs joins the business

Like Timchenko, the Rotenberg brothers also decided to divest from some of their foreign assets, in order to limit their ties with the West and allow the businesses they sold to operate freely in Europe. An important part of that strategy was to transfer ownership of some assets to their sons.

The brothers got rid of the Latvian branch of the SMP Bank, which was taken over by its managers.[36] The bank further distanced itself from its Russian founders by changing its name to Meridian Trade Bank. Moreover, the Finnish assets of the Rotenberg brothers were taken over by Roman Rotenberg (son of Boris), who is a Finnish and British national. Roman also became the formal owner of his father's residence on the outskirts of Riga.[37] However, the US administration treated those transactions as purely formal and aimed at circumventing the sanctions. As a result, in July 2015 Roman Rotenberg was also put on the US sanctions list, which blocked his co-operation with US companies, although he is still free to operate on the European market.

The Russian media has also demonstrated that despite the sanctions (imposed by both the EU and the US in the case of Arkady), the Rotenberg brothers have found a way to continue doing business abroad with trusted long-time managers of SMP Bank acting on their behalf. The authors of the anti-corruption *munscanner.com* social media portal,[38] who have

36 The bank's customers included Gazprom and around 18,000 retired Russian military personnel who live in Latvia but receive Russian pensions.

37 For more information, see 'Зарубежное имущество российских олигархов. Аркадий и Борис Ротенберги', Polit.ru, 20 February 2017, http://polit.ru/article/2017/02/20/property3/

38 The *munscanner.com* portal was founded in 2014 with the support of Boris Nemtsov and monitors the legality of actions by officials and politi-

investigated the subject, argue that Dmitry Kalantyrski, SMP Bank's CEO until February 2015, who now lives in Prague, and Denis Pospelov, who was the deputy CEO of SMP Bank until May 2014 and currently lives in Latvia, own the assets in Europe only formally, while in reality they operate and invest on behalf of the Rotenberg brothers. The foreign activities of the Rotenberg family have also been corroborated by an investigation by German journalists published in May 2018. They have produced documents showing that the Rotenbergs, including Arkady, have invested around €1 billion in properties in Germany via shell companies.[39]

The Rotenbergs have also carried out a number of operations on the Russian market to minimise the costs of doing business under sanctions. Arkady has taken over most of the companies affected by sanctions. They have limited their activities to the Russian market and to co-operation with Russian companies. Only some of the Rotenbergs' assets have been repatriated to Russia from tax havens. Most assets were shielded from sanctions because they had been taken over by Igor Rotenberg, son of Arkady, who was only put under US sanctions in April 2018. When Igor too was put on the sanctions list, his sister Liliana became a shareholder in the family businesses. (For more information about the transactions, see Diagrams on pages 29 and 32).

cians in Russia. For more information, see *Аркадий Ротенберг: Кипр наш!*, 11 April 2017, https://munscanner.com/2017/04/kinasis-llc/ and *Как Аркāдийс Ротенбергс от санкций уходил*, 12 May 2017, http://munscanner.com/2017/05/arkadijs-rotenbergs/

39 For more information, see G. Keller, K. Schlieter, 'Der Kudamm-Komplex', *Berliner Zeitung*, 16 May 2018, https://story.berliner-zeitung.de/category/kudammkomplex/

ARKADY ROTENBERG'S CHILDREN JOIN THE BUSINESS

Igor Rotenberg, son of Arkady

US sanctions April 2018

ASSETS TAKEN OVER FROM HIS FATHER

April 2014
78.7% **TEK Mosenergo**

October 2014
30% **Mostotrest**

US sanctions September 2016

→ 2015
Igor sold shares in Mostotrest to TFK Finance

→ April 2018
Arkady Rotenberg acquired TFK Finance and took control over 94.2% of Mostotrest

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October 2014
78.7% in **Gazprom bureniye** (the remaining 16.3% owned by Boris Rotenberg)

US sanctions April 2018

→ December 2017
Gazprom bureniye removed from registers in Cyprus and Saint Lucia, and registered in Russia

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October 2014
33.3% in **TPS Real Estate**

→ March 2018 (shortly before Igor has been put under US sanctions) shares taken over by Igor's sister **Lilia Rotenberg**

Case study: Yuri Kovalchuk develops business in Russia

Bank Rossiya, which Kovalchuk controls, announced immediately after its head was put on the sanctions list that it would restrict its activities to the territory of Russia and minimise its relations with foreign partners. Kovalchuk also tried to prevent sanctions from being imposed on businesses controlled by the bank, such as Sogaz.[40] To this end, he initially reduced the stakes the bank held in those businesses to less than 50%, i.e. below the 50% threshold set by the US administration.

Kovalchuk also managed to carry out some successful operations resulting in sanctions being lifted from some assets of Rossiya Bank. When he sold the Cypriot Telcrest company to the Russian billionaire Alexey Mordashov and the Russian state-owned bank VTB,[41] the company's banking accounts could be unblocked. Telcrest controlled 25.3% of shares in the US-based CTC Media company.

