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BUSINESS-STATE RELATIONS
ROLE OF THE STATE IN THE ENERGY SECTOR

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Analysis

Business-State Relations in Russia

By Robert Orttung, Washington

Summary

Currently the Russian state exercises considerable power over Russian business, often acting in a predatory fashion. The state is expanding its holdings in the lucrative energy sector as well as other strategic sectors, such as aircraft and automobile manufacturing. Unstable property rights give the bureaucrats powerful levers over business owners. At the same time, the ability of the Russian state to control the business community is severely limited by the extensive corruption in the country and the unreformed banking sector. Business plays an important role in center-periphery relations, binding regions together, and in Russia's foreign policy, helping Russia pursue Kremlin-defined state interests abroad. However, the expansion of the state into the business sphere is reducing Russia's ability to compete globally.

Different industries-different relations

The nature of state-business relations in Russia depends on which industry one is examining. In the energy sector, the Russian state is very powerful and can control the actions of the key corporations working in this field. In other areas, such as forestry, the state is very weak and has little influence over what happens on the ground.

In recent years, President Vladimir Putin and his administration have focused much of their attention on the energy sector. Energy makes up a major share of Russia's economy: Oil and gas accounted for about 20 percent of Russia's GDP for 2001, according to Masaaki Kuboniwa, Shinichiro Tabata, and Nataliya Ustinova, who recalculated official Russian data to give a more accurate assessment of energy's importance to the economy. Russia's overall economy will remain highly dependent on resource extraction for many years to come. Oil and gas exports now account for 55 percent of Russia's exports, according to the World Bank's 2004 report on the Russian economy. Russia's economy is thus highly vulnerable to changes in natural resource prices on the world market.

Even before Putin began his efforts to strengthen the Russian state, it had extensive control over the energy sector. The Constitution and federal law give ownership of Russia's resources to the state. Since oil can only be extracted under license, bureaucrats have extensive control over companies. The state also has monopoly power over Russia's oil and gas pipelines.

The Russian state recently bought a majority share in natural gas monopolist Gazprom, which essentially functions as a rent-redistribution mechanism benefiting numerous inside players. Much needed reforms are not likely to happen any time soon.

In the oil sector, there were two business-state models in recent years: oil-insider controlled companies (Surgutneftegaz and Lukoil) and financier-controlled and managed companies (Yukos and Sibneft). With the destruction of Yukos and the transfer of its assets to the state-owned Rosneft and the sale of Sibneft to Gazprom, financier-controlled companies are now gone, leaving only the oil-insider controlled companies. In addition to its natural gas monopoly, the state now controls approximately 30 percent of Russia's oil sector.

While the Russian state has taken over key energy assets, it remains unclear if it will be able to manage these assets effectively. As private companies, Yukos and Sibneft focused on immediate output since they were trying to increase share-holder value, leading to increased output for Russia. If Russia wants to maintain or expand its oil output, it needs to make extensive investments to develop new oil fields.

During 2005 the growth of Russian oil output slowed due to a lack of investment caused by a variety of political, regulatory, and geological obstacles. Moreover, Gazprom CEO Aleksei Miller announced on October 9 that the company would develop the massive Shtokman gas field in the Barents Sea without foreign partners and relying on its own resources. While Russian leaders suggest that the country can develop its energy resources on its own, critical observers doubt whether Russia currently has sufficient financial reserves for these projects or access to the necessary technology. Whether foreigners will be allowed in, and whether they would want to come, remains an open question.

Beyond energy: State expansion in other sectors

The Russian state has not limited itself to reorganizing the energy sector. Recent moves placed it at the head of aircraft manufacturing and automobile production, sectors of the economy that the Kremlin deems strategic.

Putin created the United Aircraft company in February 2006. The Kremlin claimed that forcing all of Russia's aircraft companies into one structure would help it compete on the world market. Critics argued that the giant new company really represented a sinecure for the personal benefit of high-level bureaucrats. Others pointed out that combining the firms at a time when there is already a shortage of funds in the defense sector would prevent them from innovating and therefore cause them to fall further behind in the world market.

Additionally, at the end of 2005, the state monopolist arms exporter Rosoboronexport took over the AvtoVAZ factory, Russia's largest automobile manufacturer, which produces approximately one-third of Russia's cars. The newly-installed state managers hope that they will be able to turn around fortunes at the ailing automobile maker by merging it into a larger state-owned automobile holding company. The logic behind why Rosoboronexport took over the car plant is unclear since the arms dealer is a highly bureaucratic organization with no experience in car manufacturing. AvtoVAZ is having serious trouble competing with the growing flood of foreign imports on the Russian market. Its low quality product currently only appeal to Russia's most impoverished consumers.

Despite the optimistic hopes of the new state managers, the results of state control have not been promising so far. This year Russia dropped nine places to 62 of 125 countries analyzed in the World Economic Forum's Global Competitiveness Report, released on September 26.

Conflicts of interest

As the Russian state grabs more assets from the private sector, it will face a growing number of conflicts of interest. Currently, for example, high level bureaucrats serve as board members for Russia's largest corporations. Kremlin Chief of Staff Dmitry Medvedev chairs the board of Gazprom, while Deputy Chief of Staff Igor Sechin heads the board of Rosneft. In a September meeting with foreign Russia watchers, Putin argued that Sechin had no problem dealing in a fair way with a variety of oil companies even though he sat on the board of one of them. Outside observers suspect that Rosneft's state-owned status and well-placed connections naturally give it an advantage over Russia's other oil companies.

Property rights remain unstable

The destruction of Yukos, once one of Russia's largest and most transparent companies, shows that there are a number of problems in Russia's broader institutional environment: property rights remain insecure and there are many powerful groups in Russia that have a strong interest in blocking any reforms that would put them on firmer footing. Under current conditions, the state can take action against any company it wanted to target. Putin's academic work shows that he is determined that the Russian government should have a "decisive voice" over decisions about energy and natural resources.

The shaky nature of Russian property rights give the state expansive power over business in the country. The Russian state's strength vis-à-vis big business is unusual for a middle-income country—or indeed for any country. Russia differs from post-war Japan and Italy because most businesses in Russia began with shady deals and because big businesses are associated with the oil and gas sector, which means that they must rely on state licenses, according to Philip Hanson and Elizabeth Teague. As a result, the Russian state holds considerable leverage over its companies because it can threaten them at any time with legal action or the removal of their licenses.

Since businesses acquired most of their property in a largely lawless environment, owners have no security that they will be able to hold onto their acquisitions. Property rights depend entirely on the whims of state officials. Moreover, as state officials are replaced, their successors may decide to transfer current property to new owners. Thus, even apparently legitimate businesses exist under a cloud of uncertainty about their future activities. Accordingly, the wealthiest magnates of the Putin era seek protection for their business by trying to draw as close to the Kremlin leadership as possible.

Corruption—the limits of state strength

The extensive corruption pervading the Russian economy limits the capacity of the Russia state. Data from Transparency International, the World Bank, and Freedom House show that corruption seemed to fall in the early years of Putin's tenure, but is now rising. In many spheres of the economy there is essentially no coherent state due to the prevalence of corrupt officials. In the forestry sector, for example, small businesses illegally cut down Russian trees, while paying off the inspectors who are supposed to stop them. They then export the logs to countries like China through corrupt customs points. The state has effectively lost control of this business because its agents are more interested in their personal enrichment than doing their job.

One major consequence of the extensive corruption and inefficiency within the energy sector is that

Russian policy makers are not using the income generated in this field to diversify the economy. A truly developmental state, with an eye to ensuring Russia's long-term prosperity, would work to transform current income into investments in new technologies that would support a knowledge-based economy of the future, guaranteeing jobs outside of the natural resource sector.

Banking—a black hole for business

Not only is the economy not being diversified, but energy wealth is deforming much of the rest of the economy. For example, Anastasia Gnezditskaia argues that the size of the mineral economy has had a large and negative impact on Russia's banking sector. Oil companies own some of the best capitalized banks in Russia, but force them to operate using nontransparent methods, for example by not disclosing who owns the bank. Banks with oil money do not engage in retail banking or lend money to enterprises as western banks typically do. These banks are extremely opaque because they do a large share of lending to their shareholders, owners, and affiliated structures. Moreover, there is little regulatory scrutiny of these banks.

