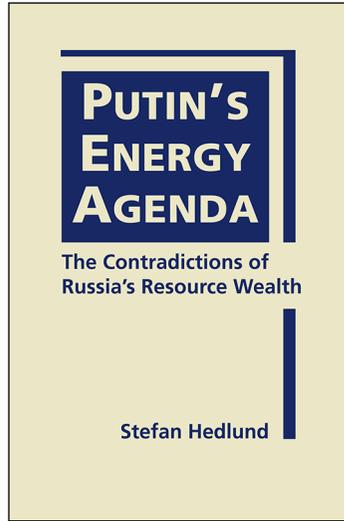


EXCERPTED FROM

**Putin's Energy Agenda:
The Contradictions of
Russia's Resource Wealth**

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ISBN: 978-1-62637-069-2 hc



LYNNE RIENNER PUBLISHERS

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This excerpt was downloaded from the
Lynne Rienner Publishers website
www.rienner.com

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1

Russia Emerges out of Chaos

The collapse of the Soviet order in Europe was a momentous event. It had been predicted by some, but such predictions had been made for the wrong reasons, such as armed conflict or rebellion by national minorities.¹ The way in which it finally did unravel was both highly unexpected and deeply revealing of the inherent fragility of the system. Mikhail Gorbachev's policies of glasnost, perestroika, and new political thinking were designed to rejuvenate the Soviet Union. But in the end, they brought about its dissolution. The outcome could not fail to bring to mind Alexis de Tocqueville's classic dictum that the most dangerous moment for a bad government is when it begins to reform.²

The sudden breakdown of a deeply ingrained bipolar world order was bound to have far-reaching consequences. And so it did. At the outset, most could entertain only positive visions. The end of the Cold War would allow states to cash in on a peace dividend through substantial restructuring and downsizing of their standing military forces. The envisioned transition to a rules-based market economy would open up tantalizing business opportunities, as long-deprived populations would scramble for Western consumer goods. And the transition to democracy and the rule of law would herald a new era of peace and fruitful international cooperation.

The Europeans in particular were prone to see a radiant future ahead. At a meeting in Maastricht in December 1991, only two weeks before the formal dissolution of the Soviet Union, European leaders agreed to transform the European Community into a European Union with a common constitution, a common currency, and eventually a common foreign and security policy. Europe, it was believed, had finally come of age and would now

stand ready to assume the responsibilities of a global player. The days when Henry Kissinger could quip about the lack of telephone contact with Europe were finally over.

It did seem very promising. But reality would not live up to the rosy expectations. The transition to a market economy resulted, at best, in what came to be known as a transformational recession. Even in the best-performing countries, such as Poland, production went into years of decline, causing hardship and raising questions about the wisdom of marketizing reform. Countries even less fortunate would experience deep and protracted depression, with severe implications both for the poor and for the pursuit of reform. In Russia, it would not be until 2007 that the level of gross domestic product (GDP) achieved in 1990 was once again attained.

The transition to democracy was similarly marred by setbacks. Although countries in the Baltic and in Central Europe would eventually pass the test of democratic consolidation, reform-minded parties as a rule lost ground to nationalists and to right- and left-wing extremists. Many countries experienced regime interventions that included vote-rigging and other, more blatant forms of electoral fraud. Some even relapsed into clan-based politics and what Max Weber would have referred to as sultanic rule.

The new world order was put to an early test when bloody civil wars broke out in the Balkans, and the Europeans eventually had to turn to the United States for help. The controversy over how to deal with the crisis drove home to Moscow that Russia was still not considered a reliable partner by the West. It was a dismal lesson. Though the Cold War might have been over, the centuries-old tradition of distrust and divergent interests between Russia and the West had not been laid to rest. Slowly but surely, new lines of division—not to mention confrontation—began to emerge.

As an increasingly resentful Russia began to ratchet up its rhetoric, other former socialist states began to strive for integration into Western structures such as the North Atlantic Treaty Organization (NATO) and the European Union (EU). Following much debate, public as well as internal, over how to proceed, in 1999 NATO made a “Big Bang” decision, granting membership to four Central European states (Poland, Hungary, Slovakia, and the Czech Republic), together with three Baltic states (Estonia, Latvia, and Lithuania). In 2004, Bulgaria and Romania followed, and in 2009 Albania was admitted. In a parallel, albeit slower, process, the EU followed suit with a similar enlargement. In 2004, the very same Baltic and Central European states were admitted, together with Slovenia, Malta, and Cyprus. Bulgaria and Romania followed in 2007, and Croatia in 2013.

Although Moscow did grudgingly accept the membership of the Baltic and Central European states in the Western alliances, countries such as Ukraine and Georgia called for lines to be drawn in the sand. Following the Revolution of Roses in Georgia in 2003, President Mikheil Saakashvili pur-

sued a strongly pro-Western policy that included inviting US military advisers to train Georgian troops and sending some of those troops to join US coalition forces in both Iraq and Afghanistan. Following the Orange Revolution in Ukraine in 2004–2005, President Viktor Yushchenko was even allowed to address a joint session of the US Congress, where he received a standing ovation. The doors to NATO for a free and democratic Ukraine appeared to be wide open.