The financial operations undertaken by Kovalchuk and Bank Rossiya since 2014 were also deemed suspicious by the US administration, as a result of which the sanctions list was expanded in 2016 to include companies and persons associated with Bank Rossiya (e.g. ABR Management and its director Kirill Kovalchuk (Yuri's relative).[42] (For more information about the transactions, see Diagram on page 34).

40 Russia's largest insurance company, founded in 1993 by Gazprom. Its customers include the largest state-owned companies. Companies associated with Gazprom currently hold a majority of shares in Sogaz, while Kovalchuk and Timchenko's daughter hold minority stakes.

41 For more information, see *ВТБ стал косвенным владельцем 7,5% CTC Media*, Interfax, 28 September 2015, http://www.interfax.ru/business/469811

42 For more information, see US Department of State, 1 September 2016, https://www.treasury.gov/press-center/press-releases/Pages/jl5048.aspx; and 20 December 2016, https://www.treasury.gov/press-center/press-releases/Pages/jl0688.aspx

YURI KOVALCHUK'S FINANCIAL OPERATIONS

Rossiya Bank

US sanctions
March 2014

Rossiya Bank's chief shareholders

Yuri Kovalchuk (37.5%)
US sanctions, March 2014
EU sanctions, July 2014

Nikolai Shamalov (9.6%)
EU sanctions, July 2014

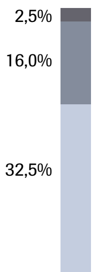
Gennady Timchenko (9.8%)
US sanctions, March 2014

Rossiya Bank sells some shares controlled by the Abros* investment company

Telcrest (54.9%)
owns 25% in CTC Media

In September 2015 Abros sold
27.9% of shares in Telcrest
to Aleksei Mordashov
and the state-owned VTB

Sogaz – insurance company**
(51%)



In March 2014 Abros sold
2.5% of shares in Sogaz

In July 2014 Abros sold 16% of shares
in Sogaz to a Gazprom subsidiary

The remaining 32.5% of Sogaz shares
owned by Abros were taken over in 2016
by Akvila, a company owned
by Bolshoy Dom 9, a company
named after the registration address
of Rossiya Bank and controlled
by Yuri Kovalchuk and his wife

* September 2014 Rossiya Bank transfers control of Abros to the company's management

** Until autumn 2014, Gennady Timchenko had held a 12.5% stake in Sogaz,
which he subsequently sold to his daughter Ksenia Frank

III. THE KREMLIN'S SUPPORT FOR ENTREPRENEURS UNDER SANCTIONS

Irrespective of their personal damage-control strategies, the entrepreneurs from Vladimir Putin's inner circle were also offered a helping hand by Russian state institutions. It was a way of compensating them for the losses suffered by the oligarchs with friendly ties to the president as a result of the sanctions imposed as a consequence of Russia's aggressive foreign policy. Enabling them to rebuild their wealth was a way for the Kremlin not to lose their support for its costly foreign policy and retain the Russian elite's loyalty. Even if Russian business did not officially criticise Russia's actions towards Ukraine, it was clear that the Russian economy and the oligarchs personally would bear the cost of those actions. Yet the Kremlin chose to put its geopolitical objectives above economic concerns.

The Kremlin's propaganda, which presents Russia as a besieged fortress and the West as the eternal enemy seeking to destabilise Russia using political and economic methods, has proven quite effective in convincing the general public in Russia. Despite falling incomes, rising prices and food shortages, the euphoria triggered by the annexation of Crimea consolidated Putin's power and boosted the president's popularity. Business, however, proved less susceptible to the propaganda, especially since the sanctions were long-term. Russian companies (especially state-owned enterprises) started demanding billions in state aid. In order to demonstrate that he is still the guarantor of the Russian elite's welfare, the president decided to compensate them (at least partly) for the losses they suffered as a result of the sanctions. The scale of that support and the instruments used indirectly show how dissatisfied the Russian business elite was with the Kremlin's confrontational policy towards the West.

1. Public procurement as the main instrument of support

Public contracts have been the main instrument deployed by the Russian government to support the businessmen affected by the Western sanctions. Goods, services and works ordered by the state, local and regional governments and state-owned companies in 2017 were worth a total of 36.5 trillion roubles (more than US$626 billion), accounting for nearly 40% of GDP. Despite the crisis, the Russian federal budget and the regional budgets tried to keep public procurement spending at around 6 trillion roubles (US$103 billion), i.e. around 6% of GDP in 2017. However, the amounts spent by state-owned enterprises were much higher. Official (registered) transaction figures show that while such companies bought goods and services worth a total of nearly 18 trillion roubles (US$468 billion) in 2014, which corresponded to around 25% of Russia's GDP, in 2017 that figure increased to more than 30 trillion roubles (US$515 billion), i.e. around 32% of GDP.[43] Most of the contracts, according to a report from the Russian Ministry of Finance, were awarded without competitive tendering procedures (around 95% in 2017). The Ministry's figures also show that Rosneft oil company and its affiliates were the biggest spenders among the Russian state companies in 2017 (7.8 trillion roubles, i.e. US$134 billion).[44] Gazprom has also systematically appeared among the largest buyers in recent years.[45] However, it should be noted that these figures only include transactions registered