Banks facilitate business development in many countries, but Russia's unreformed banking sector has not played that role. The sector is dominated by huge state-owned banks such as Sberbank and a wide variety of small private banks. There are currently about 1,200 banks operating in Russia, most of them extremely small, according to the Center for Economic Research.

Many of the banks are involved in money laundering and other criminal practices. Andrei Kozlov, Russia's top bank regulator, had been working to shut down these questionable banks, but his assassination in September will put that effort on hold for the time being. Putin set up an interdepartmental working group under the aegis of the General Procurator's office in the wake of his murder, but it is unlikely to have much success fighting bank sector crime, given the violent means at the disposal of the launderers.

Before his death, Kozlov had managed to shut down 90 of the 1,200 banks, including 33 in the summer of 2006. Optimistic observers suggest that Russia is slowly growing a core of legally functioning banks that will ultimately provide the foundation for an effective sector. Since many Russian salaries are now directly deposited in banks, ordinary people are starting to use the banks more often and the banks are beginning to offer a wider range of services.

Big companies have power in the regions

While big business has to kowtow to the Kremlin, it is often much more powerful than the average regional governor. As a result, corporate giants are often in a position to dictate terms to the regional elite. However, in regions where several large companies are active, these companies have to compete to secure the loyalties of the regional elite.

The interests of big business do not always coincide with those of the Kremlin. Where big business wants a strong governor to help protect its operations, its interests may differ from those of the federal government, which seeks to subordinate the regional elite within its vertical power hierarchy.

However, in closed regions like Tatarstan and Bashkortostan, where local elites protect their own interests by blocking outsiders from operating within their jurisdictions, big business allies with the federal government in seeking new business opportunities. In these cases, business works closely with the federal government against regional interests. In this sense, big business in Russia serves the function of helping to band the regions together into a cohesive whole. When Putin came to power, ensuring such unity was one of his main goals.

Corporate foreign policy

Russia long has used companies like Gazprom and LUKoil to flex its muscles in the former Soviet republics and the Baltic states. Most prominently, Gazprom cut off gas supplies to Ukraine in a dispute on January 1, 2006. Similarly since July Russia has used threats about future oil deliveries to Mazeikiu refinery in an effort to force Lithuania to sell this former Yukos plant to LUKoil, rather than the Polish concern PKN Orlen, Lithuania's preferred buyer.

Now Russia is seeking to exercise its influence in different ways. The state-owned foreign trade bank Vneshtorgbank recently purchased a 5 percent share in the European Aeronautic Defense and Space Corporation (EADS), seeking to gain a voice in managing the corporation. When EADS announced that Russia would not obtain a seat on the company's board of directors, Russia suspended an order for Airbus planes, which an EADS subsidiary produces. Both EADS, France and Germany expressed clear displeasure at the prospect of Russia gaining leverage over the company. In addition to making civilian aircraft, EADS is also a major European defense producer.

While Russia's leaders hope to use Russian business as a way of exerting power on the international stage, their current policies are unlikely to develop

Russian business in an effective manner. Further state control and the absence of secure property rights will undermine future business activity and make Russian corporations less competitive internationally. Thus, Russia's current efforts to manipulate the state-business relationship in favor of the state may ultimately work to undermine state interests by weakening the business community's ability to compete in a global market.

About the author:
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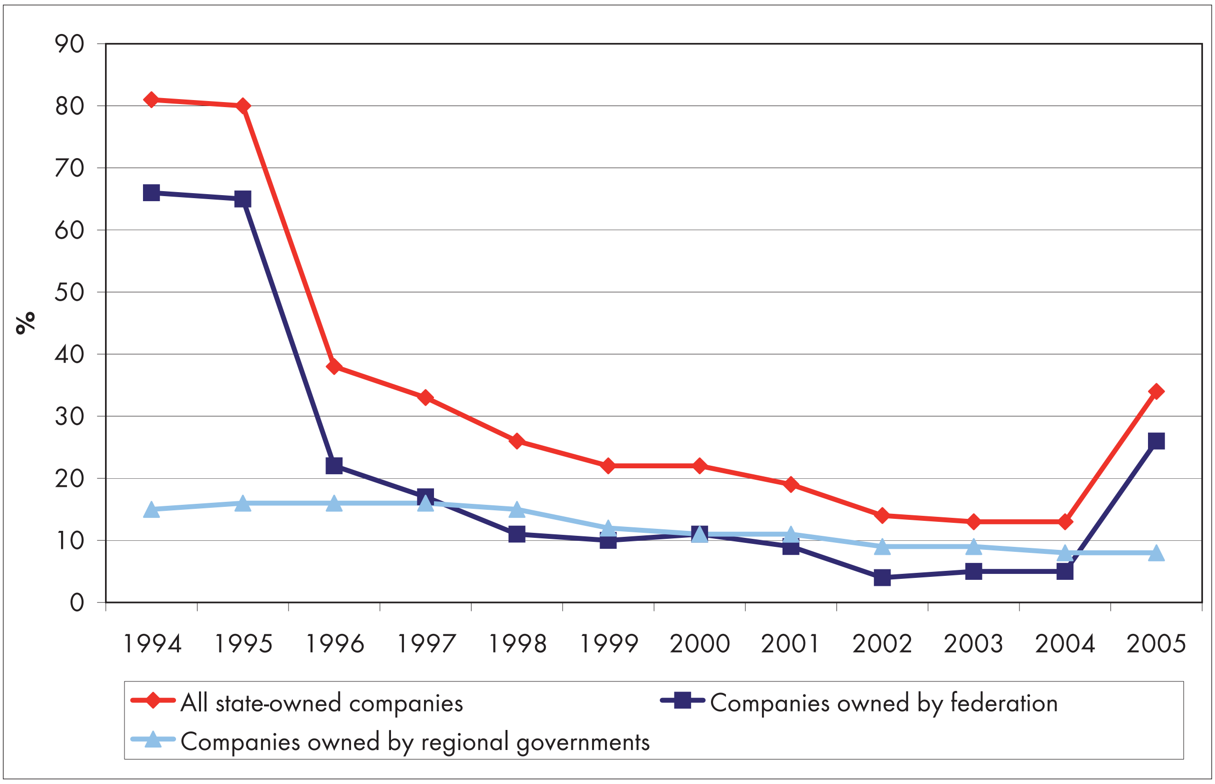
Further reading:

- Andreas Wenger, Jeronim Perovic, and Robert W. Orttung, *Russian Business Power: The role of Russian business in foreign and security relations*, London: Routledge, 2006.
- Shinichiro Tabata, *Dependent on Oil and Gas: Russia's Integration into the World Economy*, Sapporo: Slavic Research Center, Hokkaido University, 2006.
- Philip Hanson and Elizabeth Teague, "Big Business and the State in Russia," *Europe-Asia Studies* 57:5, July 2005.
- Anastasia Gnezditskaia, "'Unidentified Shareholders': the Impact of Oil Companies on the Banking Sector in Russia," *Europe-Asia Studies* 57:3, May 2005.

Diagram

The State's Share in Oil Production 1994–2005

(in % of total oil production)



Source: Research Centre for East European Studies, Bremen

Analysis

Sakhalin-II in the Firing Line: State Control, Environmental Impacts and the Future of Foreign Investment in Russia's Oil and Gas Industry

By Michael Bradshaw, Leicester

Summary
The world's largest private oil and gas companies are working offshore of Sakhalin Island in Russia's Far East to develop a new oil and gas province. The Sea of Okhotsk has the potential to become another North Sea, located next door to Asia's energy-hungry economies. Now that the projects are starting to realize their potential, the Kremlin has decided that it wants a greater share of the benefits and is using "administrative leverage" to pressure the foreign companies into renegotiating the terms of their involvement. These actions have prompted widespread condemnation in Japan, Europe and the United States and added to the growing concerns about Russia's reliability as an energy partner following the gas dispute with Ukraine in January.