While the desire to join the EU may have been conditioned by a combination of hopes for economic benefit and for the security membership in a Western alliance, that of joining NATO was clearly driven by apprehension over a resurgent Russia. And the haste in undertaking the controversial “Big Bang” enlargement was equally clearly motivated by a fear that the window of opportunity for eastward expansion might soon be shut. From Moscow’s perspective, it was becoming clear that Russia was an outcast, not to be considered for membership in either of the two Western alliances. Consequently, some prominent Russian observers became increasingly insistent that enlargement represented a breach of a promise once allegedly made to Gorbachev, that acceptance of German (re)unification would not be followed by one inch of eastward expansion by NATO.³

By the time Putin handed over the presidency to Dmitry Medvedev, who was duly elected in March 2008, the process was about to stabilize. The EU was headed for a deep fiscal crisis that would delay any ambitions for further additions to its membership. And the brief war that was fought between Russia and Georgia in August 2008 was viewed on the Russian side as having put a conclusive halt to plans for further NATO expansion. The victory of Viktor Yanukovich in Ukraine’s 2010 presidential election signaled the demise of the former heroes of the Orange Revolution, with Viktor Yushchenko completely marginalized and Yulia Tymoshenko headed for prison. The victory, finally, of Bidzina Ivanishvili in Georgia’s 2012 parliamentary elections pointed to the pending demise of Mikheil Saakashvili, thus removing a very personal thorn from Putin’s side.

It may have looked as though Russia was now well on its way toward recapturing its old position as a great power. The resurgence entailed a customs union formed with Belarus and Kazakhstan in 2010, a common economic space launched with the same members in 2012, and visions of a fully fledged Eurasian Union to be formed in 2015. To Putin, all of this was most satisfactory. In April 2011, he hailed the customs union as “the most important geopolitical and integration event in the post-Soviet space since the break-up of the Soviet Union,”⁴ and in February 2013 he said that post-Soviet integration was “unstoppable.”⁵ Whether these projects will in the end succeed in attracting sufficient membership to overcome the Russian trauma of lost superpower stature remains to be seen. Even if they were to do so, which is highly doubtful, much damage has already been done.

While Americans and Europeans found plenty of reasons for disappointment, not to mention disgruntlement, Russians in general considered themselves the main losers. Their state had been fragmented, their social and economic life had been thrown into turmoil, and their nation's standing on the global scene had been vastly diminished. From the Russian perspective, there were numerous reasons for resentment.

First and foremost was the sense of loss and humiliation associated with the collapse of the Soviet Union. In the words of Marie Mendras: "Twenty years on, the Russians still cannot comprehend how such rapid destruction was possible, and they blame it on Gorbachev and the Communist reformers. Mikhail Gorbachev's political destiny was heroic and tragic."⁶ But it was not just Gorbachev who was held culpable. The general chaos that marked the 1990s would be firmly blamed on Boris Yeltsin. To historically conscious Russians, his time in power would come to be known as a "time of trouble," a *smutnoe vremya*, recalling the period of utter chaos that followed in the wake of the collapse of Muscovy, toward the end of the sixteenth century. In addition to the general resentment against Western-inspired reform that emerged during the Yeltsin era, hard-line circles would also and more seriously find reason to view Western policies as a stab in the back, aimed at dismembering Russia in a time of weakness.

Looking back, the first decade after the dissolution of the Soviet Union seems an amorphous period in Russian development. It began with great hopes for a rapid rise in consumer welfare, for global integration, and for a constructive partnership with the West—on equal terms. What followed instead was economic depression, political fragmentation, and a severe identity crisis. The sense of bewilderment about what had happened was manifested in a search for a new Russian identity, most notably so in a special commission established by Yeltsin in 1996 for this very purpose.⁷ Although none of this was anticipated at the outset, at least not by any of the leading international actors, with the benefit of hindsight we may see rather clearly why the process evolved the way it did.

The ambition to undertake a transition to democracy and a rules-based market economy was certainly laudable. If reform really could have been implemented with a tabula rasa—without consideration of historical and cultural legacies—then it all might have turned out very differently. Democratization could have ensured accountability in government and thus laid the foundations for credible government enforcement of contractual rights. Marketizing reform could have been based on secure property rights, ensuring improved corporate governance and enhanced efficiency and consequently allowing Russian companies to compete favorably in global markets. And transition to a reasonably sized and structured defense force could have been combined with conversion of military to civilian production. The latter would have allowed the resources and brain power that was housed in military industries and research facilities to ensure a place for

Russia in the global market for civilian high technology. But as events would show, the challenges that were placed before the reformers were much greater than commonly anticipated.

