

**'Russian foreign energy policy conduct in the oil and gas sectors:  
A case study of the Caspian region 1991-2008'**

BY

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## **Abstract**

This thesis explores the continuities and change in the conduct of Russian foreign policy in the Caspian region in the period 1991-2008 with the central focus set on the inclusion of energy both as a tool and one of the main targets of Russian foreign policy during the Putin administration. More specifically it looks at the impact that the choice to establish the Russian Federation as an energy superpower based mainly on its oil and gas sectors during this period had on the conduct of Russian foreign policy in the Caspian region.

The central research question this thesis attempts to answer is how Russian foreign oil and gas companies are used as foreign policy tools in the conduct of Russian foreign energy policy in the Caspian region within the current foreign energy policy framework and to what end. Secondary questions include how the state exerts enough power over its energy companies, especially the private ones, in order to use them in its foreign policy making; and to what end does the state use its companies for when it comes to Russian foreign policy making.

The argument of this thesis is based on the hypothesis that the Russian state uses its oil and gas companies in order to infiltrate the energy markets of the Central Asian states and assert its economic hegemony in the region through a web of legal and contractual monopolies aiming at maintaining Russia's economic hegemony in the Caspian and contributing to one of Russia's main energy policy priority of becoming an influential player in the global energy markets.

To Yiannis, Tarsi and Nikos

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## CHAPTER 1: Introduction

### 1.1. Introduction

This is an area studies thesis exploring the subject of continuity and change in Russian foreign policy making in the Caspian<sup>1</sup> region in the period 1991-2008. The emphasis is on the Putin period of the 2000s as it is since then that energy has become an important component of Russian foreign policy conduct. The study focuses on the use of Russian oil and gas companies as *vehicles* of foreign policy making in the Caspian and it intends to answer how and to what end the companies' commercial activities in the region contribute to the main Russian foreign energy policy objective of retaining its economic hegemony in the area. To this end it looks at the relationship between the Russian state and oil and gas companies both domestically to establish the grip of the state over the sector, and in Russian foreign policy making in the Caspian to understand the contribution of the companies to the Russian foreign energy policy goals in the region through their commercial activities.

The argument of this thesis is based on the hypothesis that by looking at the commercial activities of Russian oil and gas companies in the Caspian we can see that through the combination of legal and contractual monopolies with the other littoral states Russia manages to maintain its economic hegemony in the region. This alternative perspective on the use of oil and

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<sup>1</sup>In this thesis the Caspian region is defined geographically as the littoral states of Russia, Kazakhstan, Azerbaijan and Turkmenistan. For the purposes of this particular study Iran has not been included as it is not a post-soviet state and thus many of the political and economic interlinks between Russia and the post-soviet states do not apply in the case of Iran. To facilitate the research and give a more holistic view of the oil and gas sector in the Caspian, a further two countries, which do not have borders with the Caspian as such but they are connected with the area as the bulk of their oil and gas goes through it, are mentioned in the study: Uzbekistan and Tajikistan.

gas companies in Russian foreign energy conduct in the Caspian adds to our understanding of Russian foreign energy policy making in the region.

The central research question this thesis answers is *how*<sup>2</sup> Russian oil and gas companies are used as vehicles of Russian foreign policy conduct in the Caspian within the current energy policy framework and *why*<sup>3</sup>. Subsidiary questions include: How does energy fit into foreign policy? Why is the Caspian important in this respect? Through which means is Russian foreign energy policy conducted in the Caspian? The hypothesis that Russia conducts part of its foreign energy policy in the Caspian through its oil and gas companies is built around the argument that the consolidation of the state under the Putin administration domestically, which brought about the centralisation of decision making under the president and the parallel consolidation of the oil and gas sector during Putin's second term, has been reflected in the foreign policy making environment.

As discussed in Chapter 4 under Putin control of the oil and gas sector passed from governmental departments, like the Ministry of Foreign Affairs or Energy, to the Presidential Administration. The direct influence of the Presidential Administration over both foreign policy making and the energy sector in addition to the state takeover of the oil and gas sector in the domestic economy

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<sup>2</sup> In the research question the term *how* refers to the means by which the Russian state utilizes its oil and gas companies in the formation of Russian foreign energy policy in the Caspian. As it is analyzed in the conceptual framework in Chapter 2, by departing from the state-centric Realist ontological and epistemological assumptions in foreign policy analysis and adopting a Neo-liberal approach to the study of the importance of non-state actors in international affairs, we can see *how* Russian oil and gas companies assist in the maintenance of Russia's economic hegemony in the Caspian through their commercial activities.

<sup>3</sup> In the research question the term *why* refers to the explanation of the ability of the Russian state to use its oil and gas companies in its foreign energy policy conduct in the Caspian. As it is analyzed in Chapter 4 on state-business relations in the oil and gas sector, and is applied to the two case studies in Chapters 5 and 6, the Russian state through the mechanisms of inclusion of the state companies in and the exclusion of the private companies from decision making, manages to maintain its grip on the oil and gas sector and while on the one hand promotes state companies, on the other hand it controls private companies. The rationale behind the mechanisms of inclusion and exclusion to decision making is outlined later in this Chapter and in more detail in Chapter 2.

rendered oil and gas companies suitable for becoming a muscle of the state in the formation of foreign energy policy in the Caspian, a fact that would probably not have been possible had the Russian oil and gas companies been completely out of the control of the state. In this respect there is a correlation between the ability of the state to control the oil and gas companies and its capacity to use them in its foreign policy making.

The Caspian is an especially interesting area where the new tendency in Russian foreign energy policy can be observed. The Soviet time economic and political links between Russia and the Caspian states, as well as the longstanding operations of Russian oil and gas companies in the area, create a unique web of interdependences among the regional states when it comes to the oil and gas sector. Russian foreign energy policy in the Caspian demonstrates the effects that the changes in the domestic environment have on the Russian foreign energy policy making environment.

By using a conceptual framework, proposed in Chapter 2, based on Neo-liberal ideas on the use of non-state actors in foreign policy making, Chapter 4 demonstrates how the installation of the power vertical and the capture of oil and gas business by the state or state companies internally have caused the emergence of new actors in foreign policy making which could deal with the demands of the new foreign policy tendencies, i.e. a combination of economic and political policies and interests, analysed in Chapter 3. Chapters 5 and 6 show through the two case studies how Russian oil and gas companies act as vehicles of Russian foreign energy policy in the Caspian.

## **1.2. The state of the literature**

A lot has been written on the subject of energy and Russian foreign policy as such although it is a fairly new subject to be analysed, mostly due to the fact that it has been a new development in Russian foreign policy dating from the first Putin administration and has effectively been realised during his second administration and onwards. The subject of state-business relations and their impact on foreign policy have been studied in different ways at different periods in Russian politics. Due to the impossibility of covering everything that has been written on foreign policy or state-business relations and foreign policy, the selection of the literature to be reviewed has been based on two criteria; the first one is the relevance of the source to Russia and the Caspian region; the second one is the relevance of the source to the argument, i.e. the writings which have dealt with the main issue of how energy in the oil and gas sector is used in the conduct of Russian foreign policy through its major companies, with a special focus on the Caspian.

The literature used in regards to Russian foreign energy policy mainly covers the period between 2001 and 2008, i.e. the period when the shift in Russian foreign policy took place, with most of the writings published after 2003-2004 when the Yukos affair took place. A part of the literature dates from the Yeltsin period and is used to identify certain trends which show continuity and change and reinforce the argument of the thesis. The state-business literature covers both the Yeltsin and the Putin administration. The decision to use both periods was based on the hypothesis that by investigating the nature of the contact between state and business we can see that the process of the consolidation of the state has both influenced and caused the consolidation



in the energy sector, which in turn led to the use of companies as key agents in Russian foreign policy conduct. The Caspian literature extends over the 1990s and 2000s as well. The earlier literature is used only to give a brief background on how the Caspian was viewed inside the framework of the Russian foreign policy analysis of the 1990s. The later literature is used to provide evidence of the lack of a more precise and cohesive framework for the analysis of Russian foreign energy policy in the Caspian.

### **1.2.1. State-Business Relations**

#### **1.2.1.1. The rise of business in the oil and gas sector in Russia and its dominance over the state**

‘State-business relations’ is a rather new concept which emerged in the writings on Russian domestic politics mainly of the 2000s. The main characteristic of the term is the idea of a completely reversed balance of power between the state and the oil and gas sector in the Yeltsin and the Putin administration. When in reference to the Yeltsin period, state-business relations were analysed as part of the multivocality<sup>4</sup> of the Yeltsin administrations and viewed oil and gas companies as independent actors in Russian politics which would lobby in order to gain advantages from the state in both the domestic and the external environments, though the focus was more on the domestic situation. The analysis mostly featured in studies on Russian elites and concentrated on the Soviet legacy, meaning the personal ties between the lobbyists and the state elites. The main theme was that a plethora of elites existed, coming both from the regions and the

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<sup>4</sup> By that is meant a plurality of actors in decision making which signified that different interests could be represented at the state level.

centre, which were trying to influence decision making. Business interests, especially in the regions, were lobbied for by them (Schroder and Bell 1999; Steen 2002, 2003). By the end of the Yeltsin period it was widely accepted that the state was captured by business in general with the oil and gas companies featuring prominently in the relationship. Terms like ‘oligarchs’ were now extensively used, most of the time without a clear definition (Tompson 2002; Goldman 2004).

Frye (2002) argued against his contemporaries, criticising them for focusing their analysis on the minority of the ‘oligarchs’ and the successful and influential lobbyists, a practice which he felt posed the danger of distorting the real picture of state-business relations. He conducted quantitative research using 500 firms and concluded that relations between influential firms and the state were better characterised by elite exchange than by pure capture as, on the one hand the companies gained from access to decision making, gaining advantages over legislation and normative acts, but on the other hand the state elites would gain from taxation. The relevance of Frye’s argument to the thesis, despite the fact that it looks at a very specific sector of businesses—the oil and gas sectors which are labelled both strategic and ‘oligarchic’—is twofold; in the realisation that the relationship provides mutual advantages to both parties and the conclusion that state businesses had in the past more chances to lobby successfully as obviously they had helpful connections to the government. This might imply that the capture of the state by the business was only temporary, linked to the specific elites of the Yeltsin period and evident in the available access to policy making through the influencing of the decision centres, be it at the regional or federal level. This shows that the consolidation of the businesses was linked to the consolidation of the state and that the development of the framework it was conducted in was a long-term process. So, despite the fact that its origins pre-dated the landmark point of the Yukos

Affair the consolidation of the business sector by the state could not take place before the consolidation of the state itself.

### **1.2.1.2. The strengthening of the state and its dominance over business**

The state-business analysis in reference to the Putin period is based mainly on the second term of the Putin administration, immediately following the imprisonment of Mikhail Khodorkovskii. His arrest and the aggressive manner in which the state seized Yukos' assets marked the beginning of a new era in state-business relations where the state would be the dominant partner in the relationship. Questions arising from this event that were tackled by the analysts were whether or not Russia was a 'normal' country and whether or not the economic development of the country would be influenced negatively, especially in regard to the investment climate (Hanson 2003, 2005; Shleifer and Treisman 2005). Discussions on the new elite, comprising mainly the *siloviki*<sup>5</sup> feature strongly in almost all the writings (Kryshtanovskaya and White 2005).

Yakovlev (2006:1033) discusses two basic strategies of Russian companies: isolation from, and close cooperation with the state. He suggests a model of analysis of state-business relations and he concludes that 'as there is little political competition and the mechanisms of democratic control are weak, state consolidation takes place as a bureaucratic consolidation accompanied by new opportunities for informal "business capture" by the authorities. Nevertheless, the high degree of openness of the economy and the remaining heterogeneity of political actors provide

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<sup>5</sup> The term *siloviki* used in the literature on Russian politics is an all encompassing term referring to the people in the Putin administration having a background in the security services. For an alternative interpretation of the *siloviki* and their role in Russian politics see Renz (2006).

business with a wide range of possible strategies of interaction with the state'. In this respect, the gradual reduction of access opportunities to decision making through lobbying in the Duma as the consolidation of the state was taking place increased the informal business capture of the energy companies by the state. The fact that the Duma became less and less multi-party meant that there was a lesser degree of accountability towards different interests and social groups of society and thus it could more easily act in favour of the state or of a state company without being checked. In relation to lobbyism there is some literature suggesting that access to decision making is limited, which mainly refers to lobbyist groups like the Russian Union of Industrialists and Entrepreneurs (RUIE) or other professional pressure groups, or again in relation to the Soviet legacy, the background of the business people (Hanson 2005; Kuznir 2006).