[43] For more information, see Рынок закупок государства и госкомпаний в 2017 г достиг 36,5 трлн руб — «РТС-тендер», *Рамблер*, 19 January 2018, https://news.rambler.ru/business/38929744-rynok-zakupok-gosudarstva-i-goskompaniy-v-2017-g-dostig-36-5-trln-rub-rts-tender/ and А. Пушкарская, 'Госкомпании не сняли маски', *Коммерсантъ*, 25 February 2016, https://www.ippnou.ru/article.php?idarticle=013699

[44] For more information, see the Ministry of Finance of the Russian Federation, *Мониторинг применения федерального закона от 18 июля 2011 г. № 223-фз «О закупках товаров, работ, услуг отдельными видами юридических лиц» в 2017 году*, https://www.minfin.ru/common/upload/library/2018/04/main/Monitoring_223-FZ__2017_aktualizirovannaya_redaktsiya.pdf

[45] Cf. А. Пушкарская, *op. cit*. According to information available from Gazprom, the company has been systematically expanding its investment programme,

in the special electronic system. Access to information about the winners of tenders and contracts from state-owned companies in Russia has been systematically restricted in recent years. For instance, in November 2017 the Russian government authorised state-owned companies and the Defence Ministry, the Federal Security Service and the Foreign Intelligence Service to stop publishing information about the transactions they enter, including information on their business partners (suppliers, contractors, etc.) until 1 July 2018.[46]

Arkady Rotenberg's Stroygazmontazh and Timchenko's Stroytransgaz have been the key contractors for Gazprom's 'Power of Siberia' gas pipeline to China. „Forbes" magazine's 'Kings of Government Procurements' rankings (see Figure 2 on page 39) also show that companies linked to these two men have been major beneficiaries of public investments in Russia. Forbes estimates, based on official published data,[47] indicate that the Rotenberg family, which was a major beneficiary of public procurement even before the sanctions were imposed, became the uncontested leader in 2015, winning contracts worth a total of 670 billion roubles (nearly US$11 billion). Companies owned by the Rotenbergs won contracts from Gazprom, Russian Railways, the City of Moscow and the Road Construction Agency. Stroygazmontazh has been

which in 2017 was worth 1.2 trillion roubles, i.e. over 200 billion roubles more than the year before.

46 That decision was related to the US sanctions and the difficulties faced by Russian state-owned companies, especially in the defence sector, in finding buyers. Classifying the list of beneficiaries was a way to circumvent the US sanctions.

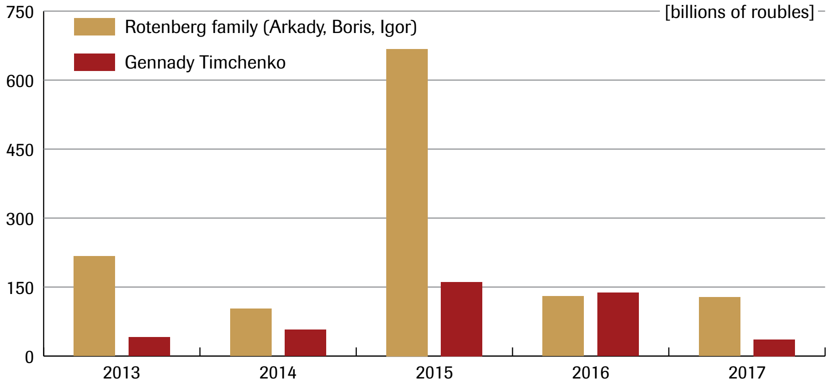
47 Forbes looks into transactions above 1 billion roubles (around US$16 million). Its journalists note that compiling the ranking becomes more difficult every year as information about the real beneficiaries is withheld. Moreover, Forbes notes that state-owned companies have increasingly been awarding contracts to companies that are too small to deliver on their commitments, which means that they are most probably acting as intermediaries. However, Forbes does not indicate for whom they may be working. The 2017 ranking was topped by the owners of the Peton company from Ufa, whose portfolio of contracts in 2016 was worth 176 billion roubles (around US$2.6 billion), having grown from a mere 1.9 billion roubles (around US$31 million) the year before.

implementing the Kremlin's priority project, building a bridge connecting Russia with Crimea (its value has been estimated at 230 billion roubles, i.e. around US$3.5 billion), and constructing a gas pipeline connecting Krasnodar *krai* with Crimea (20 billion roubles, i.e. around US$300 million). Reports that entities controlled by Gennady Timchenko and Arkady Rotenberg were the biggest beneficiaries of infrastructure projects implemented by Gazprom and Rosneft were also included in a non-public analytic report on the oil and gas sector prepared by the state-owned Sberbank. The bank's CEO Herman Gref was then forced to personally apologise to the COEs of the companies covered in the report (including Timchenko and Gazprom CEO Alexey Miller) and fire the analysts who drafted the documents. Interestingly, Gref did not call into question the report's findings, but only accused the analysts of a lack of professionalism and using uncorroborated data.[48]