There were good reasons why economics in particular failed to conceptualize the problems ahead. Standard neoclassical economic theory does well when faced with marginal change under conditions of reasonable certainty, all else being equal. The ambition to undertake sweeping systemic change represented something very far removed from the textbook ideal. It was a case of simultaneous change on multiple margins, under conditions of extreme uncertainty and pursued by hosts of actors with multiple agendas, often under the influence of conflicting advice.

The striking diversity in outcomes in the nearly thirty transition economies at that time drives home an important lesson. Instead of believing that simple deregulation would be sufficient to ensure a successful transition, the great disparity in initial conditions should have been taken into account. Included, here were differences in historical and cultural legacies, and the associated fact that different regimes had very different agendas. What today may look to outside observers as cases of failed reforms may to some regimes represent quite successful outcomes.

What unfolded may be viewed, from a more theoretical perspective, as a major confrontation between the formal and informal dimensions of the institutional matrices of these countries. Agency-based policy formulation aimed to introduce sets of formal institutions that in the case of Russia had been repeatedly attempted before but had never taken root. The counterforce was powerful institutional inertia in systems of informal norms. These norms had emerged in response to the seven decades of market repression that was the reality of central planning, and they were arguably rooted in deeper Russian history.

Recalling Nobel Prize laureate Douglass North's central insight that it is the norms that provide legitimacy for the rules, we may understand why systemic change resulted in so many unintended and often negative consequences.⁸ When self-interested actors are faced with opportunity, the core question to ask is whether they will prefer a value-adding or a value-redistributing or even a value-detracting strategy. In plain language, one should ask whether the majority of economic actors will use opportunity to form new ventures that are in accordance with given rules and add to GDP, or will prefer rent-seeking and outright predatory options that enhance their own wealth at the expense of others and in the process detract from GDP.

Much of the answer to this core question rests in the third part of North's institutional triad, that of enforcement mechanisms. Under a stable market order that is characterized by the rule of law, actors emulate the norms of the Golden Rule, exercising self-restraint when faced with the temptation to defraud others. Such voluntary rule-abiding behavior is the avenue to a high-performance economy. The alternative is that economic

actions are constrained by rules upheld not by internalized informal norms but by government supervision and powerful sanctions.

The Soviet economy was a classic case of the latter. It was marked by a grossly inefficient formal sector, surrounded by an extensive informal sector in which actors attempted to compensate for poor remuneration from formal-sector work with private semilegal or even illegal ventures at the fringes. Although such ventures were often hyped by Westerners as evidence that private production is superior to public, this was largely ideological wishful thinking. As evidenced by many third world countries, the true hallmark of informal-sector activity is that much effort is expended producing little value added.⁹ Even more important, in the Soviet case informal-sector activity generated distinctive norms regarding the morality of rule evasion and of defrauding the state, norms that would survive well into the post-Soviet period.¹⁰

The collapse of the Soviet Union was associated with, and actually preceded by, a weakening of the authority of the Communist Party in restraining private informal sector activities. The initial result was a proliferation of cooperatives, soon to be followed by a process of spontaneous privatization and eventually by a highly targeted process of insider privatization that transferred substantial wealth into the hands of cronies of the regime. Most if not all of this took place in a void, marked by the absence of adequate legislation and supervisory agencies. The discipline of the party was gone, and the discipline of the market had not yet taken hold. Pursuing a market-based economy without adequate legislation on bankruptcy, for example, was destined to produce poor results.

Adam Smith, although his thinking has been enlisted as support for neoliberal policies of extreme deregulation, was eminently aware of the dangers involved in allowing free rein for the pursuit of self-interest. His fabled “invisible hand” was used, in *The Wealth of Nations*, more as metaphor than as an argument in favor of unconstrained pursuit of self-interest.¹¹ Viewed as a whole, the process of Russian economic reform provided ample support for Lionel Robbins’s classic dictum that “the pursuit of self-interest, unrestrained by suitable institutions, carries no guarantee of anything but chaos.”¹²

The “wild capitalism” of Russia in the 1990s was marked by ad hoc policymaking, initially known as “shock therapy,” that entailed little effective coordination and little operational vision, beyond an emphasis on deregulation and speedy privatization. One might be tempted here to recall Lenin’s frequent reference to Napoleon’s classic maxim *On s’engage, et puis on voit*.¹³ The outcome was marked by uncertainty, widespread distrust in authorities, a short time horizon for decisionmaking—and mass looting.

The conclusion of this first phase in Russian post-Soviet adjustment arrived in August 1998, when the ruble was devalued and the country’s fi-

nancial markets suffered a meltdown, wiping out some \$40 billion in short-term treasury bills (the notorious GKO).¹⁴ The calamity had the combined effect of further entrenching already deep Russian resentment of Western-inspired reform and of provoking resentment from Western investors, consultants, and politicians. The latter would now blame the Russians for losses both of financial capital and of political prestige that had been vested in the wisdom of reforming Russia.¹⁵

At the time, it was widely believed that Russia was simply finished and would not be able to stage a comeback within a foreseeable future. But such gloomy predictions would soon be proved wrong. Buoyed by devaluation and by a rapid rise in hydrocarbon prices, the Russian economy staged a remarkable recovery, recording average annual growth during Putin's first two terms in office of about 7 percent.