Russia threatens international companies

On 16 September the General Prosecutor's Office of the Russian Federation issued a public statement declaring that the State Environmental Expertise Review (SEER) governing the development of Phase 2 of the Sakhalin-II project approved by the Ministry of Natural Resources (MNR) had been issued illegally. This statement prompted Minister of Natural Resources Yury Trutnev to declare that the 2003 decision by his own ministry was incorrect and should be revoked. According to Sakhalin Energy, a consortium of Western companies which runs the Sakhalin-II project, such action would result in a 12–18 month delay and could possibly cost $10 billion, plus it would severely damage Sakhalin-II's reputation as a reliable supplier of liquefied natural gas (LNG) even before the first shipment is made.

At the same time that the Sakhalin-II is under pressure, Total's Kharyaga production sharing agreement (PSA) project in the Arctic is also under threat, as is TNK-BP's license to develop the giant Kovytka gas field in East Siberia. Exxon Mobil's Sakhalin-I project has delayed the start-up of oil exports because of permitting problems while the Russian authorities have also denied a request to extent the boundaries of one of its fields. Additionally, Gazprom has made public its interest in buying BP's Russian partners in TNK-BP should they wish to sell next year. The most obvious question is why is this happening now?

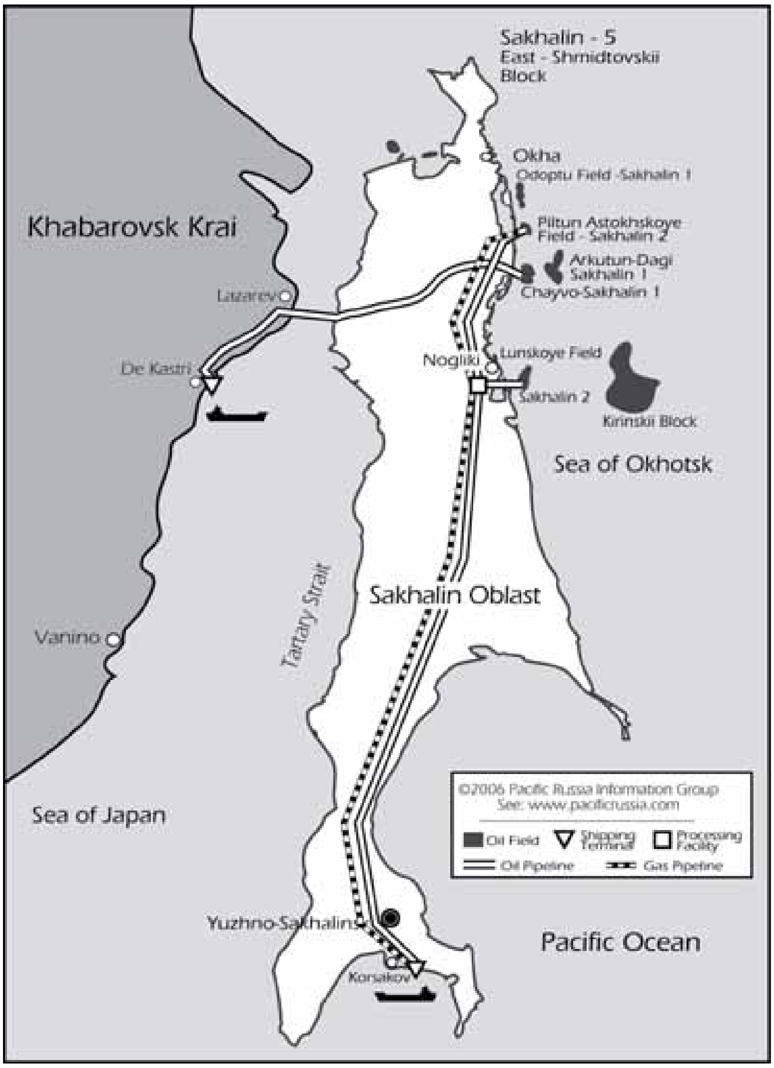
Russia seeks a greater role in energy projects

The recent actions on Sakhalin seem to be more than coincidence. Observers describe them as a "softening up" exercise to force the international oil companies (IOCs) to agree to greater Russian participation in their projects.

Foreign involvement in Sakhalin's offshore energy production began during the mid-1970s when Japan and the Soviet Union signed a compensation agreement to explore for oil and gas on Sakhalin's continental shelf. After initial success, the project fell foul of deteriorating East-West relations and the economic slump of the early 1980s, however, exploration continued and a number of oil and gas bearing structures were identified. Renewed commercial interest in the late 1980s led to an international tender being held in May 1991. Eventually two development licenses were awarded and Russia's first production-sharing agreements were signed, first with Sakhalin-II in June 1994 and then Sakhalin-I in 1995. As these projects evolved, their membership changed. Today the Sakhalin-II project is the only major energy project in Russia comprised entirely of non-Russian companies: Shell (UK-Netherlands), Mitsui and Mitsubishi (both Japanese). Participants in Sakhalin-I are: ExxonMobil (US), SODECO (Japan), ONGC Videsh (India), Rosneft and Sakhalinmorneftegaz (both Russian). Table 1 on p. 11 provides a complete breakdown of all of the Sakhalin projects and their current status, while Map 1 overleaf shows the major fields and infrastructure currently under development.

1990s PSAs made foreign investment possible

Russia in the early 1990s was a very unstable place and drilling for oil and gas in the Sakhalin shelf was considered a chancy proposition. To manage the risk inherent in these ventures, the foreign investors required the protection of PSAs that would set the legal and fiscal terms for the lifetime of the project and would guarantee a profitable return. The PSA is



Map 1: The Current Sakhalin Projects (reproduced with permission)

an internationally-binding legal agreement and each is customized to specific projects.

In July 1999 Sakhalin-II produced Russia's first offshore oil and by the end of the 2005 production season had exported over 11 million tons of crude oil. However, in the absence of an onshore pipeline, production is limited to a 6-month period each year as winter ice conditions prohibit offshore transshipment.

In May 2003 Shell and its partners committed to an investment of almost $10 billion to allow year-round export of oil and LNG. Phase 2 includes the installation of two offshore platforms, twin 800 km oil and gas pipelines down the length of Sakhalin Island and an LNG plant and oil export terminal. Together these elements represent the largest integrated oil and gas development project in the world today, all taking place in a harsh environment, with seismic risks and little economic infrastructure.

When the two Sakhalin projects hit anticipated peak oil production at the end of the decade, they will account for about 7 percent of demand in the Asia-Pacific region. Sakhalin-II's LNG output is already sold out, with the majority of exports planned to Japan, South Korea, the US and Mexico. Sakhalin-II will account for about 8 percent of Japan's total LNG consumption and Sakhalin Energy is now considering adding a third bloc to its LNG plant, which could boost capacity to 16 million tons a year. Given their size, these globally significant projects will make a major contribution to energy security in the Asia-Pacific region (APR) and bolster Russia's economic position in this part of the world, promoting a key foreign policy goal of the Kremlin. At a recent meeting of the Valdai Discussion Club, President Putin stated: "We plan to increase the share of our energy exports to Asia to around 30 percent (it is currently 3 percent) of our total energy exports over the next 10–15 years."

Foreign investors face cost overruns

With projects this ambitious, it is not surprising that there have been problems. First and foremost, both projects have been plagued by delays and cost overruns. In July 2005 Shell announced that the cost of phase 2 had doubled from $10 billion to $20 billion and pushed back the first exports of LNG from mid-2007 to third-quarter 2008. ExxonMobil recently announced that the total cost of its project has increased from $12.8 billion to $17 billion.

The reasons for these cost overruns are both internal and external to the projects. Undoubtedly it is proving more difficult and costly to develop the projects than company managers first envisaged. One major new cost is minimizing the environmental impact of the facilities. There are also external inflationary pressures, such as the cost of labor and raw materials, and the weakness of the dollar.

The nature of the Sakhalin-II PSA means that increased costs and delays extend into the future the point at which the Russian government will start to receive revenue from the production of oil and gas.