Nonetheless, as the present author confirmed during fieldwork, lobbying activities of oil and gas companies in Russia under Putin have been conducted through both professional pressure groups but also, and mainly, individually. As Rutland (2009:23) says, 'most business lobbying under Putin, as under Yeltsin, took the form of direct approaches to government officials by business groups, either individually or by industrial sector'. This is why there is a need to analyse companies separately in terms of the kind of company they are (private/state owned) and their access to power (Chapter 4 deals with the parallel processes of the consolidation of the state and the consolidation of the oil and gas sector and the access of state companies in and exclusion of private companies from decision making). For example, Rosneft does not have a formal lobbyist inside the Duma. The peculiarity of the absence of representation at the legislature of a company of that calibre is down to the fact that it is not necessary to be represented there as its interests are served at the ministerial level [Pleshin, interview by author 23 October 2008]. Lukoil does have

a Duma deputy lobbying for its interests, and it also functions from within the RUIE. The difference between Rosneft and Lukoil is that the latter is a private company and as such its interests are not directly served by state structures (See Chapter 4 for more details).

The use of state-business relations in order to explain Russian foreign energy policy conduct became widespread in the second term of the Putin presidency. The Ukrainian gas crisis triggered the resurgence of more state-business relations literature, focusing on the power of the Russian state over its businesses and their use as foreign policy tools (Orttung 2006; Sakwa 2008; Hanson 2009) and, as will be described later, it infiltrated Russian foreign energy policy analysis. Nonetheless there are some gaps in the analysis, some questions which have not been addressed correctly. These include the following; how does the state control oil and gas companies? Apart from the main reference to the Yukos affair is there no further explanation given as to why and how a commercial entity would follow the state line. Or why and how a company could be used as a geopolitical tool. The Yukos affair is of course an important development in state business relations, but state-business is seen as an isolated event from energy policy conduct. It is treated as irrelevant to the new shift in Russian foreign policy which is connected to the problematic of foreign policy in general and of Russian foreign policy analysis in particular. This is even more evident when it comes to case studies like the Caspian region. This thesis is using lobbyism, with regard to state-business relations, in order to explain how the consolidation of the state structures minimised the access of companies to power and thus helped in the rise of state companies in the conduct of foreign policy.

## **1.3. Russian foreign policy and the Caspian**

### **1.3.1. Russian foreign policy in the 1990s**

First of all it should be noted that during the 1990s energy had not yet become one of the main drivers of Russian foreign policy, even in the Caspian. Russia was a gas exporter to Europe but energy was used more towards bringing profits in to assist in the reconstruction of the economy, rather than a vehicle of Russian foreign energy policy in order to maintain its economic hegemony in the Caspian (Energy Strategy up to 2010). In this respect the literature review will not be critical of the foreign policy analysis offered during this period, but rather it will briefly underline the basic themes arising from the writings in regard to Russian external relations with the former Soviet bloc, part of which was the Caspian region, and will highlight the sporadic references to energy in the context of Russia's external relations with the Central Asian countries. In this respect similarities and continuities with present analysis will be noted.

The main themes presented in the literature of the 1990s on Russian foreign policy making are: the importance of the reintegration of Russia with the CIS; the fact that Russia is the most potent country in the region and thus the hegemon; problems based on nationalism; fear of secession; and the viewing of Central Asia as the backyard of Russia – too weak to be fundamentally independent from it. Themes involving concepts like the new 'great game', Turkey's neo-Ottomanism, the Soviet legacy, spheres of influence, buffer zones, fear of Islamic fundamentalism, search for identity in Russian foreign policy and elite competition inside the Yeltsin administration which interrupt the normal flow of foreign policy are quite common (Olcott 1995; Blank 1995; Kerr 1995; Malcolm et al. 1996; Bowker 1997). There was also the

tendency to analyse Russian foreign policy by referring to both internal and external actors. The internal environment would be dominated by competing elites and mainly the rift between the proponents of a more pro-Western policy and those of a more conservative one (Kerr 1995). Also the process of democratisation is presented as a factor influencing Russian foreign policy and is the basis for the multivocality in Russian foreign policy (Malcolm et al. 1996).

The subject of the oil and gas sector in the Caspian is mainly mentioned in relation to the Central Asian countries trying to achieve independence from Russia through their resources and economic outputs. Russia's objectives in the Caspian are mainly linked to military security issues. Conflict and cooperation are viewed within the Commonwealth of Independent States (CIS) framework and in relation to Russia's military advantage over these countries, although Russia is still viewed as a weak country with principally no economic resources to assert its power in the area. Blank (1995:16) speaks about the 'new spheres of economic and political influence within and beyond the CIS' and argues that Russia is conducting a kind of 'economic imperialism' in the area by using the Caspian seabed's legal status to prevent deals which would help Central Asian countries gain independence, to prevent the involvement of foreign companies in the region and to use oil as an excuse in order to intervene militarily in the other countries. Nonetheless it is mentioned that the real motives behind Russia's drive to the south are economic, i.e. to prevent countries like Azerbaijan from becoming a competitor for Russia for oil in the European markets (see also Hyman 1993; Lenczowski 1997; Starr 1998).

Other analysis related to energy as part of Russia's foreign policy in the Caspian focuses on pipeline geopolitics, the 'great game' and the major external players along with Russia, there

being Turkey, China, the EU and the USA. The state centric approach in this analysis focuses on traditional energy security issues, like control of the safe transport of energy, seen within the framework of the political and military domination of Central Asia by Russia. This is a trend which continued well into the 2000s and is a very common view of energy politics in the Caspian (Goetz 1997; Emerson 2000; Trenin 2001; Cherniavskii 2002).

Goetz (1997:45) mentions the use of oil companies in the conduct of Russian foreign policy in the context of the chaotic environment of decision making during Yeltsin's administration which allowed several actors to influence the process and he states that 'prominent cases of conflicting activities were the clash between the foreign ministry and Lukoil over the question of the Caspian Sea, the role of the Defence Ministry in Chechnya and Tajikistan or the involvement in arms deals with Armenia. The oil companies tend to support the claims voiced by Azerbaijan and Kazakhstan regarding independent exploitation of the resources of the Caspian sea, whereas the Russian foreign ministry calls for a common solution in which Russia and Iran have the greatest say in the matter' (see also Aleksandrov 1998).

### **1.3.2. Russian foreign policy from 1999 to 2008**

#### **1.3.2.1. Russian foreign policy in the 2000s**

The rise of Putin to power refreshed the interest of analysts in the nature of Russian foreign policy and energy but also in the importance of the Caspian's resources in the framework of the new policy (Orttung 2008). There are two trends which are noted and analysed: a trend towards the securitisation and a trend towards economisation. During this period the securitisation of the



Russian foreign policy debate took place. The September 2001 terrorist attack was pivotal in that as, on the one hand, Russia presented itself as an ally to the West, and to the great surprise of many an ally of NATO, in the global war on terrorism, but on the other hand it feared NATO's expansion in its 'neighbourhood'. Central Asia was declared a top priority in Russia's foreign policy agenda mainly in relation to fighting the resurgence of international terrorism and Islamic fundamentalism. Putin's foreign policy is characterised as being more 'pragmatic' and 'realistic' as opposed to that of Yeltsin which is often deemed 'chaotic' (Lynch 2001, 2002a, 2003; Johnson 2004). The securitisation of foreign policy, drawing on the literature of the earlier years and within the framework of the security-state centric policy, refers to spheres of interests, Russia's national interests and Russia's role as a great regional power as opposed to a superpower (Ashour 2004; Hill 2004; Oldberg 2005; Ziegler 2008; Cornell 2009). Rivalry between different strands of thought mostly referred to as the liberals and the conservatives or the *siloviki* on the securitisation in Russian foreign policy is prominent. There is also some debate stating that energy is not the single driver of Russian foreign policy (Ivanov 2004).

### **1.3.2.2. Energy in Russian foreign policy**

A shift in Russian foreign policy towards the use of energy as an important tool is starting to become evident during the Putin administration which 'has continued to rely on Russia's traditional strengths as the core of an assertive foreign trade strategy: oil, gas, pipelines, the arms trade and nuclear cooperation' (Lo 2003:61). Nonetheless high oil prices have played a pivotal role in this shift (Kivinen 2007; Fredholm 2005). Some literature also refers to the 'Putin thesis', which allegedly formed the basis for the shift in Russian foreign policy (Balzer 2005).

Companies are mentioned more often as foreign policy actors, but at least during Putin's first term it was still unclear how they were being used; Lo (2003:63) states that 'the involvement of Lukoil and Gazprom in the Caspian Oil Company, indicates how economic considerations are becoming increasingly influential not just in the Caspian, but in Russian policy as a whole'. Morse (2002) also mentions the fact that Russia can use its monopolies in its foreign policy conduct, but not its oil companies as it did not control them. There are some early signs of consolidation of the state and its effect on the energy sector as everybody is talking about how Russian foreign policy is centred on Putin but there is no clear indication of how the consolidation of the energy sector is done in practice. As the analysis offered is state-centric, companies are rarely acknowledged as independent commercial actors. They are rather seen as tools of the state in its foreign policy making without explaining how a commercial entity can act as a political tool in foreign policy formation. There has been also a lot of literature on the reinvention of Russia as an energy superpower where the analysis focuses on Putin's aspirations to turn Russia into a global actor in the energy sector (Allison 2004; Buszynski 2005; Monaghan 2007; Kazantsev 2007; Miller 2008; Lucas 2008; Perovic 2008; Torjesen 2009; Overland 2009).

A common methodology for approaching Russian foreign policy analysis has been to look at the internal factors influencing foreign policy conduct. The most frequent factors examined have been the presidential administration, including the Security Council, the power ministries, like the Ministry of Defence, and big businesses (Godzimirski 2000; Shearman 2001; Lo 2003). In this literature despite the fact that there is a conscious attempt to look into how the domestic environment reflected on the external policy sphere, the analysis remains state-centric and thus focused mainly on political gains. This type of analysis has clearly been an influence from the

earlier literature on elites and state-business relations on the Yeltsin period outlined in section 1.2.1. 1.

In reference to Russian foreign energy policy in the Caspian there have been recurring themes in the literature regarding the analysis of the energy policy of the Caspian states. The oil curse, which is very often used by political economists when looking at the foreign energy policy of the Caspian states, especially Russia and Kazakhstan, refers to the fact that resource rich countries are normally plagued with corruption because of the lucrative gains from trading their natural resources. This hinders their development as the economic sector is dominated by the oil or gas sector and there is little investment elsewhere (Considine and Kerr 2002; Ellman 2006; Campaner and Gubaidullini 2009).

The legal status of the Caspian basin and the demarcation of the seabed is another theme which occurs very often in relation to energy politics in the Caspian. The main problem identified with the status of the Caspian is whether it is a landlocked sea or a lake. The legal consequences of acquiring either status would have severe repercussions to owning and exploiting the Caspian resources. The logic of referring to the Caspian legal status when analysing Russian foreign energy policy in the Caspian is that the unresolved issue is used by Russia in order to prevent the other littoral states from acquiring full rights to their respective sectors. That would have three consequences on the Russian influence in the region: the first is the fact that Russia would not have direct rights of exploitation to other sectors of the seabed apart from its own. The second is that by settling the legal status of the Caspian the other littoral states could easily attract even more foreign direct investment and thus choose to make deals in the energy sector with other

countries than Russia. The third one is the fact that once the legal dispute is solved, the way is paved for the building of pipeline routes that will bypass the Russian route and thus threaten Russia's control over gas exports to Europe (Kamyar 2000; Gusseinov 2002; Lynch 2003; Vinogradov et al 2004; Shroder 2006; Cornell 2008; Labban 2009; Cohen 2008; Tsereteli 2008; Olcott 2009; Bilgin 2009). Despite the fact that this analysis contributes to our understanding of one of the policies that Russia uses in order to maintain its hegemony in the region, it still remains state-centric and does not include analysis of the role of oil and gas companies as commercial entities in the formation of Russian foreign energy policy in the Caspian.