The coming to power of Vladimir Putin represented a seemingly new and illuminating stage in Russian development. The way in which Russia emerged out of the "time of trouble" under Yeltsin provided fundamental insights into the scope and prospects for transforming institutional arrangements that for centuries had set Russia apart from other European states.

The sudden spike in the price of oil that marked Putin's first term in office produced a massive windfall of revenue from hydrocarbon exports. During the Yeltsin era, the main sources of rent-seeking had been rigged privatization deals, manipulation of quotas and licenses to exploit the substantial differences between domestic and foreign prices, and the rapid buildup of both domestic and foreign debt. The bonanza of hydrocarbon revenue added a new dimension to the ongoing games for power and profit. It created substantial new opportunities, and the response was a mixed bag of various ambitions and agendas.

On the positive side, it is true that much of the influx of petrodollars was put to prudent use in paying down the country's foreign debt and in building cautionary reserves that would come in handy when the global financial crisis erupted. While this was to the great credit of Aleksei Kudrin, Putin's long-serving minister of finance, it had little impact on the fundamental determinants of how the game was played. The dark side of the hydrocarbon bonanza was that it also ratcheted up the temptation to loot, to the point even that corruption would become the linchpin of the system.

During the Yeltsin era, great scandal erupted when it was revealed that leading "reform economists" had received an advance royalty of \$90,000 for a book that would never be written, and presumably was never intended to be written. During the Putin era, corruption rose to such levels that bribes of \$100,000 would be viewed by leading kleptocrats as simply laughable.

The magnitude of the difference is reflected in allegations by Moscow political analyst Stanislav Belkovsky, made in a 2007 interview with the

German newspaper *Die Welt*, that by then Putin had succeed in accumulating a private fortune of \$40 billion, making him the richest man in Europe.¹⁶ By 2012, Belkovsky would have raised the estimate to \$70 billion, making Putin the wealthiest man in the world.¹⁷ Not bad for a rather junior operative in the service of the Soviet KGB.

The main thrust of my argument is that struggles over access to resource rents emerged as the true defining feature of the Putin era. Entailed here were a host of varying objectives. Temptations ranged from using the energy wealth to restore national pride, to using threats of price hikes and supply disruptions as punishment for neighboring states that refused to comply with Russian interests, to simply diverting hydrocarbon revenues for personal enrichment. Needless to say, there was a price to be paid. As will be detailed in subsequent chapters, the associated absence of a coordinated policy on how to develop rather than simply loot the country's energy resources would have seriously negative consequences.

By the time that Boris Yeltsin opted to step down, prematurely in the eyes of many if not most Russians, both market economy and democracy had been thoroughly discredited. It was symptomatic of Russia's incomplete transition to a constitutional order that Yeltsin's time in power would end in an elaborate inside operation to resolve a pending crisis of succession. Stephen Blank maintains that Vladimir Putin's ascent from obscurity to supreme power was the "key to the resolution of a succession and state-building crisis on the part of a coalition of elites which, it turned out, held rather disparate views of what the future would bring."¹⁸

When Putin assumed power, having been duly elected president in March 2000, he was clearly expected to restore order. The experience of hardship and dislocations that had marked the "time of trouble" would be used to rationalize and legitimate harsh policies devised for this purpose. Deliberately recalling the lengthy and increasingly fossilized leadership of Leonid Brezhnev, Yeltsin's time in power would be referred to as a "period of stagnation," a *period zastoia*.

During his first term in office, from 2000 until 2004, Putin was still viewed as a promising reformer. He struck a deal with the Communist Party in the Duma, allowing long-delayed and much-needed reforms on matters such as land use and taxation to be rapidly enacted. Even when his increasingly authoritarian stance began to cause what some referred to, euphemistically, as "democratic backsliding," he still retained his credentials as market reformer.

But the early hopes for a new world order, marked by friendship and cooperation between Russia and the United States, would soon fade. Though Putin was among the first to offer condolences to the American people after the terrorist attacks of September 11, 2001, and promised to as-

sist the United States in the “war on terror,” he would soon begin to feel that there was little reciprocity and that the United States was not to be trusted as a friend or even as a partner. Although accusations that the United States contributed to the demise of the Soviet Union may not have been seriously believed, the fact remained that the Soviet empire had fallen apart and that NATO had made big inroads into the periphery of the former Soviet Union itself. The latter was not to be taken lightly.

When President Putin delivered his televised 2005 “state of the federation” address, he may have felt genuinely justified in claiming that “the collapse of the Soviet Union was a major geopolitical disaster of the century.”¹⁹ His own personal background would clearly also play into the formulation of a policy on how to make Russia great again. During his time as KGB operative in the German Democratic Republic (East Germany), he had the opportunity to watch up-close what power from below could achieve. And it is not a far-fetched guess that he harbored a deep sense of distrust, not to mention resentment, of the West in general.