The international companies will first recover the funds that they invested into the project. The Russian government audited the project this summer and has yet to approve the increased costs the companies have claimed. In fact, more than one Kremlin advisor has suggested that the government will not accept the cost increases and the PSA projects should work to their original budgets and on the basis of the normal tax and royalty regime. However, industry experts maintain that the high cost of offshore development is not economically viable under the current tax regime.

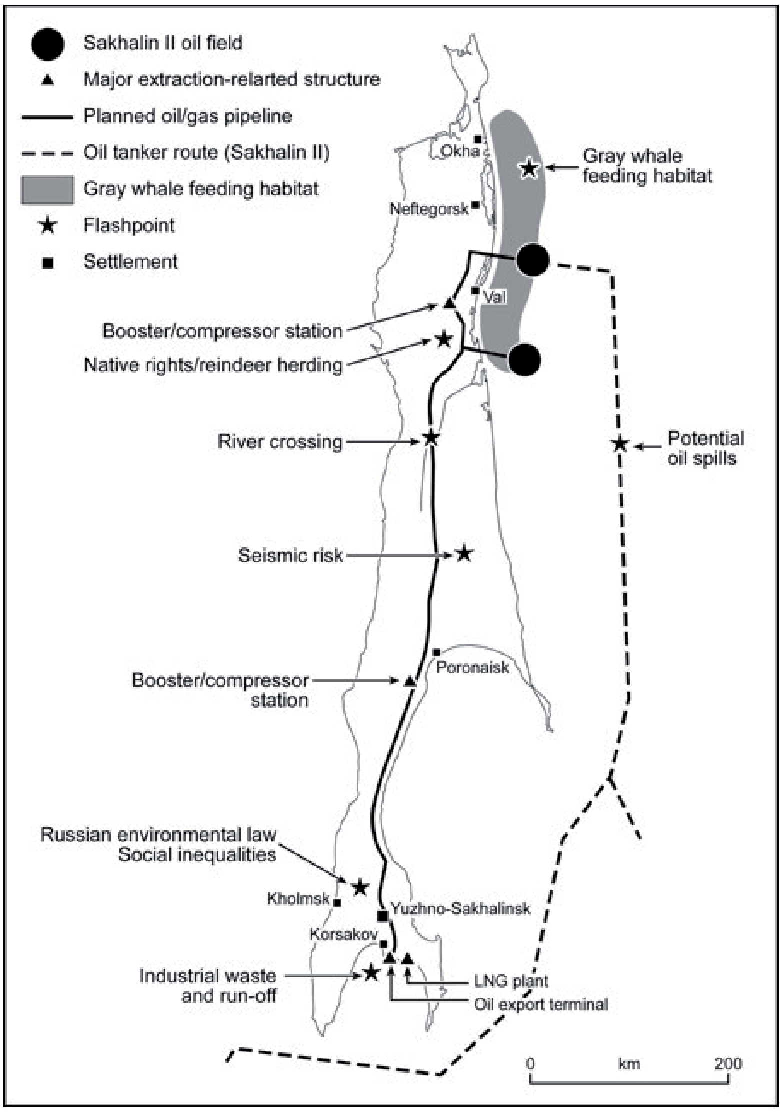
Environmental concerns slow project

The environmental concerns now raised by Moscow are genuine and are not new. In 2003 the European Bank for Reconstruction and Development (EBRD) declared the Sakhalin-II Phase-2 Environmental Impact Statement "unfit for purpose" and began negotiating with Sakhalin Energy to address the areas of concern. Upon completing this process, in December 2005, it announced the amended EIA "fit for the purpose of public consultation" and entered into a 120-day public consultation process that ended in April 2006. Since then it has delayed a final decision and has now stated that any decision must wait until the current difficulties with the Russian government are resolved.

For an EBRD loan to be granted, the project must be compliant with Russian legislation and have the support of the host government. A coalition of environmental NGOs (ENGOs) has campaigned to persuade the EBRD not to grant the loan. Among the key issues are the impact of offshore activity on the critically endangered Western Gray Whale, the impact of pipeline construction on Salmon spawning rivers, the impact of construction activity at the LNG plant on the ecology of Aniva Bay, the impact of this activity on the indigenous peoples and finally, the fact that the PSA is not a good deal for Russia (see Map 2 for a summary of the environmental problems).

Now there is a strange alignment of interests, as all of the issues raised by the ENGOs have become part of the Ministry of Natural Resources' criticism of the project. In their defense, Sakhalin Energy representatives point to the fact they have re-routed one of their pipelines, funded research into the ecology of the whale population, and created an independent advisory panel to monitor the impact of the project on the whales. On the matter of river crossings, they admit that there have been problems, in part because the contractors have not worked to international standard; but a revised river crossing strategy is in place and subject to independent review. In relation to the indigenous peoples, they are implementing an Action Plan designed to take their interests into account. Thus, Sakhalin Energy would maintain, with justification, that it is working to both Russian and international standards when it comes to the execution of the project and the management of its environmental and social impacts. Clearly, funding

Map 2: Environmental and Social Flashpoints for Sakhalin-II (Source: Author)



by the EBRD would provide a seal of approval and recognition that the project was being developed to international standards, but that endorsement is now in doubt.

Russia wants more money, faster

The principle source of the Russian government's grievance over Sakhalin-II is the fact that the cost increases will delay the time when Russia starts to receive a share of the production. Russian policy makers have decided that the current arrangement does not serve Russian interests and should be renegotiated.

However, the rapid negative reactions of governments in Japan, Europe and the US to protest the potential suspension of the project, ostensibly on environmental grounds, suggests that renegotiating the PSA would bring widespread foreign condemnation. Foreign investors are already suspicious of Russian intentions following the Yukos affair, in which the Russian state bankrupted Russia's largest and most transparent oil company and transferred its assets to a state-owned firm.

Another way to insure an increased Russian share of the profits would be to bring a Russian company into the project—Sakhalin-I already has Russian partners and is delivering profit oil and gas under the terms of its PSA. In July 2005 Shell and Gazprom announced that they were negotiating an asset swap that would give Gazprom 25 percent of Sakhalin-II in return for Shell acquiring 50 percent of the Zapolyarnoye field in West Siberia. Gazprom has plenty of reason to join Sakhalin-II: it will gain much needed experience with LNG, plus add reserves and income. The foreign partners would then have inside access in dealing with the Russian authorities. Unfortunately, the cost overruns were then made public and the two parties have been unable to agree final terms. The swap is no straightforward matter: 25 percent of Sakhalin-II is relatively easy to value since the project is almost 80 percent complete and has sold all its LNG. The Zapolyarnoye field, by contrast, is technically challenging and undeveloped, therefore any value assigned to it is based on potential rather than tangible assets. Discussions continue and form a critical backdrop to recent events. To avoid foreign criticism, and to abide by agreements reached at the recent G8 summit in St. Petersburg, any agreement on Gazprom's entry into the Sakhalin-II project must be transparent and commercially viable for Shell and its partners.

Many commentators describe the timing of Russia's sudden concerns about environmental issues as a cynical move to improve the terms for Gazprom. Speaking at the recent Sakhalin Oil and Gas Conference, Russia's Foreign Minister Sergei Lavrov denied such accusations. However, Russian Ambassador to Japan Alexander Losyukov had suggested earlier that the entry of a Russian company (Gazprom) would assist in the rapid completion of the project, and former Deputy Minster of Fuel and Energy Valery Garipov suggested at the conference that when Gazprom joined the project, the problems would go away.

The arrival of Oleg Mitvol, the Deputy Head of Russia's Inspectorate for the Use of Natural Resources (*Rosprirodnadzor*), on Sakhalin on the second day of the conference on a chartered aircraft packed with press and NGO representatives only served to add confusion and a degree of farce as he proceeded to make unfounded statements about the scale of the environmental damage caused by Sakhalin-II. Meanwhile, back in Moscow, Minister Trutnev was involved in a damage limitation exercise, making it clear that

Figure 1: Construction work at the LNG Site (Source: Author).

Figure 2: Lunskoye-A Production Platform, installed summer 2006 (Source: Sakhalin Energy Investment Company)

wider, long-term process that has increased state control over Russia's oil industry and affirmed Gazprom's gas export monopoly.