### **1.3.2.3. State-Business relations and oil and gas companies in the Russian foreign energy policy conduct**

The latest literature on Russian foreign energy policy, since 2006-2007, has started to focus on companies being used as foreign policy actors. The main trends are the use of state-business relations in order to explain the conduct of foreign policy and the use of energy companies as foreign policy tools. Also analysis of the economic policies followed by the Russian energy companies, especially in the Caspian, enters the literature (Hanson 2005; Baev 2008; Cornell 2008, 2009; Orttung 2008).

Several analysts refer to the fact that lobbyism has been used by oil companies in order to influence energy policy. Kivinen (2007:22) speaking about Russian energy actors, refers to the Yukos affair; 'first of all Khodorkovskii challenged the position of state owned companies Rosneft and Transneft by lobbying for private ownership of oil and gas export pipelines. When

this failed, he then had negotiated the grand scale plan to have his own pipeline constructed from Siberia directly to China'. The consolidation of the energy sector was a consequence of that; 'all this (the grabbing of Yukos) does not indicate that Russian natural resources would be completely nationalised or even put under state control. But the lesson is that the main process of vast natural resources management is going to be under the control of the government' (2007:22). The energy firms must be prepared to coordinate their activities with the government's foreign policy interests and those who will not follow the informal agenda will most probably be 'punished' by the Russian state, possibly through the use of law (See also Milov 2006; Larsson 2008).

Kivinen (2007) mentions that state companies like Gazprom or the Unified Energy System (UES) do not act as purely commercial entities. He gives some examples to support this point like the fact that some of the state companies' priorities include serving the state's political purposes instead of their commercial ones. For example they subsidise the domestic market instead of focusing on more profitable markets abroad. He refers to the 'rules of the game', like unwritten rules and informal sets of rules which the state companies are obliged to follow. This analysis does offer an alternative view of the role of companies as vehicles of materialisation of the political priorities of the state, but it fails to view the role of the commercial activities of the companies in the realisation of the state's commercial goals. As it will be explained in Chapter 2, most of the analysis on Russian foreign policy is informed by Realist state-centric ontological concepts, and as such it focuses on the state as the main actor in both the domestic and the foreign policy spheres and on the political side of policy at the expense of the

economic/commercial one. As a consequence it analyses the actions of the states through a political lens.

The fundamental problem with this approach is that companies are not political entities, and thus there are certain constraints placed upon them when they act inside the political environment. In analyses like Kivinen's three problems arise: the first one is that companies are seen as mere pawns of the state instead of agents in their own right. The second one is that this analysis applies only to state companies leaving out the private ones as the link between the capture of the private sector by the state has not been established properly. The third one is that the focus of the analysis is on the politics rather than on the commercial side. As it is outlined in Chapter 2, by first establishing the capture of the oil and gas sector by the state through the mechanisms of *inclusion* and *exclusion* and then by analysing Russian foreign energy policy in the Caspian through a conceptual framework informed by the Neo-liberal ideas on the importance of non-state actors in Russian foreign policy we can see how Russian oil and gas companies' commercial operations, when viewed within the Russian energy framework, contribute to the realisation of Russian foreign energy goals in the Caspian.

#### **1.3.2.4. Economic leverage in the CIS**

Russia's energy policy in the CIS includes financial means like investment of capital in key sectors of the states' economies. As Vahtra (2007:102) says 'investments in the strategic natural resource-based sectors often provide Russia with significant economic and political leverage in the target countries' (see also Larsson and Leijonhielm 2004; Jaffe 2004; Larsson 2006; Libman

2007; Hedenskog and Larsson 2007; IEA 2008). With regard to Central Asian states' gas exports the fact that Russia acts as an intermediary or as Larsson (2008) puts it the 'middle-man monopoly player' gives Russia leverage over them.

Kivinen (2007:14) proposes an alternative framework of analysis for Russian energy policy in the Caspian. He observes that 'the Russian framework can be seen as comprising three schemata: Soviet time interdependency, business logic and energy superpower aspirations. The frames are not completely mutually exclusive. Rather there is a transition from one frame to another which can be characterised by a gradual replacement of the Soviet time interdependency by a market based on mere business logic. Linked to the issues arising from state-centric analyses, the problem with this framework lies with a lack of defining clearly Russian foreign energy policy goals in the Caspian, apart from the ones linked to it being an energy supplier. Despite the fact that Kivinen mentions a shift from Soviet interdependency to business logic, he does not analyse Russian foreign energy policy through the lens of its economic priorities in the region. Furthermore he emphasises the state as the main actor and overlooks the commercial activities of Russian oil and gas companies in Russian foreign energy policy conduct. As is analysed in Chapter 3, 5 and 6, by looking at the commercial activities of Russian oil and gas companies in the Caspian within the framework of Russian energy policy, we can have a more complete picture of Russian foreign energy policy in the region.

### **1.3.2.5. Russian energy companies used in foreign energy policy making in the Caspian**

Out of the four Russian companies involved in Russian foreign energy policy in the Caspian and which the thesis considers separately, i.e. Gazprom, Lukoil, Rosneft and Transneft, it is only Gazprom that has a large amount of case studies and references. Lukoil and Rosneft have one dedicated to each and Transneft has none. Gazprom's popularity in the literature is linked to a rather bad reputation it acquired during the 2000s, especially in connection with the Ukrainian gas dispute (Heinrich 2006; Pleines 2008; Baev 2008; Socor 2008). Gazprom is also linked to European energy security, mainly linked to security of supplies and to questions related to whether or not it can be a reliable partner. With regard to the Caspian it is linked to the pipeline monopoly, capture of Central Asian gas and in general as the weapon of choice for the Russian state against its Central Asian neighbours and dominance over the domestic market (Mitrova 2008; Cornell and Nilsson 2008; CEPS 2008; Heinrich 2008; Poussenkova 2009). The main problematic that the analysis of Gazprom poses is the fact that most of the time it is not distinguished from the Russian state. Gazprom is presented as conducting foreign policy itself, though some commercial actions that the company takes in Russian foreign policy are noted as refusal to pipeline access or gas cuts. The second problematic is that any study of Gazprom is loaded with political significance and that the commercial side of the company in Russian foreign policy is almost invisible.

The same pattern is seen in the case studies of Rosneft and Lukoil. Poussenkova (2007) talks about Rosneft being an agent of the Russian state, but she does not say how that happens. How does the state hold so much power over Rosneft and what kind of political implications do



Rosneft's actions abroad have for the country where the projects take place? It is taken as a given that Rosneft should be an agent of Russia as it is its main National Oil Company (NOC), but that does not explain fully how that helps us fit Rosneft into Russian foreign energy policy and Russia's present political structure. Rosneft, like other Russian energy companies, is highly controlled and actually plays a much greater role than it is seen to play. The fact that these are state companies implies that there is an incestuous relationship between the state and the company, but is never looked at as a two way relationship, the company part is missing. Also it is implied that Rosneft is like any other NOC in the world, an argument strongly supported by both politicians and business people. Furthermore it is accepted without question because it is taken for granted that this is the modus operandi of Russian business, Russia is not a 'normal country'. The main question here, as in the case of the other companies as well, is; how does Rosneft serve Russian foreign energy policy?

Gorst (2007) speaking about Lukoil, separates politics from economics in her analysis and argues that Russia's goal in the energy sector is to create big companies which can compete abroad and make Russia an energy superpower, thus saying that these are Russia's commercial interests without bringing in the security side or the security framework of Russian foreign policy, considering how Russia's new power will serve its interests in other areas. However, she does say that the presence of Lukoil in Kazakhstan means that the majority of its oil production will go through Russia. If we connect that to international operations, like the Caspian Pipeline Centre (CPC), we will see how Lukoil helps Russia minimise external competition. Otherwise the companies are depicted as mere pawns in the hands of the Russian state, while in reality they

gain too. The case of Lukoil is very different from that of Rosneft as it is a private company. So in its case survival might be the goal.

## **1.4. Conclusions**

### **1.4.1. The problematic of the current research**

There are four main points in the current research which could improve our understanding of Russian foreign energy policy in the oil and gas sectors in general and in the Caspian more specifically. The first point is the connection between the Russian state and business in the oil and gas sectors; the second one is the connection between Russian energy policy and Russian oil and gas companies; the third one is the conduct of external policies of the Russian companies within the framework of energy policy; and the fourth one is the synthesis of all the actions of all the companies inside the framework of Russian foreign energy policy and how the objectives of the state are implemented through them.

### **1.4.2. The consolidation of the energy sector as part of the shift in Russian foreign policy**

As has been noted in sections 1.2.1.1. and 1.2.1.2., the patterns of state-business relations revolve around the concepts of the state elites competing for privileges, or the aggression of the state in occasionally acquiring private company assets. State-business relations are viewed either as a state capture by business in the Yeltsin era or a business capture by the state in the Putin era. The milestone was the Yukos affair in 2003. There is a paradox with regard to the use of the Yukos

affair to mark the sudden end of the state capture by business and in explaining the capture of business from the state. Of course that was an important point and a catalyst for the development of state-business relations, but the state-business aspect is seen as an isolated event from energy policy conduct. It is often regarded as irrelevant to the new shift in Russian foreign policy which is connected to the problematic of foreign policy in general and of Russian foreign policy analysis in particular. This is even more evident when it comes to case studies like the Caspian region. However, while most analysts agree on the fact that the Yukos case was a special and unique incident which is not likely to happen again apart from, perhaps, in a very rare case, they do not explain how the other companies' power has been consolidated. In the narratives there is also the absence of another important incident which took place at the same time as the Yukos affair and that was the acquisition of Sibneft by Gazprom. Putin's policy had two results, one was to illustrate the state's power over the companies through legal means, and the second was that it applauded the actions of oligarchs who complied with the new rules. But what was it that made the companies not have another way out from this situation? Lobbyism can shed some light with regard to this question and show that the grip of the Russian state over the companies is more powerful and more legally founded than generally believed. It is a common issue when looking at Russia for anyone to make quick assumptions about the strength of the state over the public or any sector of the economy, but the fact is that Russia is still a democracy, and by that a whole system of obligations towards its citizens is implied.

Chapter 4 analyses the relationship between the Russian state and the oil and gas sector through the mechanisms of *inclusion* of the state companies in and *exclusion* of the private companies from decision making, based on the idea of the second face of power of Bachrach and Baratz

(1962). As it is explained in Chapter 2, the ability of the state to control the channels of access to decision making has been used in order to include state companies in and exclude private companies from access to decision making centres. As a result while the state companies rose to power both inside Russia and abroad, private companies have been subordinated to the state or the state companies. By looking at the relationship through the lens of the second face of power, we can understand not only the fact that the Russian state has captured the oil and gas sectors, but the reason behind the endurance of this capture.

Access to power in Chapter 4 is viewed through the lobbying activities of the oil and gas companies from the first Duma to the fifth one covering the Yeltsin and Putin eras. The Duma is selected as it is there where we can see the parallel processes of the state consolidation and the business consolidation. As the state increased its grip on the Duma through the shrinking of any opposition to the party of power and thus through the constellation of the power vertical on the legislature, the private companies lost their ability to lobby and their ability for access to policy making reduced in size and importance. At the same time this process aided the emergence of state companies, notably Gazprom and Rosneft which benefited from the strengthening of the state by not only acquiring assets from bankrupt companies but also by partnering private companies in big projects and in a way consolidating the energy sector by themselves instead of the state. As it is argued in Chapter 4 and applied to Chapter 5 and 6, business capture by the state in the Russian oil and gas sector enabled the Russian state to use oil and gas companies in the formation of its foreign energy policy in the Caspian.