The Rotenberg family also benefited from the Platon system that collects toll from trucks weighing over 12 tonnes on federal roads, which was implemented in November 2015 despite massive protests by truck drivers. The company RT-Invest Transportniye Sistemy controlled by Igor Rotenberg (50%) was selected without tender to operate the system for 13 years. The cost of developing and implementing the system has been estimated at 30 billion roubles (around US$500 million). The operator's annual fee is 10.6 billion roubles (i.e. over US$170 million in 2017). By mid-June 2017, i.e. within 20 months of its launch, the system had collected around 29 billion roubles (around US$450 million), which was deposited with the road fund that finances the repairs of federal roads.

48 Sberbank's critical report on Rosneft was written in October 2017, and the report on Gazprom in May 2018. For more information, see А. Хачатуров, 'Газпром сильно проигрывает, а с ним Россия', *Новая газета*, 24 May 2018, https://www.novayagazeta.ru/articles/2018/05/24/76579-gazprom-silno-proigryvaet-a-s-nim-rossiya

Figure 2. 'Kings of Government Procurements'



Source: Forbes 2018

2. Additional financing for infrastructure projects under sanctions

The state has also tried to financially support infrastructure projects which have been experiencing difficulties as a consequence of the international sanctions. However, that instrument has been used more sparingly: the original scale of requests for aid made in the autumn of 2014 was massive, with state-owned entities such as Rosneft and the state-owned banks accounting for most of it, and exceeded the capacity of the National Welfare Fund (which was worth 3 trillion roubles, i.e. around US$70 billion in late 2014). However, President Putin did not allow any massive deployment of reserves, and took direct control over the decision-making process regarding co-financing for projects from the government in early 2015. As a consequence, Fund resources were mainly channelled to state-owned entities, such as the banks or the Russian Fund for Direct Investments. However, state aid was also awarded to the Yamal LNG project implemented by Novatek (owned by Timchenko and others), which received 150 billion roubles (US$2.5 billion) from the Fund in 2015. State aid to the amount of 1.5 billion roubles (around US$25 million) was awarded in 2016 to the Sakhatrans transport company, in which Timchenko holds a 89% stake, and which had been cut off from Western sources of financing and faced problems with building the coal reloading terminal at the port of Vanino in Yakutia.

3. Support for banks under sanctions

In addition to government procurements, public institutions also became heavily involved in supporting the Russian banking system, especially the private banks that were put under sanctions, namely the Rotenbergs' SMP Bank and Rossiya Bank controlled by Kovalchuk and Timchenko. The central bank initially supported the two banks very energetically with cash during the bank run in March 2014. In May the same year it handed over three banks facing bankruptcy (including Mosoblbank) to SMP Bank, which was tasked with improving their financial standing and received a ten-year loan of 117 billion roubles (US$3.4 billion) at an interest rate of 0.51% for that purpose.[49] This not only significantly supported SMP Bank financially, but also enabled it to use the card payment system of Mosoblbank (which was not under sanctions) to provide services to its own customers, and to use the Visa and MasterCard systems despite the blockade.[50] Finally, in April 2015 the Central Bank of Russia softened certain requirements applicable to Bank Rossiya and SMP Bank, including requirements concerning ratings, so that Russian pension funds could deposit their monies with the banks.[51]

49 For more information, see А. Вержбицкий, 'Плата за дружбу: как банк Ротенбергов переживает санкци', *Forbes*, 13 April 2015, http://www.forbes.ru/finansy/igroki/285505-plata-za-druzhbu-kak-bank-rotenbergov-perezhivaet-sanktsii

50 For more information, see В. Лебедева, 'СМП Банк получил 16 млрд рублей прибыли благодаря санации Мособлбанка и торговле бумагами', dp.ru, 1 September 2015, https://www.dp.ru/a/2015/09/01/SMP_bank_poluchil_16_mlrd/

51 Cf. Decision of the Central Bank of Russia, 23 April 2015, http://www.cbr.ru/press/PR/?file=23042015_151314sbrfr2015-04-23T15_08_08.htm. For more information, see *ЦБ облегчил доступ к пенсионным деньгам для банков, находящихся под санкциями Запада*, banki.ru, 24 April 2015, http://www.banki.ru/news/lenta/?id=7949942

According to Russian media reports, the state administration has also supported Rossiya Bank and SMP Bank by issuing an informal recommendation to state-owned enterprises to move their financial accounts to the two banks. As a result, in the following months companies such as RusGidro and Rosseti became their customers. Moreover, SMP Bank considerably expanded its portfolio of loans to regional administrations: in 2014 it won 400 loan competitions announced by the regional governments for a total amount of 12.5 billion roubles, i.e. over US$320 million (the year before it had won 292 tenders worth a total of 4.5 billion roubles, i.e. around US$141 million). Importantly, the Russian government approved a modification of the tender conditions under which the banks' original pre-sanction ratings had been taken into account (as a result of the sanctions, the bank had their ratings withdrawn). As a result, SMP Bank expanded its loan portfolio by 20 billion roubles (around US$500 million) in 2014.[52] Finally, in March 2014, President Vladimir Putin ostentatiously opened an account with Rossiya Bank into which his salary is paid.