Ultimately expanding state control over Russia's energy sector may prove self-defeating. Oil and gas revenues are fueling Russia's current economic revival and its continuation, in large part, is dependent upon maintaining and even increasing current levels of oil and gas production. But the signs are that the established fields are running out and new fields need to be developed. The Sakhalin projects represent the future of Russian oil and gas production, both in the Sea of Okhotsk and the Arctic. These projects are best developed by Russia's state-owned giants like Gazprom and Rosneft in partnership with the IOCs, although Gazprom's recent decision to reject foreign partners in its development of the Shtokhman field suggests that it prefers to go it alone.

For their part the IOCs see Russia's frontier regions as a key element of their global strategies. However, the terms of engagement and operation need to be commercially viable, transparent and backed by the rule of law. The battle for Sakhalin, which is far from over, suggests that these conditions currently do not pertain in Russia. While the IOCs will fight hard to keep the value they have created, for the moment at least they will have to reassess their view on Russia.

The net consequence of this conflict will be delays in the development of Russia's frontier production, which will reduce the country's near-term oil and gas revenues and its ability to contribute to global energy security. In such circumstances, it is more than a little ironic that Russia put energy security at the top of the G8 agenda in 2006.

the SEER would not be revoked and that the project would continue while further inspections are carried out. But there have already been over 200 inspections this year alone. A range of issues has been identified (some 90 in total) and Sakhalin Energy is working through them now. The new review will be completed by late October and Minister Trutnev has announced that he will visit Sakhalin at that time to see the results first hand. Meanwhile, there is a momentary cease-fire and no doubt battle will recommence at the end of October.

Expanded state control will be counter-productive

While it is accepted that foreign oil companies should abide by Russian legislation, those familiar with the state of Russia's natural environment and with its track record of environmental degradation and resource utilization will find it hard to believe that the Russian government's recent statements represent a new environmental consciousness on its part. The current effort to use "administrative leverage" against international oil companies is part of a

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Michael Bradshaw is professor of Human Geography and head of the Department of Geography at the University of Leicester, UK.

Table 1: The current status of the Sakhalin projects (as of 1st September 2006)

Project	Fields/Blocks	Participants	Recoverable Reserves	Project Status
Sakhalin-1	Chayvo, Odoptu, Arktun-Dagi (oil & gas)	Operator: Exxon Neftegaz Ltd (US) 30% SODECO Ltd. (Japan) 30% ONGC Videsh Ltd. (India) 20% SMNG-Shelf (Russia) 11.5% Rosneft-Astra (Russia) 8.5%	307 mln t of oil 485 bcm of gas	PSA Phase 1: early oil. First oil in October 2005. First exports October 2006
Sakhalin-2	Piltun-Astokhskoye (oil), Lunskoye (gas)	Operator: Sakhalin Energy Investment Co. Royal Dutch Shell (Netherlands/UK) 55% Mitsui (Japan) 25% Mitsubishi (Japan) 20%	600 mln t of oil 700 bcm of gas	PSA Phase 1: early oil in 1999 Phase 2: Gas/LNG in 2007-08
Sakhalin-3	Krinskii	Operator: Pegastar ExxonMobil (US) 33.3% ChevronTexaco (US) 33.3% Rosneft (Russia) 33.3%	453 mln t of oil 700 bcm of gas	Exploration project suspended due to loss of exploration rights
	Vostochno Odoptinski, Ayashski,	ExxonMobil (US) 66.6% Rosneft (Russia) 33.3%	167 mln t of oil 67 bcm of gas	Project idle and now suspended due to loss of exploration rights
	Veninski	Rosneft (Russia) 51% Sakhalin Oil Company (Russia) 24% Sinopec (China) 24%	51 mln t of oil 578 bcm of gas	First drilling season summer 2006
Sakhalin-4	Astrakhanovskii offshore structure	Rosneft (Russia) 51% BP (UK) 49%	89 bcm of gas	Project stopped by Rosneft
Sakhalin-5	Vostochno-Shmidtovski and Kaigan/Vasyukan (and Zapadno-Shmidtovskii)	Rosneft (Russia) 51% BP (UK) 49% Joint Venture Company Elvary Neftegas being created to develop the project	600 mln t of oil 600 bcm of gas	Exploration First well drilled in summer 2004, second in 2005 and two planned for 2006.
Sakhalin-5	Lopukhovski	Gazpromneft (Russia)100%	130 mln t of oil 5 bcm of gas	Sibneft acquired block from TNK-BP. Gazpromneft was created in late 2005 when Gazprom purchased Sibneft
Sakhalin-6	Progranichnii	Urals Energy	200 mln t of oil	Acquired when Urals Energy purchased Alfa Echo.

Source: table based on oil and gas industry press and oil company websites and press releases.

Regional Report

Business and State in Komi: Managing Common and Conflicting Interests

By Yury Shabaev, Syktyvkar

Summary

The rise of big business in post-Soviet Russia disrupted the mono-centric political systems that developed in Russia's regions after the collapse of Communism. In Komi, the 2001 gubernatorial and 2003 regional legislative elections marked the divide between the old system and the new. Since that turning point, however, big business and the bureaucracy have found a way to work together to defend their mutual interests. The adoption of a new electoral system in 2007, in which voters elect half the members of regional legislatures through party lists, will make it even easier for business leaders to gain political representation. Nevertheless, the success of big business has not filtered down to small business, which remains largely unrepresented in the political system.

Mono-centric political regime built on consensus

After President Boris Yeltsin abolished Russia's parliamentary republic in 1993 and began accelerating the process of de-sovietization in the Russian regions through the adoption of a new constitution, many of the 21 republics began forming authoritarian political regimes. These regimes quickly took control of all spheres of social life and the economy, recreating the old Soviet system of political and economic relations, while removing the ideology from them. Ultimately, it was the elite's total control over the economy that allowed the oligarchs to quickly gather their initial capital in the 1990s. These oligarchs came either from the elite or were able to gather their wealth with the elite's direct participation.

Komi's political system evolved through a variety of stages. From 1990 to 1991, it went through a process of de-ideologization, when the Communist Party and ideology stopped determining government policies. From 1994 to 1995, it experienced a process of de-sovietization, when it dropped the Soviet style legislature and adopted a system more typical of western models. Over time, Komi's political system evolved to create a "political corporation" in which all branches of government were subordinated to one political actor, the governor.

In many ways this system resembled the old Soviet model, but the ideological base allowing the consolidation of the new system was a desire to overcome the deep socio-economic crisis in Russia and reform society. In the early 1990s, the political elite was not alone in supporting consolidation to overcome Russia's crisis and reduce the harmful economic consequences of the transformation. The population, as many public opinion polls showed, considered that powerful and authoritative regional leaders and regional political institutions, rather than the federal authorities, should solve the country's difficult political problems. In this way there was a consensus between the authorities and the people which made it possible to establish a mono-centric political regime. Former Komi leader Yury Spiridonov, who rose to power as the first secretary of the Communist Party of the Soviet Union's Obkom during the Gorbachev era, came to embody this regime. Spiridonov later became chairman of the Komi Supreme Soviet and then was Komi's first directly elected governor.

Big business causes regime change

This consensus was destroyed in 2001 when the population withdrew its confidence from Spiridonov and replaced him with his rival, republican parliamentary speaker Vladimir Torlopov, then considered a liberal politician who had the backing of the Union of Right-wing Forces and Yabloko. Torlopov's victory led to the destruction of the power elite's political corporation and the beginning of elite fragmentation. The 2003 republican parliamentary elections marked an even more important turning point because there was an extensive redistribution of political resources between the bureaucracy and the business elite. In the political competition for the legislature, the business elite gained the upper hand.

In Komi the bureaucracy/nomenklatura, as defined by Milovan Djilas and Michael Voslensky, dominated political life until the 2003 elections. Therefore, the elections of the new republican chief in 2001 and the parliamentary elections of 2003 marked the real beginning of Komi's transition away from the Soviet system. Only after these political collisions was the basis for democracy created because the monopoly of the nomenklatura was blasted apart and the parameters of the regime began to more closely resemble democracy. The nomenklatura suffered defeat in the elections of 2003 because the "industrial party," various business leaders and enterprise managers, won a majority of the seats.

