

### ***Applying the Concept: Foreign Investment and the Russian Legal System***

The headline on the front page of the *Financial Times* on May 13, 2005 read “Carlyle abandons \$300m Russian fund plan.” And along side the story was a picture of Mikhail Khodorkovsky, head of the giant Russian oil company Yukos, behind bars, obviously in jail. Carlyle, one of the biggest private investment companies in the world, had bailed out of its Russian investments on the news that Khodorkovsky and the Russian government were clashing. Several weeks later, after a lengthy trial, Mr. Khodorkovsky was sentenced to nine years in prison.

Until he was arrested in the fall of 2003, Mr. Khodorkovsky ran Yukos, a firm that provided 2 percent of the world’s oil. He was said to be the richest man in Russia, with personal wealth estimated at \$15 billion. That was before he began publicly criticizing the Russian government.

Privatization allowed a handful of Russians to amass riches in questionable ways after the Soviet Union dissolved in the 1990s. The bargain seems to have been that they would be allowed to keep their wealth as long as they paid their taxes and kept out of politics. It seems that Mr. Khodorkovsky violated the deal by criticizing the government, and the result was a tax bill that exceeded the value of the company and a trial that has landed him in jail for tax evasion.

It is hard to feel too much sympathy for a billionaire, especially one who appears to have made his fortune using connections to purchase state-owned oil assets at far below market prices. But in this particular case the problem is that Russian President Vladimir Putin looks as if he is using the legal system for political purposes. This is the real reason that Carlyle and other foreign investors got nervous and withdrew investments. If laws are enforced selectively, it leads to instability in the financial system because it is hard to know what the authorities will let you do. Without legal protections, no one wants to invest. Until Russia’s government is considered to be more stable and democratic, investors will remain leery.