Although Russia has arguably never been more secure from foreign invasion than during Putin’s time in power, the rhetoric from hard-line circles would become infused with virulent projections of NATO as an enemy, and with a growing sense of hostility toward the West in general. Sentiments of this kind came to a head at a security conference in Munich in February 2007, where Putin accused the United States of “an almost uncontained use of military force” and made it clear that Moscow would no longer accept being treated without respect.²⁰

It was a heady brew. Russia might have lost a battle, but the war was still on. And it was a war in which Moscow would have to stand its ground. In military circles, the ensuing urge to overcome “superpower hangover” was fueled by feelings of gross conspiratorial injustice and by a belief in the temporary nature of the weakness. NATO generals would report frequent cases of conversation with Russian counterparts whose message was to wait and see, that “we shall be back.”²¹

With the election of Barack Obama as president of the United States, there was a brief interlude, framed as a “reset” of relations between Russia and the United States. As Dmitry Medvedev, the equally newly elected Russian president, proved to be responsive, hopes were rising that the increasingly confrontational Putin era was over. Consequently, diplomatic efforts were made to persuade Medvedev to run for a second term. As it turned out, however, that possibility had never been real. When Putin returned to the Kremlin following his turbulent election in March 2012, there was general agreement that the reset was dead.

The negative reactions that followed brought into focus the question of whether Putin had a deliberate and premeditated authoritarian strategy for

Russia that he would now return to. Given how dramatically different the Putin era did seem to be, if compared to that of Yeltsin, it was tempting to believe that there had indeed been a master plan of sorts, perhaps even one that incorporated the building of an energy superpower.

There is a clear danger of overinterpretation here. With the benefit of hindsight, it is always tempting to assume that deliberate policies have been pursued and to see causality where none may have existed. In countries with strong leaders, it becomes all the more tempting to suggest that what evolved was in accordance with the ruler's preferences.

The plethora of distinctive slogans that accompanied Putin's first term in office did support such a view, ranging from the introduction of a "dictatorship of the law" and a "power vertical" to threats of eradicating the oligarchs "as a class." His characteristically foul language added to the worries that some felt about a pending police state, about a return to autocracy, and about the rebirth of imperial ambitions. But we must be wary of assuming that what did happen was in line with some more detailed vision. It would simply ascribe to the ruler far too much capacity in achieving institutional transformation by intervening directly and deliberately.

There can be little doubt that Putin did have certain overriding ambitions. He was clearly committed to putting an end to the chaos of the Yeltsin era, to restoring the pride and dignity of Russia, and to standing up against the West. But these were very general ambitions concerning desired outcomes. They did not really touch on the fundamental institutional characteristics of the system. As Robert Ortung puts it, the main driver of early political events was simply that of Putin "reacting to his perception of the 1990s and working to correct what he considered to be some of the mistakes of that era."²²

What happened during Russia's first two decades of post-Soviet existence was not so much the result of deliberate policy. Rather, it was a case of ongoing, endogenous, systemic readjustment, mainly in the form of old, established institutional patterns responding to massive systemic shock by reestablishing themselves. Agency-based interventions were obviously important, but they did not always have the intended consequences.

The initial trigger was the erosion and eventual collapse of Communist Party command and control, which implied that state property was suddenly up for grabs. Faced with massive opportunity, and with equally massive uncertainty, self-interested actors formulated strategies for gain that wrought serious havoc on the prospects for an orderly transition to democracy and a rules-based market economy. With Putin's ascent to power, the nature of the game appeared to be transformed. New cronies of the regime were promoted, and the role of hydrocarbon revenues became paramount. But the nature of the game remained that of multiple actors responding to multiple

changes in multiple ways. The frequent views of Putin as a strong and decisive leader bent on remaking Russia in his image grossly underestimate the power of institutional inertia, notably the dependency that follows from investments made in playing opaque influence games.

Against the prevailing imagery of a radical break between the Yeltsin and Putin regimes, replacing ambitions toward democracy with ambitions toward authoritarianism, Stephen Holmes suggests that closer consideration will instead reveal substantial continuity and systemic inertia. Below the turbulent surface, the bureaucracy simply muddled on. Enjoying a vast expansion in its numbers, which had begun already under Yeltsin, under Putin it persisted with impunity in tending to its own interests and in simply ignoring directives from above.²³

The point of departure for this book shall be that as Russia emerged from the “time of trouble,” Russian elites were permeated by an increasingly powerful drive to restore lost greatness. I agree with Pavel Baev’s argument that these elites are possessed by a “mental scheme” of great power, of Russia as an “indispensable power” that is “objectively destined to come out as an independent player, a separate center of force not to be dissolved in any international amalgamations.”²⁴

Public opinion polls have also demonstrated firm support from the general population for such an agenda.²⁵ The trauma over the loss of the Soviet Union had been compounded by a sense of shame over the sometimes rather odd forms of behavior that were displayed by President Yeltsin in front of foreign audiences. President Putin’s promise to restore the country’s dignity was consequently well received.