However, Komi's governor and legislature could not find a common language and the political competition between them led the executive to give up on public politics and replace it with informal practices. Being a weak politician, Torlopov could neither consistently implement a liberal political course, nor build constructive relations with the legislature, political opposition, or social groups. Moreover, he faced powerful opposition from the republic's former leaders, who exerted heavy pressure against any liberal policies.

Since Torlopov was incapable of exerting pressure on the republic's political institutions and unable to win in open political competition, he chose to rely on tactics of intrigue and behind-the-scenes deal-making. His main goal was to recruit a majority of deputies in the republican legislature who would be loyal to him. He sought to achieve this goal by exerting individual pressure on each of the deputies. He offered each legislator particular inducements to support him and threatened their business interests if they refused. Komi's business leaders, many of whom had been recruited from the region's Soviet nomenklatura, proved to be vulnerable to pressure from the governor and, in the interests of their business, were ready to make a deal with the authorities. Torlopov also managed to gain control of the pro-Kremlin United Russia political party in the republic and with its help, convinced President Putin to appoint him to another term in December 2005.

After Torlopov secured Putin's blessing, the business elite was once again dependent on the governor. Rather than set up a united front to pressure him to meet the general interests of the entire business community, the individual businessmen preferred to resolve their individual problems through opaque agreements with the governor and his closest advisors. In this sense, the bureaucracy, represented by Torlopov, and the business elite, represented by the legislators, found common ground.

Looking to future elections

For the March 2007 elections, Komi will use a new electoral system, electing half of the members of parliament from party lists and half by single-member districts. In the past, all of the legislators had been elected directly from districts. The Kremlin devised this new system for regional elections and forced each of Russia's regions to adopt it.

In the new situation, the interests of the political elite and business coincide in that both want to create the most comfortable conditions for pursuing their goals. In this sense, neither politicians, nor businesspeople want clear and transparent rules for their activities. In Komi as elsewhere in Russia, the authorities and business always seem to be able to come to agreement with each other. All the big businesses operating in the region (the oil companies LUKoil and Rosneft, natural gas monopolist Gazprom, and aluminum maker SUAL, among others) have cooperation agreements with the governor's administration and can directly solve their problems with the republican political elite. These big businesses have such extensive resources that they can guarantee themselves top priority in their relations with the authorities and direct representation in regional political institutions. Thus, Vladimir Mulyak, the president of LUKoil-Komi, which controls 70 percent of the oil reserves in the region, was able to defeat former governor Spiridonov in the district where the latter had a strong position in the 2003 regional legislative elections.

Now, when party identification, rather than personality, will be the main resource in legislative campaigns, it has become easier for business to secure political representation by making agreements with party leaders. Thus, Severnaya neft, the local branch of the state oil company Rosneft, has already reserved a spot in the republican parliament on the United Russia party list, according to unofficial sources. This will not be the only example, since many other businesses and individual business people will want to send their representatives to the political institutions or become politicians themselves.

Business people are seeking representation in political institutions at both the local and republican levels. In the city of Usinsk, the oil capital of Komi, Severnaya neft is working to take control of the local municipal council in an effort to squeeze LUKoil's representatives to the periphery of political life. Characteristically, residents of Usinsk see the large companies as the most influential political players, with the fate of the local economy depending on their activities. According to a poll taken in May 2006, 70 percent of the respondents said that the oil companies determined the situation in the city and surrounding area, not the political authorities at the federal, regional, or local levels. It is not surprising that people with ties to these companies make up the local civil service and form the local political elite.

Today the various pro-Kremlin youth groups, such as Nashi or Molodaya gvardia, the youth branch of United Russia, are not preparing a new generation of political elites for the country. Instead Russian business has started the process of renewing the Russian elite.

No room for small and medium business

The political influence of big business does not translate into similar success for small and medium sized business. Small business is essentially not represented in Russia's political institutions and is under constant pressure from the authorities. Moreover, small and medium sized business are the main sources of income for bureaucrats, since these businesses typically need bureaucratic protection to continue their operations and often have to pay bribes to secure it. In Komi, as in the rest of Russia, representatives of the authorities and the law enforcement agencies serve as a "roof" for practically all small and medium businesses. Even the former mayor of Komi's capital city Sergei Katunin complained about this problem when he was locked in battle with the republican authorities.

Small business still lacks political organization, even though national groups like OPORA or local groups like the Komi Trade Association theoretically represent its interests. Although the authorities constantly boast of their efforts to improve the situation of small business, there are few real accomplishments in this area. Even though small business faces a difficult battle with the Russian bureaucracy and is growing only extremely slowly, it has developed an ability to survive in difficult conditions, which will inevitably lead it to self-organization.

It is also important to point out that small business grew not from the ranks of the nomenklatura, but more spontaneously from below. It draws on different social and political bases than big business and these groups are making themselves felt in both the political and economic spheres. Nevertheless, big business does not want to involve small and medium sized business in its projects or forego profits in their favor. The authorities also are not interested in creating conditions for big and small business to work together. Thus, a round table on cooperation between big and small business planned for September never took place. It is clear that now is the time for owners of small businesses to seek political representation and defend their interests.

For the March 2007 regional legislative elections, it will be important to see how well representatives of small and medium business do. The March elections will determine whether the bureaucracy will gain the upper hand or whether the business elite will preserve its position. Of course, in many cases the bureaucracy and business manage to find common ground. The border between these two groups is increasingly flexible and their interests are often interweaved.

About the author:
Yury Shabaev is a researcher based in Syktyvkar, Komi Republic.

Literature quoted in the text:

- Milovan Djilas, *The New Class: An Analysis of the Communist System*, Orlando: Harcourt, Brace, Jovanovich, 1957, 1985.
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Opinion Survey

Do Russian Businessmen Benefit the Country?

Is the activity of … at present beneficial or harmful to Russia?

	Large Russian enterprises	Medium and small business
Definitely beneficial	9%	12%
More likely beneficial	34%	51%
More likely harmful	32%	17%
Definitely harmful	12%	6%
No answer	13%	14%

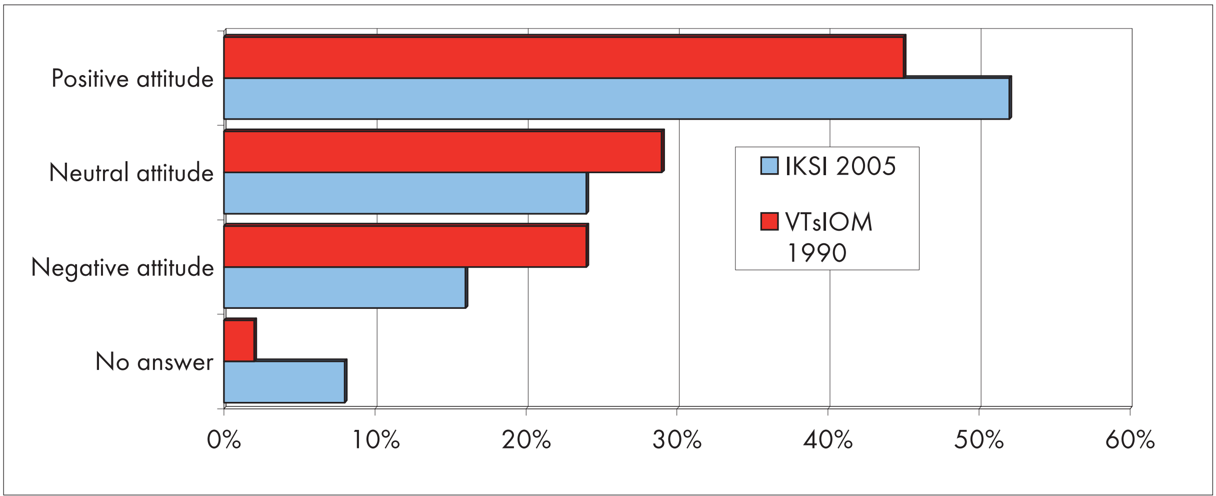
Source: Opinion survey by Levada Center of 13 September 2006
http://www.levada.ru/press/2006091302.html