In addition, despite the general tendency to impose stricter conditions on access to operations involving public funds for Russian banks, the government decided to grant access to SMP Bank and Bank Rossiya to conduct such operations. Ordinances signed by Prime Minister Medvedev on 28 October 2017 authorised the monies contributed to the fund of obligatory insurance against industrial accidents and vocational diseases to be deposited with Bank Rossiya and SMP Bank; moreover, Bank Rossiya was also allowed to accept deposits from the federal budget, and SMP Bank to receive spare cash from the state-owned enterprises.[53]

52 For more information, see А. Вержбицкий, 'Импортозамещение', *Forbes*, 3 April 2015, http://www.forbes.ru/forbes/issue/2015-04/283043-importozameshchenie

53 Cf. Ordinance of the Government of the Russian Federation, 27 November 2017, http://publication.pravo.gov.ru/Document/View/0001201710310025. For more information, see Т. Воронова, С. Бочарова, 'Банки Ковальчука и Ротенбергов допущены до государственных денег', *Ведомости*, 1 No-

Another important form of support for the Russian banking sector, and especially the banks under sanctions, was offered by the Central Bank of Russia, which created a national payment card system. This was established in 2014 to handle all card transactions in Russia, including transactions involving international Visa and MasterCard cards (which the system started to service in mid-2015). Thanks to this, those Russian banks that had been disconnected from the international systems (Rossiya Bank, SMP Bank and the banks operating in Crimea) could continue to use foreign-issued cards in internal Russian transactions. Moreover the national system issued a Russian payment card, MIR.[54] Thanks to its agreements with the large global payment systems such as MasterCard and JCB, which permit the issuance of dual brand cards, MIR functions both in Russia and abroad. As a result, the card became particularly popular in Crimea (where Rossiya Bank is one of the market leaders).[55]

4. Compensatory tax breaks for oligarchs

For those entrepreneurs from the president's inner circle who faced individual sanctions and restrictions on travel, it was particularly important to be exempted from taxes in Russia. The law to that effect, dubbed the 'Timchenko law' by the media, was enacted in a fast-track procedure in April 2017.[56] Under the new

vember 2017, https://www.vedomosti.ru/finance/articles/2017/11/01/740158-banki-druzei

54 More than 30 million MIR cards were issued before the end of 2017; they are available from around 150 Russian banks.

55 Rossiya Bank was one of the few Russian financial institutions to become involved in providing financial services for Crimea, which were of crucial importance for the Kremlin, including services for the Black Sea Fleet troops stationed there; it also acquired shares in the Simferopol airport and contributed to its expansion. The state-owned banks in Russia decided not to involve themselves in Crimea, fearing further Western sanctions.

56 Provisions on tax breaks for oligarchs under sanctions were added to the governmental draft bill 'On amending Chapter 23 of the Tax Code of the Russian Federation' (which initially did not concern that subject matter at all) in mid-March 2017 at the second reading. The amendments tabled by the depu-

rules, a natural person upon whom third-country sanctions had been imposed and who was forced to stay in Russia for at least 183 days a year (the number of days spent in Russia which normally entails a legal obligation to pay taxes in the Russian Federation) could avoid paying taxes in Russia if they could demonstrate that their tax domicile was in another country. To demonstrate this, the persons concerned only needed to present documents proving they were registered as taxpayers in a third country, without having to show that they actually paid any taxes, which facilitated abuse and effectively enabled the beneficiaries of the law not to pay any taxes at all. The law came into force retroactively, enabling the beneficiaries to claim back taxes paid since 2014. When introducing the new rules, the Russian government did not present any calculations of the likely cost to the state budget, and refused to disclose who benefited from the bill.

5. Indirect support mechanisms

The National Media Group (NMG) holding, controlled by Kovalchuk via Rossiya Bank[57], became one of the main beneficiaries of new regulations concerning the Russian media sector, including the 2014 bill which required foreign investors to scale down their stakes in media companies in Russia to 20%. NMG exploited the situation of the foreign investors who had been forced to divest

ties radically changed the meaning of the governmental draft, including its main assumption that the new law would not create any costs for the state budget.