### **1.4.3. Russian Foreign Energy Policy priorities**

While most writings do not offer a definition of what Russian energy security is, it is implied that it is linked to the security of supplies. Consequently, Russia's foreign energy policy priorities in the region are defined as securing the safe supply of oil and gas flows to Europe (Churfin 2001; Fredholm 2005; Larsson 2006; Bilgin 2009). Nonetheless, this is not entirely correct. Chevalier (2009:19) offers a definition of the geopolitics of energy: 'The geopolitics of energy concerns the balance of power among nations and companies for access to energy resources and within each nation the management of energy issues and resources. In oil and gas exporting countries the geopolitics of energy are closely associated with the appropriation of oil and gas money and its allocation through political decisions. In oil and gas importing countries the security of energy supply is a major political concern. The geopolitics of energy embraces energy policy, foreign policy and sometimes military action'. By looking at Russian foreign energy security concerns in the Caspian through a critical security studies lens, explained in Chapter 2, this thesis adopts a broader concept of Russian energy security priorities in the area with a focus on Russia's commercial priorities in the region. In chapters 5 and 6 the specific interests of the Russian state are presented in both the oil and gas sector. They are a mixture of economic and political issues within the security mindset of the foreign policy framework, which in the case of Russian foreign energy policy are closely linked. Russia's objectives in the Caspian region in the oil and gas spheres are principally two; control of oil and gas production and control of oil and gas transportation, mainly to the European markets, where Russia's energy priorities and goals are firmly established, but also to Asia. In short, obtaining economic hegemony in the area is central to Russian foreign policy.

#### **1.4.4. Non-state actors in the implementation of Russian foreign policy**

The third issue is that of the use of companies in Russian foreign policy conduct. Despite the fact that after the Cold War foreign policy analysis has departed from the more traditionalist theories of analysis, like the concept of spheres of influence -a recurring idea when it comes to Russian foreign policy analysis -it has remained largely not only state-centric, but most of the time 'oblivious' to non-state actors, like companies. As is discussed in Chapter 2, the influence of Realism and its positivist ontological assumptions have largely influenced the study of Russian foreign policy. As a result the state is viewed as the central actor in foreign policy making and politics as the main goal. Consequently commercial interests and non-state commercial actors are not taken into consideration. As Reinalda (2001:130) states 'The traditional concept of foreign policy ignores the possibility that non-state actors are themselves conductors of a state's foreign policy rather than merely actors trying to affect the men and women who 'really' conduct foreign policy. This bias is furthered by the pluralistic notion that underlies much foreign policy analysis. It portrays non-state actors as occasional winners or losers in the recurring battles to influence the 'real centres of power', but never as centres of policy conductors of foreign policy themselves'. This is extremely evident in the current literature both on state-business relations but also on Russian foreign policy.

Linked to the central the role of the state in foreign policy analysis is the fact that the literature focuses on a few milestones in order to discuss and analyse foreign policy. As Reinalda (2001:129) remarks the problem with that is: 'that most studies focus on major decisions or even crisis situations, instead of routine policy making. This produces a tendency to ignore non-state

actors, because of the commonly accepted hypothesis that the handling of such situations requires centralisation of decision making. This bias is furthermore reinforced by the implicit idea that major or crisis situations occur in the realm of territorial security. There is however no prima facie reason why non-state actors could not be part of crisis or major policy making'. This is true when it comes to oil and gas companies in the conduct of Russian foreign policy. Obviously when it comes to major decisions or crises, like important deals for pipelines, the state is present in order to intervene. An example would be the signing of the Trilateral Agreement on the use of the Central Asian Gas Centre between Russia, Kazakhstan and Turkmenistan, outlined in detail in section 5.3.4. The deal was signed among states and not among gas companies. But in the day to day conduct of foreign policy the company through its commercial activities conducts policy inside the energy and foreign policy framework. An example outlined in section 6.4.1.1. is Lukoil's and Rosneft's involvement in Kazakhstani oil projects.

Having said that, one should not overestimate the power of non-state actors, as the state is the key actor in the conduct of foreign policy. This is because it is not correct to say that the companies act in place of the Energy Ministry or the Russian state. Companies do not function as ministries, they do not have executive power and they cannot take decisions in place of the state. It is more correct to call them agents of the state as they function as commercial entities within the boundaries and by serving the official Russian energy policy. The Russian state tries to control the region through different channels using companies, like contracts which prohibit other countries from using routes bypassing the Russian pipeline system, or by promoting state companies in the region with political pressure.

This thesis in no way implies that the relationship is rigid and that either the behaviour of the state or that of the companies is predictable or fixed. All the actors interact with each other within the general guidelines of the energy concept or strategy, which has been decided collectively and is influenced by the unequal dynamics of the state-business relations where the state is more dominant than the companies. Especially in the cases where there is no crisis or important state intervention the liberty of the company to act as a commercial entity increases.

#### **1.4.5. Synthesis**

The last point this thesis is making is the need for *synthesis* in order to understand the importance and effectiveness of oil and gas companies being used in the context of Russian foreign energy policy in the Caspian. As it is explained in Chapter 2, *synthesis* is part of the methodological suggestion of *analysis* and *synthesis* this thesis makes. By that is meant that in order to gain a deeper understanding of the processes of Russian foreign energy policy in the Caspian we first need to look at all the components separately, namely Russian foreign energy policy goals in the region, Russian energy security priorities in the area and state-business relations in the oil and gas sector, and then combine them together and apply them in the two case studies of the oil and gas sectors in the Caspian. Finally, by combining the two case studies we can understand how Russia maintains its economic hegemony in the Caspian through the commercial operations of its oil and gas companies.

As was noted in sections 1.3.2.2., 1.3.2.3, and 1.4.4., more often than not the literature review on Russian foreign energy policy in the Caspian although refers to the different components of the



policy separately, like assets owned in the CIS by Russian oil and gas companies, it does not demonstrate how combined they assist in the conduct of Russian foreign energy policy in the region. The manner in which this is done is through a web of legal and contractual monopolies which ensure that Russian companies and the Russian state preserve and reproduce Russian economic hegemony in the area. This is the main contribution this thesis makes to the study of Russian foreign energy policy in the Caspian.

## **1.5. Thesis structure**

Chapter 1 functions both as introduction and literature review. It outlines the research question of the study and connects it to the case of the Caspian region, it reviews the literature on both Russian foreign energy policy and state-business relations and it concludes by introducing a summary of the main logic of the thesis analysis. Chapter 2 presents the conceptual framework informing the thesis and the methodology used in the analysis. Chapter 3 looks at the relationship between Russian energy policy in the oil and gas sector and Russian foreign policy conduct in the Caspian where the priorities of the Russian state in the oil and gas sector in the region are defined. Chapter 4 looks at the relationship between the Russian state and the oil and gas sector through the mechanisms of *inclusion* of the state companies in and *exclusion* of the private companies from decision making. Chapter 5 and 6 offer two case studies of the oil and gas sector in the Caspian where the commercial activities of Gazprom (Chapter 5) and those of Rosneft, Transneft and Lukoil (Chapter 6) are analysed within the Russian foreign energy policy framework. Chapter 7 concludes by bringing together all the separate analysis of the previous

chapters and presenting the complete picture of the use of Russian oil and gas companies in the conduct of Russian foreign energy policy in the Caspian through their commercial activities.

## CHAPTER 2: Conceptual Framework and Methodology

### 2.1. Introduction

This thesis is a qualitative study undertaken for the purposes of answering the research questions *how* and *to why* are Russian oil and gas companies used in its foreign energy policy making in the Caspian. It is based on the hypothesis that Russian oil and gas companies are used as *vehicles* of Russian foreign energy policy in the Caspian through their commercial operations and within the Russian foreign energy policy framework. A two-level analysis is conducted in order to test the hypothesis; the first is the domestic level through the mechanisms of *inclusion* and *exclusion* and the second is the foreign policy level through *analysis* and *synthesis*. The logic behind the first level analysis is that in order for us to understand the relationship between the state and companies abroad we first need to understand their relationship in the domestic sphere. The enduring constancy of the state grip over the oil and gas sector is demonstrated through the mechanisms of the *inclusion* of state companies in and the *exclusion* of private companies from decision making, generating two phenomena; the takeover of the private oil and gas companies by the state and the rise of state companies as important actors in both Russian domestic and foreign politics. The logic behind the second level analysis is that by already having established the power that the state holds over the oil and gas companies, by *analysing* the commercial activities of the companies and *synthesising* them inside the foreign energy policy framework we can see *how* and *to what end* Russian oil and gas companies are used as vehicles of Russian foreign policy and thus we achieve a more complete picture of Russian foreign energy policy conduct in the Caspian.

This is a thesis firmly grounded in the area studies tradition and as such its contribution to Russian foreign policy analysis in the Caspian is more *empirical* and *methodologically concerned* rather than theoretical in the sense that it is an improvement on *how* foreign policy analysis is approached in Russian area studies. This thesis has a broad conceptual framework located within International Relations with Neo-liberal ideas on the use of non-state actors in international relations predominating but nonetheless it is not theory driven. In essence, it is a *critical discussion* of the *logic* behind the current area studies analysis of Russian foreign energy policy in the Caspian. It argues that because of some gaps in the existing approach to the analysis the picture of Russian foreign energy policy in the region is not complete. These gaps refer to the lack of consideration of domestic factors in foreign policy making, acknowledging the importance of economic and commercial goals in the external policies of the state alongside the political ones, defining clearly Russian foreign policy objectives in the Caspian region and Central Asia and considering energy issues in a more broad sense.

As a whole, this thesis is not trying to challenge the theory of International Relations at the discipline level but rather it suggests a conceptual framework of analysis which is generally informed by the Neo-liberalist tradition in its ontological assumptions on international relations, mainly based on the works of Robert Keohane and Joseph Nye (mainly 1971a; 1971b) on the role of non-state transnational actors in foreign policy making, though with some objections to certain arguments in the theory. Furthermore, under the umbrella of liberalism and along the same lines of ontological and epistemological assumptions of non-state centric approaches to research it is using the core concepts of Critical Security Studies in its perception of Russian foreign security priorities in the Caspian.

The goal of this area studies thesis is to add to our knowledge of Russian foreign policy conduct in the Caspian through its companies by looking at the changes in the domestic arena and how they were reflected on foreign policy making. This chapter is divided into three sections: a discussion on the state of the literature on the dominant theoretical trends in Russian foreign policy analysis and the Neo-liberal alternative, the proposed conceptual framework of analysis and methodology. The literature review section is divided into two parts: the first part looks at the legacy of Realism in Russian foreign policy analysis and the major problematic that arises from that in the analysis of Russian foreign energy policy in the Caspian. The second part outlines how concepts borrowed from Liberalism and Neo-Liberalism offer an alternative perspective on the analysis of foreign policy in the Caspian. The section on the conceptual framework maps the logic of the analysis in two subsections; the first one is on the mechanisms of *inclusion* in and *exclusion* of oil and gas companies to decision making which aims at contributing to our understanding of the continuous hold the Russian state has on its companies domestically; the second subsection is on the *analysis* and *synthesis* of the commercial actions of the Russian companies in the Caspian inside the framework of Russian foreign energy policy. The last section on methodology outlines the methods used and the sources employed in the research.

## **2.2. Dominant trends in Russian foreign policy analysis and Neo-liberalism**

### **2.2.1. The Legacy of Realism in Russian foreign energy policy and its impact on Russian foreign policy analysis in the Caspian**

The initial hypothesis of this thesis is based on the fact that although lately there has been some very interesting and original analysis in area studies of the new focal point in Russian foreign policy in the Caspian, there has also been a lack of a more precise and systematic study of the actual *processes* of foreign policy conduct in this specific region. By *processes* is meant the ways in which Russia is *actively* and *consistently* pursuing its energy goals and implementing decision-making in the Caspian region. In the view of the author this has been due to several theoretical and as a consequence methodological influences on Russian foreign policy analysis in area studies from the discipline of International Relations and its sub-discipline of Security Studies.