How Middle-Class is Russia Today? The Attitudes of Russians Towards Property

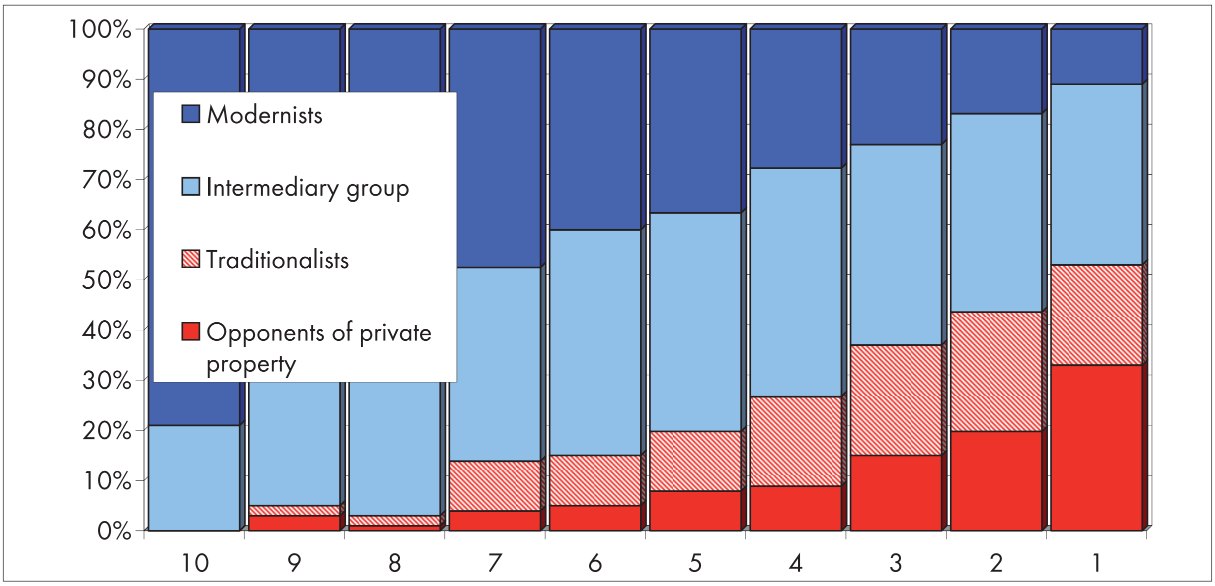
Results of an opinion survey carried out by the Institute of Complex Social Research of the Russian Academy of Sciences (IKSI) on behalf of the Friedrich Ebert Foundation (Germany)

Source: Dr. Matthes Buhbe: Die Einstellung der Russen zum Eigentum: Wie bürgerlich ist Russland heute? Kommentierte Auswahl einiger Ergebnisse. Eine Studie im Auftrag der Friedrich-Ebert-Stiftung: Bearbeitung: Dr. Matthes Buhbe. Leiter der Studie: Prof. Dr. Michail Gorschkow, Direktor des Instituts für komplexe Gesellschaftsstudien der Russischen Akademie der Wissenschaften IKSI [The Attitude of Russians Towards Property: How Middle-Class is Russia Today? Selected Results with Commentary. A Study on Behalf of the Friedrich Ebert Foundation. Adaptation: Dr. Matthes Buhbe. Head of Project for the Study: Prof. Dr. Mikhail Gorshkov, Director of the Moscow, Institute of Complex Social Research of the Russian Academy of Sciences (IKSI), 7 June 2005, 6 p.

Is private property on a large scale desirable at all? (Opinion surveys conducted by IKSI in 2005 and VTsIOM in 1990)



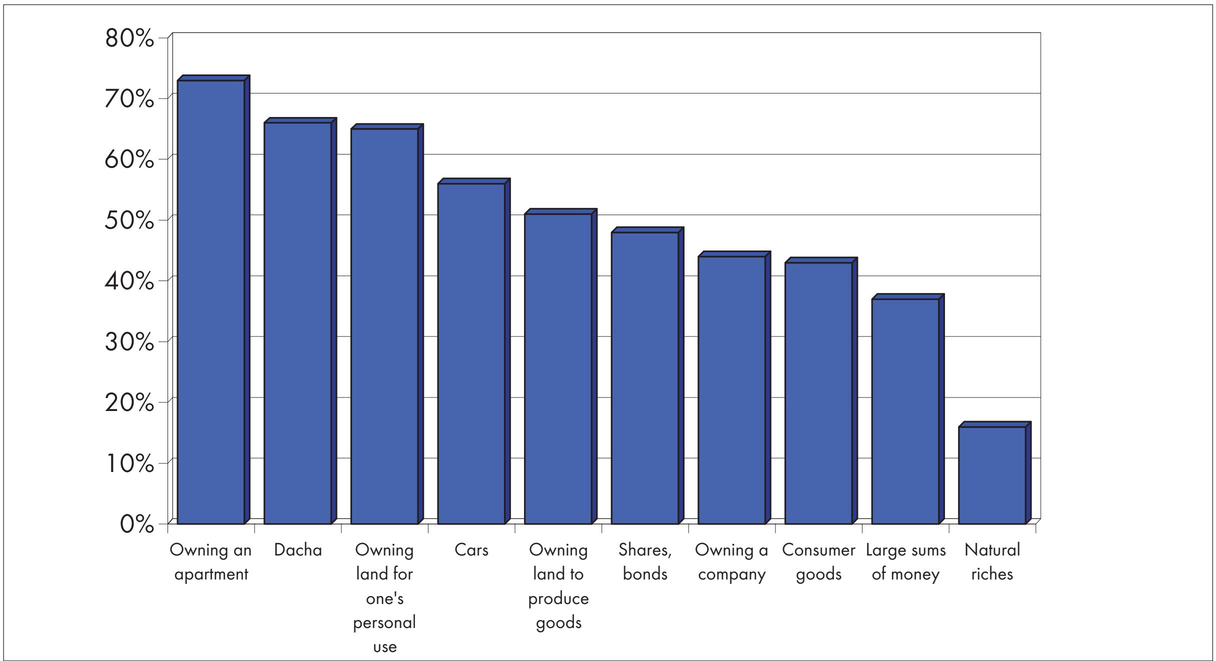
Relative proportions of "mentalities" according to income (Deciles; 10 = high income, 1 = low income)



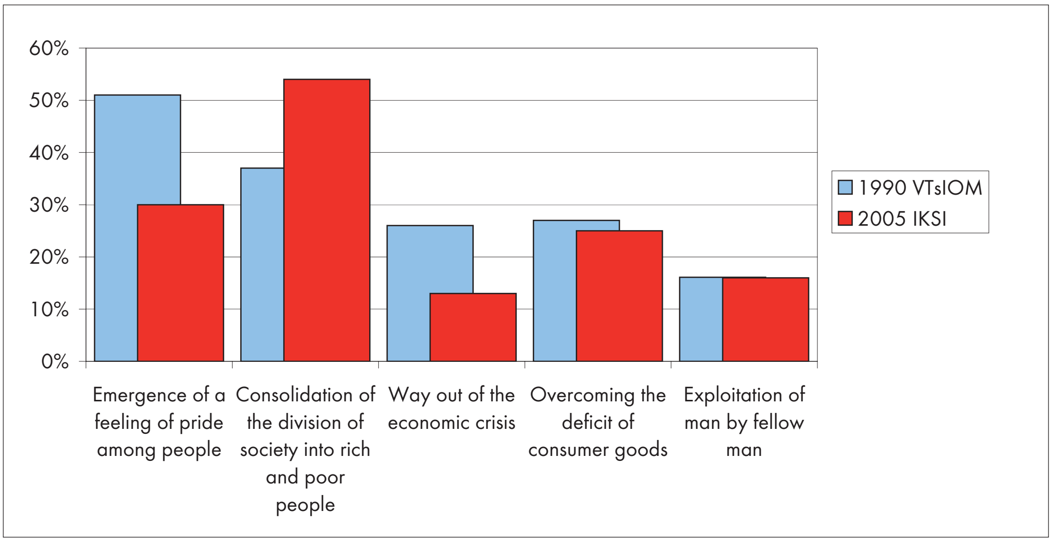
What mentality groups associate with concepts of "power of disposal"