57 The National Media Group was created in 2008 as a result of a merger between the media assets held by Rossiya Bank, Sogaz, the oil company Surgutneftegaz and the tycoon Alexey Mordashov. Its current ownership structure is unclear. The NMG Board of Directors is chaired by Alina Kabayeva, whom the Russian media regard as Vladimir Putin's partner, while Kirill Kovalchuk, a relative of Yuri Kovalchuk, is a member of the Board. NMG holds shares in three freely available television channels in Russia: it has 25% of shares in the country's most popular Channel 1 (which had a market share of 11.5% in 2016); an 82% stake in REN TV (6% market share) and a 72.4% stake in Channel 5 (5.9% market share). The Kovalchuk-controlled holding also owns the newspaper *Izvestia* (100%).

from most of their Russian assets by 1 February 2017, and took over many of those assets[58] – at no financial cost, according to Russian media. NMG reportedly took over those assets in return for assurances to its foreign partners that they would be able to remain on the Russian market, obtain broadcasting frequencies, comply with the new legal requirements, and receive administrative support.[59]

58 Acting via the Media Alliance company in which it holds an 80% stake, NMG has taken over control of 11 channels available in Russia of the US-based Discovery corporation, as well as 3 channels of the Turner Group (including CNN). NMG has also taken over 80% of shares in a company that operated 12 Russian-language versions of channels offered by the Swedish Viasat holdings. Thanks to those acquisitions, in 2016 NMG's share of the pay-TV market in Russia rose to 20%.

59 For more information, see К. Болецкая, 'НМГ собрала 20% рынка платного ТВ', *Ведомости*, 2 February 2016, https://www.vedomosti.ru/technology/articles/2016/02/03/626532-nmg-platyaschih-zritelei

IV. THE CONSEQUENCES OF THE SANCTIONS FOR THE PRESIDENT'S INNER CIRCLE AND OWNERSHIP RELATIONS IN RUSSIA

It is very difficult to accurately estimate the losses suffered as a result of the sanctions by these four entrepreneurs from Vladimir Putin's inner circle, because much information about operations concerning their assets remains undisclosed. Moreover, the impact of the Western sanctions has been compounded by the economic crisis in Russia, which has further adversely affected the performance of Russian companies. Separating the impacts of those two factors is practically impossible. Forbes rankings show that between February 2014 and April 2015 the total wealth of the men in question decreased by over a third, to US$14.2 billion.

Because of the sanctions, these entrepreneurs have had to scale down their foreign operations and put them under Russian jurisdiction. The men themselves and their assets became 'toxic', i.e. burdened with heightened risk. Even though most of them have only been subject to sanctions by the US, they have still been treated with caution by international business which did not want to endanger its deals with US (or European) partners. As a result, the Russians faced difficulties in accessing technologies and capital. The sanctions turned out to be painful for the Russian elite, not only in the financial dimension, but also due to hard-to-quantify non-material damage, including damage to their image and prestige related to their forced relocation to Russia and the restrictions on travel, which have undermined their international position.

However, the financial operations which the Russian oligarchs have undertaken have been successful in minimising losses abroad: they have managed to avoid freezes on most of their assets, or have succeeded in getting the restrictions lifted quite quickly. The fact that the four men's wealth was concentrated in Europe was crucial for the scale of the losses they suffered. The European sanctions were much less heavy-handed that the

American ones, thanks to which the Russian oligarchs could continue doing business abroad, either directly (like Boris Rotenberg or Gennady Timchenko) or via intermediaries (relatives or business partners). Identifying and preventing transactions aimed at circumventing the sanctions turned out to be very difficult, and required a great deal of determination from the Western states, because of the opaque ownership structures of many companies and the high dynamics of ownership transfers.

Because the sanctions targeted people who are at the core of the Kremlin elite and most probably responsible for the personal wealth of the president and his relatives, the Kremlin became heavily involved in supporting the select group of persons facing sanctions from the very start, in order to compensate them at least partly for the losses suffered. Measures aimed at rebuilding the wealth of Putin's insiders have been a co-ordinated element of state policy for the last four years. The public administration and the legislature became involved by enacting the necessary ordinances and laws, while the state-owned companies did their share by taking advantage of government contracts. Ambitious investment programmes by the state-owned corporations have for the most part been implemented by a select group of private companies. Public funds have been redistributed within a narrow group of the elite and the companies it controlled on the basis of political decisions, while competitive mechanisms have been almost completely excluded. Moreover, the oligarchs under sanctions were granted tax exemptions in Russia, in return for which they were expected to participate in projects of key importance for the Kremlin, such as the development of Crimea (including the construction of the bridge connecting the peninsula with Russia, and the provision of banking services for financial operations in Crimea).

The oligarchs have been assisted by the state despite the deteriorating living standards in Russia and dwindling real wages, and in many cases even at the expense of the general public, which has in many cases led to outbursts of public discontent. The deployment of the Platon toll system by Igor Rotenberg's company, which triggered protests by truckers throughout the country, is a case in point. Despite the large scale of the carriers' protests, the government proceeded to carry out its plans, which revealed where the Kremlin's priorities are, and how it is determined to satisfy the ambitions of the Russian elite, even if that means facing popular protests.

Thanks to the financial operations that were undertaken, and to the Kremlin's general support, the wealth of the Russian president's insiders has been growing in recent years, while a good part of that wealth is now concentrated in Russia. According to Forbes rankings based on official figures concerning the assets of the two hundred wealthiest Russians, Gennady Timchenko's wealth was worth US$16.8 billion in early June 2018, i.e. US$3.5 billion more than before the sanctions and the crisis. The total wealth of the Rotenberg family has been estimated at US$4.87 billion, i.e. US$800 million less than prior to the crisis, but it has been rising systematically over the last two years. Yuri Kovalchuk, whose assets were worth US$1.24 billion in June 2018, has also been making up for the losses, although the value of his wealth is still lower than before the crisis (US$1.4 billion in February 2014).