Although there may have been broad agreement on the need to restore Russian greatness, that still left unanswered the question of how to achieve it. There was, above all, a distinct risk here of overestimating the ability of the ruler to ensure implementation of whatever plans he might have nourished. Posturing as a fearsome authoritarian leader is one thing. Making sure that underlings actually do what they are told is something very different. In the words of Holmes, the predicament of the Putin regime provides an important insight, namely, that “an authoritarian regime is almost as difficult to create and consolidate as a democratic regime.”²⁶ It is against this background that we must view the entry onto center stage of the Russian energy complex and the ensuing ambitions to build an energy superpower.

When Putin embarked on his program of “authoritarian restoration,” the military was in such a sorry state that reclaiming greatness by way of restoring a military superpower was clearly not an option. Proudly proclaiming that it was promoting conversion of military to civilian production, the Yegor Gaidar government undertook sweeping cancellations of state orders to the country’s formerly mighty military-industrial complex,

which then ground to a halt. From 1991 to 1998, the output of this crucial sector dropped by more than 80 percent.²⁷ Given that military production had accounted for perhaps 30 percent of Soviet GDP, this was an important reason why the country was thrown into depression.²⁸

The Kremlin, having divested itself of the option of placing a wager on the military complex, instead logically focused its ambition to restore greatness on the energy complex, which offered a very different set of opportunities. To Baev, the shift of focus from the military to the energy complex occurred simply by default: "As the more traditional characteristics that justified Russia's claim for this status, like military might or cutting edge natural science, have been eroding, energy has become the default option that appeared infallible."²⁹

It is true that by the time of the collapse of the Soviet Union the Russian energy sector was beset by numerous problems. It suffered from a dilapidated infrastructure, and it was faced with the fact that traditional oil and gas fields in Western Siberia were being depleted. Maintaining a high rate of output would require moving into new areas, into Eastern Siberia and into the Arctic offshore. Meeting the challenges of adverse climate and geology that mark these regions would in turn require access to foreign technology. But in theory, as in the case of the attempted transitions to democracy and market economy, none of this was beyond the realm of the possible.

A considered policy of restructuring and privatization could have resulted in better corporate governance. Targeted investment into upgrading pipelines and compressor stations could have paid off handsomely. A wager on exploration combined with foreign partnerships to acquire technology could have ensured new field development. A policy of energy conservation and of increased energy efficiency could have freed up larger volumes of exportable resources. And a rational business model could have been formulated to integrate pipelines, tankers, and liquefied natural gas (LNG) plants into a viable marketing strategy.

The outcome could have been an energy superpower in a positive commercial sense, with energy companies assuming the role as drivers of high-technology development. It might even have been supportive of the vision of Anatoly Chubais, espoused in 2003, that "Russia's ideology in the 21st century should be liberal capitalism with the aim of creating a liberal empire."³⁰

Although there has been much talk about a presumed need to diversify the Russian economy, which essentially means attempting to escape from the dependence on hydrocarbons, there is little actual substance in such talk. It is, on the contrary, easy enough to agree with Clifford Gaddy and Barry Ickes that "even under optimal conditions for investment, any dream

of creating a 'non-oil' Russia that could perform as well as today's commodity-based economy is unrealistic. The proportion of GDP that would have to be invested in non-oil sectors is impossibly high."³¹

Thane Gustafson makes much the same point: "Oil, together with natural gas, remains Russia's chief comparative advantage in the modern world." And he calls for a realization by Russian leaders of where their efforts need to be aimed: "But Russia can make better use of the opportunities that oil offers as a high-tech sector and as a catalyst for home-grown innovation."³²

The conclusion reached by Gaddy and Ickes is twofold. First, that the only realistic future for Russia is one that continues to be based on the commodity sectors, and second, that true modernization of Russia is not possible without modernization of its oil and gas sectors. This would be the way in which a wager on the energy complex could be construed as a sensible choice, if not the only rational choice. If only a way could be found to achieve modernization of the energy complex, Russia would be home free: "With the oil and gas companies in the lead for modernization, Russia would become a genuine energy superpower, an 'energy superpower in depth.'"³³

What followed instead was a scramble by hosts of differently motivated actors to secure their own short-term interests, often with little regard to collateral damage. Writing about developments in the military sector, Stephen Blank presents the image of "a game played concurrently on multiple boards with multiple interrelated players all jockeying for power and assets." And he argues that "this game has gone on, relatively uninterrupted, for decades if not centuries," conditioned by "the unending legacy of how to overcome backwardness."³⁴