Pursiainen (2000) in his study of Russian foreign policy and International Relations discusses the heritage of Soviet foreign policy studies on current foreign policy analysis and identifies the main theoretical influence as Realism. He notes that because of the ‘seemingly bipolar’ world which emerged after the end of the Second World War, Soviet foreign policy studies fell automatically under the auspices of Realism, influenced by the writings of E. H. Carr ‘The Twenty Years Crisis 1919-1939’ and of H. J. Morgenthau ‘Politics Among Nations’, as Liberalism couldn’t apply to Soviet politics by default. This is because of the nature of the Soviet regime being the exact opposite of the fundamental ideals promoted by Liberalism like free capitalist markets, trade and pluralism. Pursiainen (2000:37) argues that even in the early descriptive historical accounts of Soviet foreign policy ‘the main players are states and the stakes

national security, but the idiosyncrasies of individual diplomats and leaders were seen to influence the strategies of these states'. Pursiainen (2000:47) in the rest of his very detailed account of Soviet foreign policy analysis and its parallel development with the International Relations debates, he concludes that despite all the theory oriented and methodologically concerned debates within Soviet and later Russian area studies 'theoretically and methodologically the study of Russian foreign policy has not yet divorced from its Soviet era traditions'.

The Realist legacy of using the state as the main subject of analysis and politics as the central and sometimes only point of significance for both the examination and the conclusions of an inquiry are still relevant to Russian foreign policy analysis today, despite the fact that the focal point of Russian foreign policy in the Caspian has acquired a more economic and commercial character. This is down to three factors connected to studying energy in Russian area studies at the foreign policy level. The first one is that the concept of energy has been treated first and foremost as a security issue in the strict sense of the term. In traditional Realism, security is mostly concerned with the safety of the state, with respect to military force, from war or an external threat. The Realist view on security is linked to the fundamental beliefs of this theory about the state in international affairs. Based on the ontological and epistemological claims of Realism that there is only one objective truth and one rational way to obtain it, i.e. a reality which cannot be altered; conflict is a central idea arising from the fact that it sees the international system as anarchic and the basic human nature as belligerent as an objective and unaltered reality. In this fundamentally unchanged hostile environment the national interests of the state in the sphere of security are inexorably linked to its ability to protect itself in times of

war, i.e. to have sufficient military power, and the ability to use this military power in order to gain from other states inside the anarchic environment. The referent object of security is the state as it is widely accepted to be the most important actor in international relations. Security is 'the state's capacity to protect its territorial boundaries and its sovereign ability to act as it sees fit' (Terrif 1999:63). If we accept that international relations is a 'struggle for power' among states for the protection of their national interests and power is measured in military strength, then the state with the greatest military force is the strongest one (for further discussions on the nature of the anarchic environment, the national interest and power politics see Morgenthau 1948; Carr 1939; and for a Neo-Realist perspective see Waltz 1959).

In essence this is not a flawed logic as energy is directly linked to security for both the supplier and the importer. In the current literature on Russian foreign energy policy, especially regarding the Caspian region, the issue of energy security is mainly related to the steady and uninterrupted flow of oil and gas to the European markets through the Russian pipeline system. In this framework, for Russia the importance of the Caspian region is connected to the preservation of Gazprom's and Transneft's monopoly in the oil and gas transport and the utilisation of Central Asian gas for the purposes of assuring that Gazprom is able to deliver the agreed volumes of gas to its clients in Europe. The relevance of this view to the Realist view is down to two assumptions. The first one is that the security of supply is always seen in the framework of Russia's attempt to preserve its sphere of influence over the Caspian and Central Asia and the second one is that the ultimate goal of Russia is to use this power as a leverage both in its contacts with Central Asian countries and Europe and thus primarily for political purposes (see for example accounts of the Ukrainian gas dispute in Orttung 2008; Kivinen 2007; Larsson 2006).



The problem with this approach is that it offers a very narrow and state-centric view of security which is restricting our understanding of other forms of Russian security priorities in the Caspian, like the preservation of its economic hegemony as part of its energy policy and its aim of becoming an influential actor in the global energy sector.

The second factor which derives from the first one and reinforces it is the separation of politics from economics. The Realist state-centric approaches to the study of foreign policy and of security place the weight of the analysis on the politics rather than on the intersubjectivity of politics and economics. According to Realism the international system is anarchic, that is without a higher authority, as opposed to the domestic one, a fact that prevents states from collaborating with each other and thus automatically renders any economic and commercial relations, which obviously are based on cooperation between actors, inferior to the military ones. Furthermore Neo-Realism is concerned with units, i.e. states, and how they are positioned in relation to each other and not how they interact (Terrif 1996:34). As a consequence Russia's military security concerns in the Caspian and Central Asia, for example in relation to the country's political-military challenges or border security related to terrorism, are perceived as more important than the issue of Russia's economic hegemony in the region. Economics are acknowledged but they are seen more like the means to an end rather than an end in itself. In this respect the weight of the analysis falls on the political actions or political gains that Russia can obtain in its foreign policy in the Caspian (Fredholm 2005; Lo 2003; Olcott 2009).

Looking at the interrelation between economics and politics in Russian area studies is normally a feature of International Political Economy rather than of foreign policy analysis, a practice which

strengthens the view that economics plays a lesser role in Russian foreign policy analysis as such and can only be a feature of the analysis of specific disciplines. Deriving from this logic domestic politics are separated from foreign policy. As Nye and Keohane (1971a:330) suggest ‘from the state-centric perspective geography, technology, and domestic politics comprise aspects of the "environment" within which states interact. They provide inputs into the interstate system but for considerations of analytic convenience are considered to be outside the system’.

The third factor, which is a consequence of the previous two, is the fact that non state actors are not acknowledged in Russian foreign policy making as influential players in their own right; they are of little importance as they lack military power. As Verbeek (2001:128) states, ‘the majority studies in foreign policy analysis still focus on traditional issues such as trade or security [...] most academics will study the behaviour of state officials. Non state actors [...] do figure in their analyses, but they usually only constitute the environment in which politicians and civil servants operate’. This is due to the idea that ‘the locus of power in foreign policy making can be found in such self evident centres like the White House, the Kremlin and so on’. The insufficiency in explaining the role of the companies in Russian foreign energy policy is linked to the fact that when analysts are looking at foreign policy they are focusing on how companies *do not* act as commercial entities, i.e. they are trying to find the political activities of companies, while they are commercial entities and thus they are *restrained* in acting within the sphere of commercial interests. The most important consequence that this has on Russian foreign policy analysis in the Caspian is that the focus is on major events where the core of the analysis is on the role of the state, like the Ukrainian gas dispute or the Yukos affair. This is done because the state usually interferes only at times of crisis or when there is really an issue which calls for the direct

involvement as the path of a commercial solution has no results. This practice has two consequences; the first one, which is the most obvious, is that the role of the companies is overlooked. The second one is that because we choose to ignore both the importance of economics in Russian foreign energy policy and the commercial activities of the companies, we fail to grasp the complete picture of Russian foreign energy policy in the Caspian.

Although this could be the subject of analysis of a different thesis in the discipline of International Relations, a clarification needs to be made of the use of Liberalism in this thesis between its broader philosophical goal of achieving peace through political and economic interdependence and the ontological components of the theory which, as well as acknowledging the importance of the state in international affairs, argues in favour of non-state actors and their significance in foreign policy as a whole. Within this logic the Neo-Liberal writings on transnational corporations in international relations make the assumption that multinational corporations are non-state in the literal meaning of the word. This view leads Neo-liberalists to two further assumptions. The first is that multinational corporations in international relations act independently of the state and as a consequence sometimes against the state. The second is that through the economic interdependency created via the commercial activities of the companies abroad there is a lower possibility of military intervention and thus cooperation among states is promoted.

This in part is a consequence of the historical circumstances of the development of Liberalism as a theory which first and foremost was concerned with what was conceived to be the Western world at the time with all that is implied by that, i.e. democracy, pluralism, separation of the state

from other actors inside and outside its boundaries and so on. This is one of the reasons that Liberalism has been largely ignored when it came to Russian foreign policy analysis. At the same time, in this author's view, an area studies thesis which is informed by the basic concepts of Liberalism can offer a different perspective on the processes of Russian foreign policy making, at least in the Caspian region, as we can see in practice some of its assumptions applied, and this is one of the main functions of area studies in Social Sciences. Without aiming to offer a criticism of these views on Neo-liberalism at the theoretical level, it should be noted that for the purposes of this study both claims are not taken into consideration. Regarding the first one obviously the core purpose of this thesis is to explain the links between the state and oil and gas companies and how the multinationals actually operate in favour of the state as *vehicles* of foreign policy and not how they operate outside the influence of the state. Nonetheless the ideas on non-state actors are still relevant as the companies are officially independent from the state and the state's influence is at the informal level. Regarding the second claim that cooperation in international relations lowers the possibility of military intervention, in the view of the author the fact that this might or might not be a possibility in the Russian or Central Asian/Caspian case, is irrelevant to the outcome of this research and thus it is not a factor in the analysis of thesis.

## **2.2.2. Neo-Liberalism, economic agendas and non-state actors in Russian foreign energy policy in the Caspian**

### **2.2.2.1. The role of state and non-state actors in foreign policy making**

The state has a central role in international relations in the literature of liberal and neo-liberal theories as is the case of Realism. Its main critique of Realism is in relation to the state viewed as a unitary actor. As Nye and Keohane (1971a:330) observe, in Realism ‘the state [is] regarded as an actor with purposes and power [and it] is the basic unit of action; its main agents are the diplomat and soldier’. Liberalism’s view of the state is that of an actor who has a plurality in its actions, i.e. it does not have a unified single manner of conducting its policies. By that is meant that the preferences of a state in its foreign policy making may vary according to factors like its government type, its military or economic capabilities. In this respect it acknowledges the fact that foreign policy can be conducted at different levels both politically and economically, or as it is usually referred to, high and low politics. Liberalism and especially Neo-liberalism, without denying the anarchical nature of international relations, but rather by criticising its elevated importance assigned to it by Realism, looks at the absolute gains that a state can have through different channels of cooperation which create *interdependence* with other states, instead of the relative gains that the state can only have in the anarchic international environment. Non-state transnational actors, like multinational companies, play an important role in that.

Keohane and Nye (1971a), writing on the nature of the international environment, noted that it is made up of multiple channels of cooperation and interdependence which transcend the

boundaries of the traditional nation state. These relations range between interstate interactions to multinationals operating abroad. They identify three kinds of relations between states; interstate relations which refer to the classical Realist notion of state interaction; trans-governmental relations which are visible when we depart from the notion that the state acts as a unitary actor and thus we look at the interaction between a larger number of actors, though still connected to the government and the state; and transnational relations which are visible when we depart completely from the concept of a solely state-centric approach to international relations and we take both state and non state actors under consideration, like the use of multinational companies in foreign policy making. Interaction in international affairs is done through all of these relations.

Based on the same ontological assumptions of looking at pluralism in a state's actions in the international environment, apart from the fact that there is a plethora of state and non-state actors interacting with each other, Keohane and Nye (1971b:721) argue that there is no hierarchy of importance in the different types of foreign policy making. By that they mean that military or traditional security agendas should not be regarded as more significant than the economic and commercial ones. As an implicit consequence, when it comes to the interrelation between the domestic and external spheres of the policy of the state, there is a mutual reciprocity of influence in agenda setting as the goals of foreign policy are not specific to the military capabilities of the state. They note that according to Realism 'diverse domestic interests have effects on international politics only through governmental foreign policy channels' and thus they are filtered through the priorities of the state in foreign policy but always in the Realist framework of the military/security foreign policy objectives.

Not taking non-state actors into consideration in foreign policy analysis is explained by Nye and Keohane as an ontological consequence of Realism which overlooks in its analysis any other actor apart from the state, distinguishes domestic policies from foreign policies and separates economics from politics, and as a result views non-state commercial actors as operating inside the domestic economic sphere of a state and thus irrelevant to foreign policy analysis. They note that ‘states are by no means the only actors in world politics [...] and relatively little attention has been paid to non-state actors or to their connections with the interstate system’ (Nye and Keohane 1971a:330). Reinalda (2001) in his typology of non-state actors in International Relations defines multinational corporations as ‘profit-oriented corporate actors’ and says that the importance of non-state actors in foreign policy making is linked to the fact that ‘they play a public part in implementation procedures’ as they are ‘part of political, policy and institutional arrangements in the international system’. This last crucial point on the importance of the function of non state actors within a specific policy agenda is a central point in the construction of the argument of this thesis and it refers to the *synthesis* part.