The special support from the state has been available only to selected oligarchs from the president's inner circle, but even they cannot take it for granted, as indicated by the declaration of loyalty to the president made by Timchenko in August 2014. Timchenko said in a press interview that he was ready to cede his assets to the state if necessary.[60] On the one hand he expressed his full loy-

60 See 'Если понадобится, завтра же передам все государству. Или на благотворительность', an interview with Timchenko in *Комсомольская правда*, 4 August 2014, https://www.kp.ru/daily/26264.5/3142757/. A similar declaration of loyalty was made by one of Russia's wealthiest oligarchs Oleg Deripaska in the wake of the Yukos affair in 2007. Deripaska said: "If the state says we need to give it up, we'll give it up. I don't separate myself from the

alty to the Kremlin, and on the other, he demonstrated his awareness that he could not possibly retain his assets if the government or a more influential elite member asked for them. So much had already been demonstrated by the case of Vladimir Yakunin, another presidential insider under Western sanctions, who has lost control of Russian Railways, the state-owned enterprise he had been managing for the last ten years, in unclear circumstances in mid-2015.[61]

The support that oligarchs from Putin's inner circle received in the first years after the imposition of the first wave of sanctions stands in sharp contrast to the rather restrained reactions by the Russian leadership to the financial difficulties faced by other Russian billionaires (including Oleg Deripaska and Viktor Vekselberg) who were put under the new US sanctions in April 2018.[62] Even though the sanctions delivered a major blow to the companies owned by those oligarchs, triggering panic on the Russian stock exchanges and currency markets, the Kremlin was not only slow to help,[63] but also allowed state-owned corporations

state. I have no other interests." K. Hille, 'Oleg Deripaska, Russian oligarch under siege for Putin ties', *Financial Times*, 4 May 2018, https://www.ft.com/content/08f230b0-4dfb-11e8-8a8e-22951a2d8493

61 The Russian media have implied that he was too insistent in demanding subsidies from the state's reserve funds, showing no appreciation of the financial difficulties in which the Russian economy finds itself. Despite losing his job, he has managed to retain a considerable portion of his wealth. For more information, see K. Chawryło, 'Dymisja szefa Rosyjskich Kolei – memento dla elity', *OSW Analyses*, 26 August 2015, https://www.osw.waw.pl/pl/publikacje/analizy/2015-08-26/dymisja-szefa-rosyjskich-kolei-memento-dla-elity

62 Most of the oligarchs who were put under sanctions in April 2018 had built their wealth back up in the 1990s. Even though throughout Putin's rule they have demonstrated their loyalty and readiness to share their resources, investing in infrastructure projects important for the state, they are not members of the president's inner circle of friends.

63 In May, Viktor Vekselberg was awarded a US$1 billion loan from the state-owned Promsvyazbank to repay his debt to foreign banks and avoid losing control of his business assets on which those banks had a lien. See Д. Коржова, 'Ренова Вексельберга погасила кредиты в западных банках на $1 млрд', *Ведомости*, 20 May 2018, https://www.vedomosti.ru/business/articles/2018/05/20/770058-renova-pogasila-krediti

(VTB Bank, Avtovaz) to comply with the US sanctions and discontinue their co-operation with those companies, which further exacerbated their situation.[64]

The flexible circulation of assets between the different members of the Russian elite, including flows between private entrepreneurs and state-owned companies (such as Gazprom and VTB), which occurred in the aftermath of the sanctions and the measures taken to mitigate their impact, highlighted the close symbiosis and increasingly blurred boundaries between private and state-owned capital in Russia. The consolidation of the state's role in the economy has been accompanied by the rise of selected private companies which have profited from co-operation with state-owned enterprises. This makes the picture of who really profits from business assets in Russia even more opaque.

Paradoxically, the Western sanctions have also had positive consequences for the Kremlin, because they have enabled it to further increase its control of members of the Russian business elite. The sanctions have forced the oligarchs to settle permanently in Russia and put most of their assets under Russian jurisdiction. This is in line with the Kremlin's policy of de-offshoring, which aims to persuade Russian businesses to stop hiding their capital in tax havens and repatriate it to Russia. In the aftermath of the sanctions, the dependence of business on the Kremlin has increased.

Moreover, the Western sanctions have reinforced the Kremlin's policy of self-isolation motivated by the Russian leadership's paranoid fear of an external, Western threat to its grip on power. This attitude has manifested itself in the ban on agricultural and food imports from the West and the policy of import substitution, which has also facilitated the redistribution of public funds to

[64] In May 2018 the VTB Bank announced that it had stopped co-operation with Deripaska's Rusal concern and would not extend any new loans to it, while the Avtovaz automotive holding announced that it was seeking new aluminium suppliers to replace Rusal.

selected companies in the form of subsidies and cheap loans, and further restrained competition for foreign products and services on the domestic market (to the benefit, *inter alia*, of Timchenko's agricultural and foods businesses).