Much the same can be said about the games that have been played around the country's energy assets. I agree, for example, with Markku Kivinen's suggestion that what is good for the Russian natural gas giant Gazprom may not necessarily be good also for Russia. Rather than view Russia as a monolithic actor in the energy field, we should note the presence of numerous competing agendas and conflicting interests. Gazprom has suffered from being at the same time a commercial operation and a residual ministry. Tax and pricing policies have been held hostage to competition between various resource lobbies. The relative fortunes of major actors such as Gazprom and Rosneft are determined by key political appointments at the peak of power. Even the "energy superpower" agenda, in Kivinen's words, is more likely driven by domestic than by foreign policy agendas.³⁵

The process as a whole resulted not just in a massive redistribution of both assets and revenue streams, allowing some to build up substantial private wealth. More seriously, it also had a clearly detrimental influence on

the prospects for reforming the country's energy sector. On the domestic scene, competing agendas and outright turf battles wrought havoc on the prospect for exploration and development of new oil and gas fields as the old went into decline. In the foreign policy field, blurred lines of division between commercial and foreign policy objectives of major energy companies such as Gazprom caused a plethora of problems, ranging from conflicts with neighboring governments to damage to Russia's reputation as a secure provider of energy, and massive outlays on the construction of commercially dubious pipelines. While it was all seriously debilitating to a sound commercial development of the energy sector, to the Kremlin it presented an irresistible temptation.

President Putin, in the lead-up to Russia's chairing of the Group of Eight (G8) in 2006, was "clearly excited about this perspective for maximizing the returns on his political investments and converting gas earnings into political dividends," in the words of Baev.³⁶ This was the essence of the country's new status as a great energy power, and the challenge was to convince the European partners that Moscow could be trusted as a benevolent provider of energy. It was thus that the vision of building an "energy superpower" was born. But the vision would fall far short of being realized.

The much publicized ambition to transform the defunct Soviet military superpower into an ersatz Russian "energy superpower" would be marked by three core features, to be explored in subsequent chapters. It would further entrench path dependent patterns of unaccountable government, rent-granting, and dependency. It would be seriously detrimental to the prospects for a rational commercial development of the country's energy resources. And it would ultimately be supplanted by an ambition to funnel energy rents into rebuilding the traditional military superpower.

Outline of the Book

This book tours the various games that have been played around Russian energy assets, with emphasis on the Putin era. It identifies the main actors, inside as well as outside Russia, and details how the prospects for conflict and cooperation have evolved. The main argument is that privatization and an open field for foreign investment represented a temporary interlude in a long-term tradition of state control over resources, and of an economic policy that rests on resource extraction as a means to support the country's capacity for military defense.

Chapter 2 sets the stage. It aims to place the notion of a Russian "energy superpower" into a sobering context by emphasizing what it meant to be a true Cold War superpower. It discusses the meaning of the wielding of an

“energy weapon,” detailing the case against Russia as an energy bully. This chapter presents the argument that Russia, rather than suffering from a “resource curse,” is suffering from an institutional curse rooted in old patterns.

Chapter 3 provides added background on the energy assets that have been at the Kremlin’s disposal. It discusses the legacy of Soviet oil and gas, the looting of Russian oil during the Yeltsin era, the emergence of new energy powers to the south, and the mounting complications of relations between the Soviet Union and the European Union.

Chapter 4 looks at the ways in which Putin set out to assemble the powerhouse of his envisioned energy superpower: by restoring state control over the country’s energy assets, by cutting domestic oligarchs down to size, by rolling back the influence of foreign oil majors, and by seeking to ensure that energy-producing republics in the Caspian Basin would remain locked into the Russian sphere of interest.

Chapter 5 takes a special look at the Russian natural gas giant Gazprom, which emerged as the core of the energy powerhouse. Placed in the awkward position of serving as a combination foreign policy tool and cash cow for Kremlin-affiliated interests, it seriously neglected its core business of extracting and exploring for natural gas. Its mixed roles instead bred corruption and poor corporate governance, consequently eroding the very foundations of the energy complex.

Chapter 6 looks at reactions to Russian foreign energy policy, which emerged from a variety of directions, beginning with countries in Central Asia and the South Caucasus, notably Turkmenistan and Azerbaijan; proceeding to Ukraine and Belarus, with serious spillover effects for the European Union; and in the end also encompassing China, which must be viewed as the ultimate challenge to Russian energy policy.

Chapter 7 looks at the impact of the global financial crisis, at the revealed wisdom of accumulating reserves while the going was good, at just how vulnerable the Russian economy proved to be to a serious drop in hydrocarbon revenues, and at how all such experience would be conveniently forgotten once the economy emerged from the crisis.

Chapter 8 looks more broadly at how the Kremlin went about picking up the pieces after the crisis, demonstrating that Russian energy policy had long been in disarray. It looks at the prospects for sustaining output growth and for developing foreign markets, and suggests that pipeline politics have been driven by objectives that go beyond the commercial.

Finally, Chapter 9 looks at challenges and prospects for Russia, which presently may be characterized as moving backward into the future. This chapter questions the sustainability of its energy policy, presents the obstacles faced by its ambitions to modernize, and outlines how the burden of history is again being manifested.