	Opponents of private property	Traditionalists	Intermediary group	Modernists
The state should be the owner of firms and organizations	75%	57%	33%	15%
I am an opponent of any form of private-sector economics	73%	24%	6%	0%
Entrepreneurs cash in on other peoples' work	84%	65%	46%	27%
Entrepreneurs give people work	17%	35%	54%	73%
The term "entrepreneur" creates positive associations	22%	51%	73%	92%
The term "owner" creates positive associations	20%	53%	75%	90%
The term "competition" creates positive associations	33%	49%	60%	71%
The term "wealth" creates positive associations	47%	62%	79%	88%

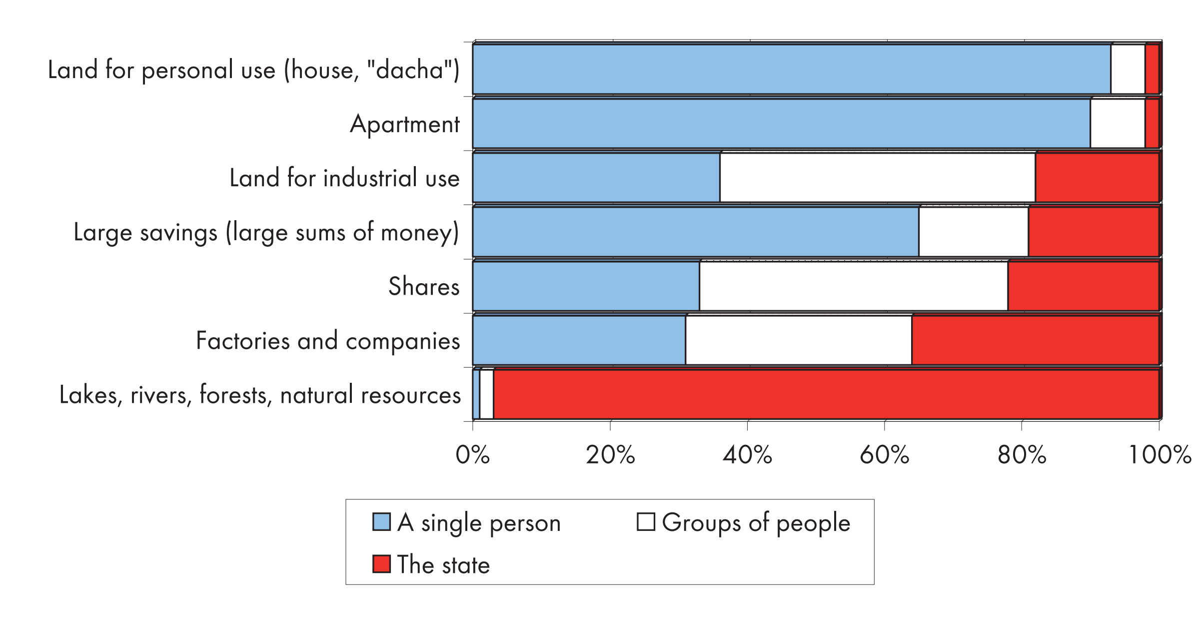
What Russians think of when they talk about private property



What are the consequences of private property for Russia? (Multiple answers possible)



Who should have the right of disposal over the following types of property?



Documentation

Internet Links to Further Information on the Role of Business in Russia
(in Russian)

Opinion surveys

FOM Survey of 8–9 April 2006 http://bd.fom.ru/zip/tb0615.zip
see Tema (Subject) 3. Krupnyi biznes v Rossii [Large Businesses in Russia]

Survey by the Levada Center of 16 September 2005 on the role of businessmen in Russia
http://www.levada.ru./press/2005091601.html

Survey by the Levada Center of 30 May 2006 on the on the attacks on Mikhail Khodorkovsky
http://www.levada.ru./press/2006053000.html

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Reiting milliarderov – 2006 [Russia's leading billionaires in 2006], Finans Nr. 6 (143), 13–19 February 2006
http://finansmag.ru/offline/num143/milliarderi-2006/25495

A. Samarina: 100 vedushchich politikov Rossii v sentyabre [Russia's 100 Leading Politicians in September], in: Nezavisimaya Gazeta, 29 September 2006
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A list of Russia's leading entrepreneurs

Biznes-lidery Rossii [Russia's Business Leaders]
http://www.amr.ru/pdf/leaders2006.pdf

About the Russian Analytical Digest

The Russian Analytical Digest is a bi-weekly internet publication jointly produced by the Research Centre for East European Studies [Forschungsstelle Osteuropa] at the University of Bremen (www.forschungsstelle-osteuropa.de) and the Center for Security Studies (CSS) at the Swiss Federal Institute of Technology Zurich (ETH Zurich). It is supported by the Otto Wolff Foundation and the German Association for East European Studies (DGO). The Digest draws on contributions to the German-language Russlandanalysen (www.russlandanalysen.de), the CSS analytical network on Russia and Eurasia (www.res.ethz.ch), and the Russian Regional Report . The Russian Analytical Digest covers political, economic, and social developments in Russia and its regions, and looks at Russia's role in international relations.

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Research Centre for East European Studies [Forschungsstelle Osteuropa] at the University of Bremen

Founded in 1982 and led by Prof. Dr. Wolfgang Eichwede, the Research Centre for East European Studies (Forschungsstelle Osteuropa) at the University of Bremen is dedicated to socialist and post-socialist cultural and societal developments in the countries of Central and Eastern Europe.

The Research Centre possesses a unique collection of alternative culture and independent writings from the former socialist countries in its archive. In addition to extensive individual research on dissidence and society in socialist societies , in January 2007, a group of international research institutes will be assembled for a collaborative project on the theme "The other Eastern Europe – the 1960s to the 1980s, dissidence in politics and society, alternatives in culture. Contributions to comparative contemporary history" which will be funded by the Volkswagen Foundation.

In the area of post-socialist societies, extensive research projects have been conducted in recent years with emphasis on political decision-making processes, economic culture and identity formation. One of the core missions of the institute is the dissemination of academic knowledge to the interested public. This includes regular email service with more than 10,000 subscribers in politics, economics and the media.

With a collection of publications on Eastern Europe unique in Germany, the Research Centre is also a contact point for researchers as well as the interested public. The Research Centre has approximately 300 periodicals from Russia alone, which are available in the institute's library. News reports as well as academic literature is systematically processed and analyzed in data bases.

The Center for Security Studies (CSS) at ETH Zurich

The Center for Security Studies (CSS) at the Swiss Federal Institute of Technology (ETH Zurich) is a Swiss academic center of competence that specializes in research, teaching, and information services in the fields of international and Swiss security studies. The CSS also acts as a consultant to various political bodies and the general public.

The CSS is engaged in research projects with a number of Swiss and international partners. The Center's research focus is on new risks, European and transatlantic security, strategy and doctrine, state failure and state building, and Swiss foreign and security policy.

In its teaching capacity, the CSS contributes to the ETH Zurich-based Bachelor of Arts (BA) degree course for prospective professional military officers in the Swiss army and the ETH and University of Zurich-based MA program in Comparative and International Studies (MACIS), offers and develops specialized courses and study programs to all ETH Zurich and University of Zurich students, and has the lead in the Executive Masters degree program in Security Policy and Crisis Management (MAS ETH SPCM), which is offered by ETH Zurich. The program is tailored to the needs of experienced senior executives and managers from the private and public sectors, the policy community, and the armed forces.

The CSS runs the International Relations and Security Network (ISN), and in cooperation with partner institutes manages the Comprehensive Risk Analysis and Management Network (CRN), the Parallel History Project on NATO and the Warsaw Pact (PHP), the Swiss Foreign and Security Policy Network (SSN), and the Russian and Eurasian Security (RES) Network.

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