The many efforts made by the Kremlin in recent years to get the sanctions lifted have not been successful, and moreover, Russia's actions have provoked a further tightening of restrictions, especially those imposed by the United States.[65] At the same time, Washington's policy towards Russia has become much less predictable, and the successive waves of sanctions have been increasingly painful to business in Russia, posing a mounting threat to the stability of the Russian economy. Meanwhile, because of the considerable asymmetry in Russian-US economic relations (in favour of the United States), Moscow has had very little room to effectively respond in the economic dimension to the United States' sanctions policy. So much is clear from the provisions on retaliatory measures that Russia could take against Washington as proposed in the law on counter-sanctions, or the proposal to punish those who comply with US sanctions with a fine or imprisonment.[66] Enforcing those provisions would hit the Russia economy more than it would American interests. That is why the Russian

65 For more information, see I. Wiśniewska, S. Kardaś, 'Ustawa o amerykańskich sankcjach przeciwko Rosji', *OSW Analyses*, 4 August 2017, https://www.osw.waw.pl/pl/publikacje/analizy/2017-08-04/ustawa-o-amerykanskich-sankcjach-przeciwko-rosji; I. Wiśniewska, 'Washington's game of 'sanctions poker' Russia awaits America's decisions', *OSW Commentary*, 5 February 2018, https://www.osw.waw.pl/en/publikacje/osw-commentary/2018-02-05/washingtons-game-sanctions-poker-russia-awaits-americas and M. Menkiszak, 'A test of strength. The escalation of the crisis in Russian-American relations', *OSW Commentary*, 11 April 2018, https://www.osw.waw.pl/en/publikacje/osw-commentary/2018-04-11/a-test-strength-escalation-crisis-russian-american-relations

66 Most of the economic retaliatory measures proposed by the Russian parliament while working on the bill were much more harmful to the Russian economy than the United States. See I. Wiśniewska, 'Russia's demonstrative response to US sanctions', *OSW Analyses*, 23 May 2018, https://www.osw.waw.pl/en/publikacje/analyses/2018-05-23/russias-demonstrative-response-to-us-sanctions

leadership has been trying first and foremost to ease the negative impacts of Western sanctions and hamper their enforcement. The government of the Russian Federation has been mainly concerned about ensuring the secure functioning of the defence and security sectors, and to this end, all transactions involving defence companies or the Ministry of Defence have been made secret. Moreover, the financial services for the entire defence sector have been concentrated in one bank, the state-owned Promsvyazbank. The government has also offered Russian entrepreneurs who hold foreign assets special conditions for repatriating and investing their capital in Russia.

Looking at the costs and consequences of the sanctions for Russia, as well as Moscow's responses so far, it seems likely that in the immediate future, the Kremlin will continue making efforts to prevent the synchronisation of the European and American sanctions policies towards Russia. Moscow will demonstrate its willingness to co-operate with European partners, while at the same time exploiting the divergences of interests among different European states, and between Brussels and Washington, in order to prevent a new tightening of European sanctions and secure the easing of the existing ones. That is because the European Union remains Moscow's single most important economic partner.

At the same time, the Kremlin will try to prevent a further escalation of the conflict with the United States; this will be the aim of the new meeting between Putin and Trump that Moscow is seeking. Apparently the Kremlin still believes that the two presidents will be able to develop a special personal relationship, thanks to which it will be possible to dissuade the US president from tightening the sanctions policy towards Russia – and achieve the extra effect of deepening internal political divides within the US political elite.

A further expansion of the US sanctions could be a major blow to the Russian economy, as demonstrated by the aftermath of the inclusion of Rusal and Oleg Deripaska on the US sanctions list in

April 2018. Russia is only beginning to recover from the financial crisis; despite higher oil prices it has been unable to rebuild its financial resources, and is not in a position to help all the oligarchs in distress (the US sanctions list includes around 100 Russian billionaires). We should therefore expect that the new group of Russian oligarchs sanctioned by the United States, most of whom built up their wealth back in the 1990s, will not receive the kind of state support that was extended to President Putin's friends. The Kremlin may even exploit the troubles of the Russian oligarchs to strip them of some of their assets and start a new wave of ownership transfers in Russia. Deripaska has already withdrawn from the management boards of his companies, and is considering scaling down his stakes, as a result of which some shares will most probably be taken over by state-owned enterprises.[67]

The limited opportunities for foreign expansion that Russian businesses have, combined with a further tightening of sanctions against the oligarchs, may trigger a mounting rivalry among the members of the Russian elite over the available business assets, with the group of potential beneficiaries becoming ever narrower.

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[67] В. Петлевой, П. Трифонова, 'Дерипаска снизит долю в En+ из-за санкций', *Ведомости*, 27 April 2018, https://www.vedomosti.ru/business/articles/2018/04/27/768154-deripaska-snizit-v-iz-za