#### **2.2.2.2. A broader concept of Russian foreign energy security interests in the Caspian**

The way this thesis views security is conditioned by the fact that it is area studies research and thus it has no intention of offering a more general concept of energy security but rather to present the specific way Russian energy security is conceived in the Caspian, though the two are not necessarily mutually exclusive. As Jones (1999:116) notes, ‘when analysis is historicized and particularized through the analysis of specific issues in specific areas, it becomes apparent that the appropriate referent object varies from case to case’. In this specific case energy security for

Russia is subject to the particular geographical, economic and political ties it has with the area and of course the overall role that the Caspian plays in relation to its energy resources and transportation (Chapter 3 deals with the link between Russian foreign policy and energy in the Caspian region in more detail).

Booth (1991:314) offered his argument against states being central actors in International Relations and Security Studies by pinpointing the insufficiency of state-centric security theories: 'states are unreliable as primary referents because whereas some are in the business of security [internal and external] some are not. Even those which are producers of security [internal and external] represent the *means* and not the *ends*. States are not diverse in their character to serve as the basis for a comprehensive theory of security'. Some analysts advocated the need to change the referent object of Security studies as 'defining security or even redefining it, becomes problematic when the referent of security itself is ill-defined or changing' (Lipschutz 1995:6).

As has already been argued before in this chapter, the concept of security which has been central in the analysis of Russian foreign energy policy in the Caspian has been closely connected to the state-centric Realist idea of the national interest. Linked to the national interest, as was discussed previously, is the survival of the state within the anarchic international environment through force and the use of the state's strength vis-à-vis other states in order to gain advantages. This can lead us to incomplete conclusions, as Nye (1988:239) argues: 'Realist theory is better at explaining interactions than interests. A theory of interests defined solely in terms of power is an impoverished theory of interests. Here Liberalism can help. The more sophisticated variants of Liberal theory provide a useful supplement to Realism by directing attention to the ways in



which domestic and international factors interact to change states' definitions of their interests. To say that states act in their self-interest is merely tautological or "change" is reduced to merely a change in means unless we have a reasonable account of how such interests are perceived and redefined. Both Realism and Liberalism can contribute to such an account'.

In the case of the Caspian region energy security, when used inside this specific framework refers to Russia using energy in order to have leverage in relation to the security of the Central Asian and European states through preserving its monopoly on gas transportation and by restricting their independence. By approaching energy security more broadly within the main framework of the Neo-liberalist ontological claims outlined above, that is through intersubjectivity, (i.e. not separating economics from politics), empirical research and reciprocal causality we can get a broader picture of Russia's energy security and foreign policy goals in the Caspian.

The changes in the definition of security priorities connected to national interests are always linked to the specific changes in the international environment at the time of the research, in the case of Russia the fall of communism and the emergence of newly founded democratic states in the Caspian region, or the addition of new actors, both state and non-state, like the transnational corporation of the littoral states or foreign multinationals, other states outside the region and so on. As Nye argues (1990:157) 'with changing actors in world politics come changing goals; in the traditional view states give priority to military security to ensure their survival. Today, however, states must consider new dimensions of security. National security has become more complicated as threats shift from the military to the economic and ecological'.

As is analysed and explained in detail in Chapter 3 Russian foreign policy priorities in regard to its energy security in the Caspian are linked to the preservation of its economic hegemony in the area. Russia is an oil producer and supplier, not an oil importer, and that distinguishes its foreign policy from that of other countries which back up their oil companies abroad vigorously but are oil importers, like the USA and China. It is only logical to pursue a policy of pushing for open markets, favourable terms for foreign direct investment and diversification of transport pipelines and routes when a state is mainly a consumer and in essence to link energy security with the removal of any kind of monopoly or even hegemony in the oil sector. On the other hand, when a state is an oil producer and supplier, energy security is linked more with restricting competition to the minimum, increasing access to oil resources of other states and controlling the transportation of oil. This way the state pursues its interests both by asserting control over the area and by safeguarding its safety, and the oil companies have unlimited access to the resources and transportation systems, even in the resources of other states, and to the gains that come from that. 'Multinational corporations are sometimes more relevant in achieving a country's goals than are other states' (Nye 1990:157).

### **2.3. Conceptual Framework**

This thesis is informed by the philosophical assumptions of critical realist ontology, not to be confused with the International Relations theory of Realism discussed and criticised before in this chapter. Critical realism is a middle ground ontological position which tries to consolidate the two extremes of positivism and interpretivism (Sayer 2000:2-3). Grix (2004:84) notes that

the term 'Realism as an ontological position is shared in part by positivism and a number of perspectives under the label of "post-positivism". Positivism tends towards empirical realism i.e. it treats the world as consisting of observable objects, a world with no unobservable qualities, [while] the post-positivist account tends towards a critical realism'. In this respect, critical realism adopts a foundationalist ontology but allows for interpretation in research, and this is the critical aspect of this paradigm. As Grix (2004:85) states: 'critical realist scholars have attempted to combine the "how" [understanding which is linked to Interpretivism] and the "why" [explanation which is linked to positivism] approaches by bridging the gap between the two extremes'. This philosophical point of the paradigm is very important to this study as on the one hand it acknowledges a reality which is independent of our perception of it, and thus advocates objectivity, and at the same time it sustains that it might not be directly observable. Bhaskar and Archer (1995:17) approach the analysis of social and political processes as follows: 'the world is structured in such a way that it exhibits a separation of appearance and reality. As Archer (1995:17) herself notes, 'there is no direct access to the "hard facts" of social life at least for the vast majority of us who cannot subscribe to the discredited doctrine of immaculate perception'.

Indirectly observable phenomena are no less important than the directly observable ones, and our acknowledgement of them adds to a more complete understanding of reality. As Neuman (2000:77) states, 'the immediately perceived characteristics of objects, events, or social relations rarely reveal everything'. As it was discussed earlier in this chapter, the positivist ontological assumptions of the International Relations theory of Realism, which have heavily influenced Russian foreign energy policy analysis in area studies, have led the attention of scholars to focus on the observable links between the Russian state's policies and those of the other Caspian

countries or outside actors, like the United States or European countries. The adoption of a 'depth ontology'<sup>6</sup> offered by critical realism reveals other important parts of the equation which might not be as apparent when the study is conditioned by the Realist assumptions of the separation of politics from economics and that of the domestic from foreign politics. The use of a conceptual framework informed by Neo-liberal ideas about the use of non-state actors in international relations and the combination of the commercial activities of the Russian companies in the area seen through the framework of Russian foreign energy conduct can assist us in the observation of these more complex phenomena in Russian foreign energy policy in the Caspian.

The question of structure versus agency is treated in critical realism as a mutually reciprocal relationship. As Grix (2004:86) states, 'structure and agency [in critical realism] are mutually constitutive'. This way as opposed to positivism, critical realism acknowledges a degree of independence which agents have in relation to the interpretation of the structure and the acknowledgement of their role in it, and thus the capacity to influence the structure to a certain degree (Kerr 2003:122-123). Nonetheless, the agent's actions are still conditioned and restrained by the structure. Hay (2002:209) referring to Jessop's (1990) idea of strategic selectivity argues that, 'actors are strategic, moreover structures are selective of strategy in the sense that, given a specific context, only certain courses of strategic action are available to actors and only some of these are likely to see actors realise their intentions. Social, political and economic contexts are densely structured and highly contoured. As such they present an unevenly distributed

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<sup>6</sup> The term 'depth ontology' is used by Kerr in his separation of realism from positivism. He states that 'realism works on the assumption of "depth ontology" i.e. that these generative mechanisms are highly complex, often structural and most crucially, not always directly observable. In this sense, part of the explanatory schema must be an attempt at "interpreting" causal links from observable outcomes (Kerr 2003:122-123).

configuration of opportunity and constraint to actors'. This particular aspect of critical realism assists in the interpretation of both state-business relations in the oil and gas sectors as well as of the role of companies in Russian foreign energy policy conduct in the Caspian. In Chapter 4 the present author argues that the consolidation of the state and the installation of the power vertical brought about the consolidation of the energy sector and thus allowed for the use of Russian oil and gas companies as *vehicles* of foreign energy policy in the Caspian by the state. In essence it is argued that the political environment in Russia under Putin, seen through the second face of power of Bacharach and Baratz (1962) analysed later in the chapter, posed certain restraints on the options that Russian oil and gas companies had in their actions both domestically and abroad. As Bhaskar (1989:2) states, 'we will only be able to understand and so change the social world if we identify the structures at work that generate those events and discourses... these structures are not spontaneously apparent in the observable pattern of events they can only be identified through the practical and theoretical work of social scientists'.

The methodological contribution of this thesis to the study of Russian foreign energy policy in the Caspian is related to both the *framework of analysis* and the *sources* employed. The two elements are closely interconnected as the interpretation of the data collected from both primary and secondary sources, as well as elite interviews, have been interpreted in line with the conceptual framework. The first methodological contribution of this thesis to the study of Russian foreign energy policy in the Caspian is in relation to the conceptual framework of *analysis*<sup>7</sup> and *synthesis*<sup>8</sup>. This thesis looks at *how* and *why* Russian oil and gas companies are

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<sup>7</sup> The term *Analysis* is used in this thesis in its original meaning of the word, i.e. "the detailed examination of the elements or structure of something" (<http://oxforddictionaries.com/definition/analysis>). As this is a qualitative type of analysis, it looks at the kind of these elements instead of their quantity. Quantitative data are used in the two case studies of the oil and gas sector in Chapter 5 and 6, but their interpretation is carried out through a qualitative

used in Russian foreign energy policy. In order to understand the interrelation between the state and the companies at the international level, we need to establish the relationship at the domestic level. The two level analysis, in order to test the research question, consists of the *analysis* of the relationship between the Russian state and the oil and gas companies at the domestic level, and the *analysis* of the two case studies of Gazprom for the gas sector and Lukoil, Rosneft and Transneft for the oil sector within the Russian foreign energy policy making framework the foreign level through. The first level of *analysis* is done through the mechanisms of the *inclusion* of state companies in and the *exclusion* of private companies from the decision making process in the domestic sphere of politics. This analysis is based on the logic, which will be outlined later, that the relationship between the state and business is conditioned by the strength of the state and thus its ability to control the channels of access to decision making, for example to the Duma. This alternative perspective of looking at state-business relations adds to the already extensive literature of analysing the relationship in the sense that it proves the enduring hold of the state over the oil and gas sector and its two consequences: the rise of the state oil and gas companies

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framework. *Analysis* in this thesis is viewed as a component of the *Analysis* and *Synthesis* methodological framework which is suggested in order for us to understand Russian foreign energy policy making in the Caspian. It refers to the analysis of state-business relations through the mechanisms of the *inclusion* of *state companies in* and the *exclusion* of private companies from decision making, the analysis of the priorities of Russian foreign energy policy in the Caspian through the conceptual framework informed by Neo-Liberalist notions on the use of non-state actors in international relations, and the two case studies of the oil and gas sector inside the framework of Russian foreign energy policy conduct.

<sup>8</sup> The term *Synthesis* in Philosophy has been used in the writings of Kant in reference to the unification of two separate ideas. (for example in several of his writings on the purity of logic or the mind and the consciousness of the self). The same term has also been used by Hegel, with reference to Kant, as the final part of the triad, *Thesis*, *Antithesis* and *Synthesis*, making up the *Hegelian dialectic*. For example see his study *The Science of Logic*, 1812. This thesis uses the term *Synthesis* in its original meaning of the word, i.e. “the combination of components or elements to form a connected whole” (<http://oxforddictionaries.com/definition/synthesis>). The separate components are the different parts of the analysis in both the domestic and foreign policy spheres, i.e. analysis on state-business relations in the Russian oil and gas sector, analysis on Russian foreign energy policy goals in the Caspian and analysis of the two case studies on the oil and gas sector in the Caspian. *Synthesis* refers to the combination of all those components and their interpretation through the Russian foreign energy policy framework. In this respect it is treated as a *methodological* term and it is used in this thesis only in relation to the *Analysis* and this way creating a *methodological* framework of analysis of Russian foreign energy policy.

as influential players in both the domestic and the foreign spheres and the ability of the state to use its companies in its foreign policy making.