Notes

1. For example, Amalrik, *Will the Soviet Union Survive Until 1984?*; and Carrière d'Encausse, *L'Empire éclaté*.

2. Tocqueville, *The Old Regime and the Revolution*, p. 214.

3. Exactly what was said at the time, and whether any firm promise was issued, has long been an issue of contention. For an update that expresses some sympathy for the Russian position, see Uwe Klussmann, Matthias Schepp, and Klaus Wiegrefe, "NATO's Eastward Expansion: Did the West Break Its Promise to Moscow?" *Spiegel Online International*, November 26, 2009, <http://www.spiegel.de/international/world/0,1518,663315,00.html>.

4. "Putin Praises Post-Soviet Integration," *RIA Novosti*, April 11, 2012, <http://en.ria.ru/russia/20120411/172746585.html>.

5. "Post-Soviet Integration Is Unstoppable," *RIA Novosti*, February 14, 2013, <http://en.ria.ru/russia/20130214/179465611.html>.

6. Mendras, *Russian Politics*, pp. 39–40.

7. The notion of a "Russian Idea" has important historical roots that stretch back to Fyodor Dostoyevsky. In the 1990s it became a prominent part of Communist Party rhetoric, and following Yeltsin's defeat of Communist challenger Genady Zyuganov in the 1996 presidential election, he appointed a commission to find a more precise definition. Although the commission failed to reach a consensus opinion, Yeltsin incorporated much of its agenda. Vladimir Putin would, symptomatically, be fond of calling for a "new Russian Idea."

8. In his Nobel Prize speech, North emphasized that deregulation alone would not do the trick, that "transferring the formal political and economic rules of successful Western market economies to third world and Eastern European economies is not a sufficient condition for good economic performance." North, "Economic Performance Through Time," p. 366.

9. Soto, *The Mystery of Capital*.

10. Rose, "Living in an Anti-Modern Society."

11. See further Hedlund, *Invisible Hands, Russian Experience, and Social Science*, chap. 2.

12. Robbins, *The Theory of Economic Policy*, p. 56.

13. The literal meaning is "engage, and then see what happens." It was one of Napoleon's favorite expressions, reflecting his emphasis on decisiveness. Lenin was similarly fond of repeating it, when describing the challenges faced by the young Soviet state.

14. Hedlund, *Russia's "Market" Economy*, chap. 7.

15. This would become a political issue even in the United States, in the 2000 electoral race for the presidency, with an all-Republican congressional committee producing a massive report titled "Russia's Road to Corruption" that purported to detail "how the Clinton administration exported government instead of free enterprise and failed the Russian people." Text available at <http://www.globalsecurity.org/wmd/library/news/russia/2000/russia/index.html>.

16. Luke Harding, "Putin, the Kremlin Power Struggle, and the \$40bn Fortune," *The Guardian*, December 21, 2007, <http://www.guardian.co.uk/world/2007/dec/21/russia.topstories3>.

17. "Vladimir Putin Could Secretly Be the Richest Person in the World," *Business Insider*, April 19, 2012, <http://www.businessinsider.com/is-vladimir-putin-secretly-the-richest-person-in-the-world-2012-4>.

18. Blank, "The 18th Brumaire of Vladimir Putin," p. 133.

19. President of Russia, "Annual Address to the Federal Assembly of the Russian Federation," April 25, 2005, http://archive.kremlin.ru/eng/speeches/2005/04/25/2031_type70029type82912_87086.shtml.
20. Andrew Tully, "Russia: Washington Reacts to Putin's Munich Speech," *Radio Free Europe/Radio Liberty*, February 13, 2007, <http://www.rferl.org/content/article/1074671.html>.
21. Personal information from multiple sources.
22. Orttung, "Energy and State-Society Relations," p. 54.
23. Holmes, "Never Show Weakness."
24. Baev, *Russian Energy Policy and Military Power*, p. 119.
25. Pipes, "Flight from Freedom."
26. Holmes, "Fragments of a Defunct State," p. 28.
27. Cooper, "The Russian Military-Industrial Complex," p. 43.
28. Problems relating to the role of the military-industrial complex in the Soviet economy, and the prospects for relying on remilitarization as a means to kick-start renewed economic growth, are analyzed in Rosefelde, *Russia in the 21st Century*.
29. Baev, *Russian Energy Policy and Military Power*, p. 119.
30. "Anatoly Chubais: Russia Should Aim to Create Liberal Empire in CIS," *Pravda*, September 25, 2003, <http://english.pravda.ru/news/russia/25-09-2003/52757-0>.
31. Gaddy and Ickes, "Bear Traps," p. 119.
32. Gustafson, *Wheel of Fortune*, p. 29.
33. Gaddy and Ickes, "Bear Traps," p. 119.
34. Blank, "Voodoo Economics," p. 48.
35. Kivinen, "Public and Business Actors in Russia's Energy Policy."
36. Baev, *Russian Energy Policy and Military Power*, p. 124.