The second level of *analysis* first establishes Russian foreign policy priorities in the energy sphere which are connected to the preservation of its *economic hegemony* in the region and then, by using the two case studies of the oil and gas sector, demonstrates *to what end* Russian oil and gas companies are used as *vehicles* of Russian foreign policy making in the Caspian through the use of *legal* and *contractual monopolies* in their commercial activities in the region in the framework of Russian foreign energy policy conduct. This different perspective on the use of Russian oil and gas companies in the Caspian adds to the current analysis the perspective of routine policy making through the everyday commercial activities of the companies in the region and thus supplements our knowledge of Russia's foreign energy policy in the region. The complete picture of the Russian oil and gas foreign policy in the Caspian is given through the *synthesis* of the commercial activities of the Russian oil and gas companies in both sectors in the Caspian inside the framework of Russian foreign energy policy making in the region for the purposes of preserving the economic hegemony of Russia in the Caspian.

### **2.3.1. First level Framework of Analysis Inclusion in and Exclusion from decision making**

The first methodological contribution this thesis makes is at the domestic level which corresponds to the first level of *analysis* in this research. The present author offers a different *methodologically concerned* perspective of looking at the relationship between the state and the oil and gas companies through the mechanisms of *inclusion* of the state companies as influential

players in and the *exclusion* of the private companies from the decision making centres and the decision making process as a whole by the state. The submission of Russian private companies to the power of the state companies was adhered through two mediums. The first one was through the cherry picking process of punishing oligarchs who were becoming too powerful. This process of the state grabbing assets can be divided further into the Yukos and the Sibneft case. In the first one Khodorkovskii did not comply with the state's requests and thus there was a legal battle which ended in Yukos' bankruptcy and the imprisonment of Khodorkovskii. The second one ended in Abramovich losing Sibneft (which later became GazpromNeft) retaining his other assets and his office but obviously acknowledging the state's strength. This process has been widely analysed and referred to as the pinnacle of the demonstration of the strength of the state in relation to the oil and gas companies and the eventual capture of the energy sector by the state (Milov 2006; Larsson 2008).

Analysis of the relationship between the state and business in the oil and gas sector through the first medium is quite accurate and does demonstrate the capture of the energy sector by the state. What this analysis fails to do is to demonstrate *how* the state maintains its constant capture over the private companies and at the same time promotes the state companies. By looking at the mechanisms of *inclusion* and *exclusion* from decision making we understand the endurance of the dependence of private oil and gas companies on the Russian state. The hypothesis of the relationship is that the strength of the state has a directly reversed effect on the ability of the companies to have access to the decision making process independently of the state or the state controlled companies. The consolidation of the energy sector, i.e. the capture of the private business by the state or state controlled companies in the oil and gas sector has been a parallel



and interlinked process to the consolidation of the state, i.e. the installation of the power vertical in the political and economic life of Russia. Thus consolidation of the energy sector has been a direct consequence of the consolidation of the state and the importance that energy acquired in Russian foreign policy making.

The idea of the mechanisms of *inclusion* and *exclusion* is based on the analytical framework of Bacharach and Baratz (1962) on the concept of power. In their seminal work “Two Faces of Power” they offered an additional dimension to Weber’s theory on the legal power of the state. Weber, as part of constructing his ideal type, identified a tripartite classification of authority, one of which is the rational-legal authority. He suggests that the rational-legal authority is linked to the legitimate use of legal force by the state, i.e. the prerogative of the state to use the law in order to exert power<sup>9</sup> over other actors in domestic politics. Weber’s rational-legal authority is what Lukes (1974) later identifies as the first face of power, i.e. the power to *make* and *implement* decisions. In the current analysis of state-business relations in the Russian oil and gas sector the first face of power is used widely in order to explain the capture of the business by the state (see accounts of the Yukos affair in Larsson 2006). This analysis helps us in our understanding of the *directly observable* actions taken by the state in its pursuit of capturing business. This is a correct observation of the relationship in the sense that it gives us the milestone events which transformed the interrelation between the Russian state and the oil gas business. What is lacking from this analysis is the explanation of *how* the Russian state managed to maintain its capture of the oil and gas sectors.

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<sup>9</sup> Power is defined as the ability of A to force B to do what A wants (Hay 2002:74)

Bacharach's and Baratz's (1962) second face of power refers not only to the capacity to control decision making, but also the non-decision making process. This is linked to the ability of the people in power to set up the agenda and this way *control* what is being brought forward for consideration at the decision making level. The framework of state-business relations analysis offered in this thesis of the mechanisms of inclusion and exclusion to power is based on this idea of controlling the channels of access to decision making. The parallel processes of the consolidation of the state politically and the consolidation of the energy sector created an environment where access to decision making could principally be done through state controlled channels, like the Duma where United Russia holds the majority of votes and thus controls decision making, or through state oil and gas companies which are assigned the major projects and then they decide whom their partners are going to be. In this respect the survival of the private companies is linked to the state. By employing the second face of power on state-business relations through the mechanisms of *inclusion* and *exclusion* to decision making this thesis demonstrates the continuous nature of this asymmetrical link between the state and business and thus as a consequence the ability of state to use its companies as vehicles of foreign policy in the Caspian as it will be shown in Chapters 5 and 6. This alternative perspective on looking at the relationship unveils a different dimension of the *constant grip* that the Russian state holds over the oil and gas companies and contributes to our knowledge of the dependency of the sector on the political structure. As it will be demonstrated in Chapter 4 and later in the two case studies chapters 5 and 6, the fact that the consolidation of the state caused the consolidation of the energy sector had two consequences; the first one is rise of the state companies both in the domestic and foreign spheres and the capture of the private companies either through the state or through state controlled companies; and the second one the ability of

the state to use the Russian oil and gas companies as vehicles of Russian foreign energy policy in the Caspian.

Chapter 4 looks at how much access did the state and private companies have to the decision making bodies, mainly the Duma. The Duma was the only place where non state actors could actually have access through elected state elites, so by looking at the processes of *inclusion* in and *exclusion* from decision making we can see how private companies lost their power vis-à-vis the state. Throughout the five Dumas the decrease of the private companies' access to power is directly linked to the increase of the consolidation of the state. During the Yeltsin administration, when the executive was separated from the legislature and the balance of power between them was much more symmetrical, different companies had various degrees of access to power depending on two factors; the first factor was whether or not their main capital was state or private. This was more evident in the oil sector rather than the gas sector which was largely protected from being broken into different companies. The second factor was whether the company had enough money to buy influence inside the Duma either through bribes or through running for office themselves. A consequence was that the apparent capture of the state, which could not control the channels of access to power by mainly the private oil and gas companies, rendered it incapable of supporting the state companies in the sector. This is reflected in the decline of Gazprom during the 1990s (Chapter 5) and in Rosneft's near extinction during the 1990s and its re-emergence in the oil sphere under Sechin (Chapter 6). Their relationship with the decision making centres is outlined in Chapter 4. As a result, while private companies had access to decision making, state companies were 'blocked' by the private ones as they could not compete with them.

The rise of Putin to power and the consolidation of the state under the power vertical signalled the beginning of the capture of the business by the state. Putin's goal to assert the power of the state over every strategic sector of the economy and political life and a rise in oil prices were the factors driving the decision to do so. The mechanisms of *inclusion* and *exclusion* were put in motion with the gradual takeover of the Duma by United Russia. Nonetheless during the first Putin administration the state was still too weak to exert any influence over the private companies and the activities of the company people inside the Duma were still vast, with the period just before the Yukos affair being the most active one for the access of private oil and gas companies to power. Towards the end of 2003 the Yukos affair took place and the state started to reassert its power over the oil and gas sectors. With United Russia gaining the absolute majority inside the Duma and the strengthening of the Presidency the power vertical was put firmly in place. As a result of the state starting to have power over the Duma through the changing laws which guaranteed the domination of the party of power, United Russia, the state was now in a dominant position to push for the strengthening of its state companies and the capture of the business. Concentration of power at the top made any other channel for lobbying, redundant. Lobbying activities became controlled and institutionalized. The mechanisms of *inclusion* and *exclusion* restricted access to decision making to foreign and private companies and promoted that of the state ones. Two major blocks were created, Gazprom and Rosneft, and all other companies need to lobby through one of those blocks to have access to power. Major projects are only given to Rosneft and Gazprom.

It should be noted here that this logic of looking at state-business relations is about the capture of big oil and gas companies by the state. It is probably the case that at the lower level of small and medium businesses the capture of the state was different as businesses were much more susceptible to actors other than the upper echelons of the state, like local authorities, the mafia and police (see Yakovlev 2006). Of course it is also the case that the oil and gas sectors have been largely consolidated (as will be discussed in Chapter 4), in addition to the fact that small and medium businesses do not play an important role in foreign policy making, especially in the case of Russia and the Caspian region.

This is due to several factors, including the monopoly on export pipelines in both the gas and oil sectors, and the fact that at least in the gas sector Gazprom, apart from its own holdings, has stakes directly or indirectly in most of the small and medium gas companies or companies related to gas. In the oil sector things are a little bit different in the sense that the consolidation of the sector is not as thorough as in the gas sector due to the privatisation process of the oil industry. Nonetheless it is clear that in Russian foreign policy the dominant corporate actors are Transneft, Rosneft and Lukoil, a private company which for reasons explained in Chapters 4 and 6 remains loyal and close to the state.

### **2.3.2. Second Level Framework of Analysis: Analysis and Synthesis**

The second methodological contribution is done at the foreign policy level which corresponds to the second level of analysis in this research, i.e. the sphere of Russian foreign policy conduct through its companies in the Caspian. The present author offers an alternative *methodological*

approach, informed by the conceptual framework outlined in the first section of this chapter, to its investigation through the *analysis* of the continuities and change in the Russian domestic and external politics and their *synthesis* in order to further our understanding of the actual processes of foreign energy policy making. As explained in detail in the conceptual framework, the legacy of Realism and its ontological assumptions in the current Russian foreign energy policy in the Caspian create restrict our understanding of the foreign policy processes, especially in the use of oil and gas companies. By adopting a more flexible conceptual framework generally informed by the Neo-liberalist writings on transnational actors in foreign policy we can have a more complete picture of the use of oil and gas companies as *vehicles* of Russian foreign energy policy in the Caspian.

By using a conceptual framework informed by the Neo-Liberal ideas on the role of transnational corporations in foreign policy and based on a more elaborate concept of security within the same logic we can have an alternative perception on the priorities of the Russian state in its foreign policy in the Caspian and the means used to achieve them. With the use of this conceptual framework the problematic in the current analysis rooted in the basic Realist positivist ontological assumptions on the dominance of politics over economics in Russian foreign policy analysis, the lack of drawing links between domestic and foreign politics and the narrow notion on security are overcome. Chapter 3 offers an analysis of the current main official documents on Russian foreign policy and Russian energy policy and it concludes that the Russian foreign energy policy making goals in the Caspian are linked to its commercial interests as much as they are linked to its political and military security issues, with the main objective of maintaining Russia's economic hegemony in the region. Chapters 5 and 6 show to what extent Russia has

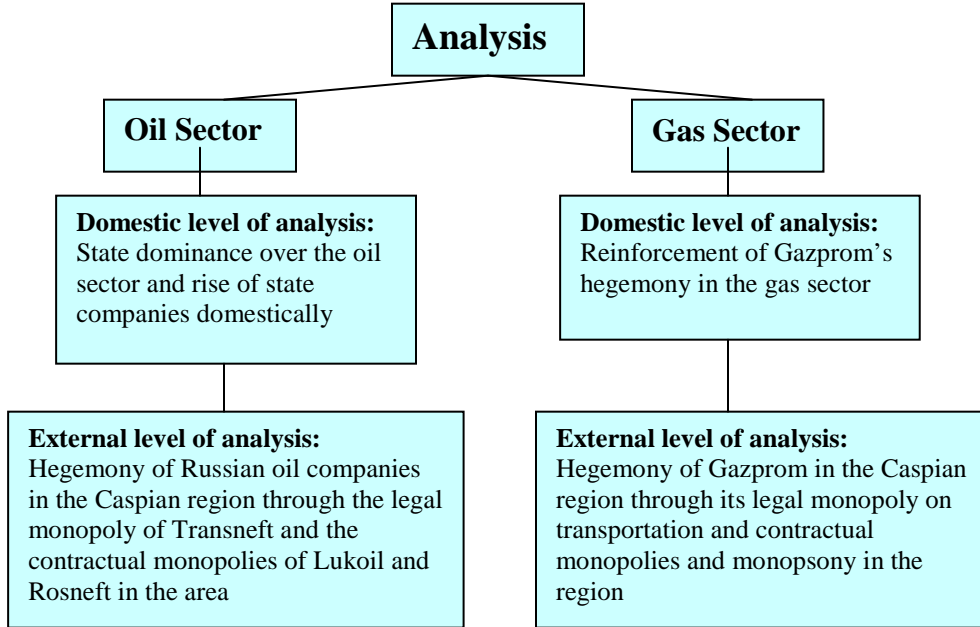
captured Central Asian oil and gas resources through the commercial activities of its oil and gas companies in the area when viewed inside the framework of Russian foreign energy policy in the Caspian.

The economic hegemony of Russia is maintained through a combination of *legal* and *contractual* monopolies that the companies have with the littoral states, which oblige them to either sell the bulk of their oil and gas production to Russian companies or to send it through the transportation system which passes through Russia. This way the Russian state gains from both the revenues from the transportation of the oil and gas through its system and from using the resources of the littoral states. As a consequence Russia manages through its companies to achieve three objectives related to its energy security in the area; the first one is to prevent wherever it can the use of alternative transportation routes by the Central Asian states and thus minimizes the competition to the European markets; the second one is that it prevents the infiltration of foreign oil and gas companies in the area; the third one is that it has at its disposal the resources of the littoral states in order to fulfil its aspirations of becoming a global energy player.

The third methodological contribution this thesis makes to the study of Russian foreign energy policy in the Caspian regards the *synthesis* of all the components of the *analysis* mentioned above. There is a general attitude in foreign policy analysis of avoiding the *synthesis* of the domestic and external factors in policy making in order to explain both the *factors* driving foreign policy and the *actors* conducting it. By looking at the relationship formed between the Russian state and the oil and gas companies (see Chapter 4) we can understand *why* and *how* the state is in a position to exert enough power over the energy companies in order to use them in its

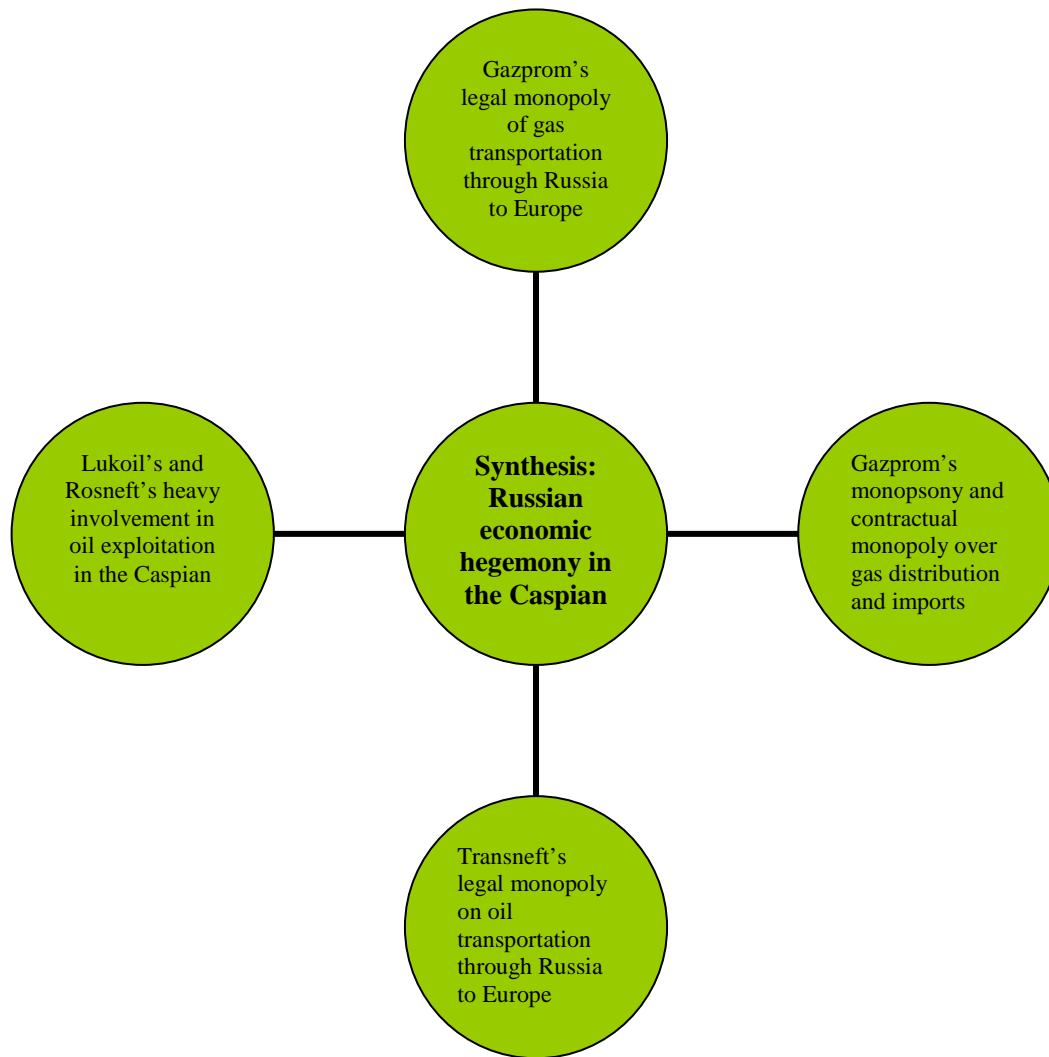
foreign policy conduct. By establishing the links between Russian foreign policy and energy (see Chapter 3) and thus outlining the Russian priorities in its foreign energy policy we realize that Russia's goals in relation to energy in the Caspian region, i.e. maintenance of its economic hegemony in the area, though they are of a mixed political and economic nature, are mainly realised through commercial means, like legal and contractual monopolies. The above analysis answers the question *how* does energy fit into Russian foreign policy. Finally by *synthesizing* all the above and *applying* it to the Caspian region in two separate case studies of the oil and gas sectors (see Chapters 5 and 6) we can see how Russian oil and gas companies operate within the framework of Russian foreign energy policy conduct and thus act as agents of the state through their commercial activities with political consequences. In this respect we can see the *harmonisation* of the state and commercial interests in the Caspian region. The following two diagrams offer a schematic representation of the two level analysis and synthesis. In the first diagram (figure 2.1) we can observe the different parts that constitute the *analysis*: the separate investigation of the oil and gas sector and the examination of both the domestic and external sectors.





**Figure 2.1 Analysis**

In the second diagram (figure 2.2) on *synthesis* we can observe how the commercial activities of Russian oil and gas companies when combined together facilitate Russia in achieving economic hegemony in the Caspian region.



**Figure 2.2 Synthesis**

## **2.4. Methodology**

The second methodological contribution of this thesis concerns the sources employed, both in reference to the empirical data used, as well as, to the alternative reading and interpretation of primary and secondary already existing sources. Fieldwork plays a very important role in this area studies thesis as the main goal of the study is to understand the specific processes of Russian

foreign energy policy in the Caspian. The advantages of an area studies thesis methodological contribution to the analysis of Russian foreign energy policy are based on in-depth knowledge of the area in terms of both the historical context of the development of its politico-economic system, as well as, knowledge of the Russian language which assists in the direct analysis of prime sources and the ability to conduct interviews with Russian policy makers and experts. As Bates (1997:168) notes, 'area studies emphasizes the importance of cultural distinctions. Cultures are distinguished by their institutions. They show how institutions shape individual choices and collective outcomes, and therefore provide a framework for exploring the origins of political difference'. In this respect the experience of fieldwork is an integral part of this research. The empirical data collected during fieldwork, conducted by the present author in Moscow, consist of elite interviews with high level Russian state and companies' officials, as well as with Russian journalists, analysts and academics researching and commentating on current Russian foreign energy policy. The opinions and expertise of the people interviewed together with the personal experience of the present author of living in Russia for 5 months and being directly exposed to the political and economic environment of the country have immensely influenced not only the outcome of this thesis but to some extent the hypothesis itself. In addition to the above, the present author obtained some unpublished company data and reports. Primary sources used in this thesis include Russian language official documents on foreign policy, security and energy policy, in addition to data obtained through companies' official sites. Secondary sources include academic writings on Russian foreign policy, state-business relations and the Caspian region, as well as, newspaper articles, reports and quantitative data on the operations of Russian oil and gas companies in the Caspian region.

The focus of this study is to understand the nature of the interrelationship between domestic and external Russian policies, as well as the links between the state and oil and gas companies. To this end this thesis uses a qualitative methodology and a mixture of both qualitative and quantitative data (Sayer 2000; Bryman 2004; Mason 2002; Grix 2004). Methods used in research normally follow the logic of an epistemological position of how knowledge can be accessed or produced. A positivist ontological position which advocates that reality can be measured would use a quantitative methodology. Likewise an interpretative epistemology 'that stresses the dynamic, constructed and evolving nature of social reality' would benefit from a qualitative methodology (Devine in Marsh and Stoker 2002:30). Although this is the norm, in the case of critical realism there is no strict connection between its ontological position and a certain type of method. As Marsh and Furlong (2002:31) say '[critical] realism has clear methodological implications. It suggests that there is a real world "out there", but emphasizes that outcomes are shaped by the way in which this world is socially constructed. As such it would acknowledge the utility of both quantitative and qualitative data'.

This thesis uses both qualitative and quantitative data in order to support its hypothesis. According to Read and Marsh (2002:237) there are two main reasons for combining methods: 'first it might be that using one method does not allow the researcher to address all aspects of the research question. Second, many researchers argue that combining methods increases the validity of research, because using a variety of methods means that one method serves as a check on another'. The mixing of qualitative and quantitative data in this thesis is linked to both claims. Quantitative data are complimentary to the qualitative data, i.e. they offer support in favour of the argument, but they are also instrumental to the formation of the thesis in instances when

qualitative data are either not efficient or not obtainable. This is very often the case with choosing elite interviewing to be the main method of the research or when the research is complex. The use of qualitative data in this study aims at viewing both state-business relations in the oil and gas sectors, as well as, Russian foreign energy policy in the Caspian in terms of processes (Bryman 2004:279). While the use of quantitative data aims at presenting the direct facts linked to the hypothesis, which can be measured, like for example the amounts of oil traded between Russia and Kazakhstan. The key to combining methods is whether they are ontologically and epistemologically consistent (Grix 2004:135). In the case of this thesis both kinds of data are used with reference to the ontological and epistemological positions of the philosophy of critical realism.

#### **2.4.1. Sources employed**

The sources employed in this thesis are both qualitative and quantitative data interpreted through the conceptual framework suggested above. The study draws heavily on empirical data collected during fieldwork conducted in Moscow in 2008 through elite interviews with both Russian state elites and company officials at the high level, as well as interviews with journalists and analysts who are actively engaged in the analysis of Russian politics and the Russian oil and gas sector. Elite and specialist interviews form the basis of the analysis on state-business relations in Chapter 4, and assist in the interpretation of the data used in Chapters 3, 5 and 6. The prime sources are a selection of official documents connected to Russian foreign policy, security and energy policy, as well as, official statements on deals made between the Russian Federation and the Caspian states in the oil and gas sector. Official documents of the Russian government are

analysed in Chapter 3 in order to provide the Russian foreign energy policy framework through which the commercial activities of the companies are interpreted in the case study Chapters 5 and 6. Also data have been used from the companies' official sites as well as company reports obtained during fieldwork. Other qualitative data include secondary sources from academic writings on Russian foreign policy, state-business relations and the Caspian region, as well as, newspaper articles and reports. Quantitative data, deriving from both official sites dealing with energy and studies on the energy sector, are used mainly in Chapters 5 and 6 in order to support the argument that the commercial activities of the Russian oil and gas companies contribute to the realisation of Russia's foreign energy policy in the Caspian.

#### **2.4.2. State Elites, Business Elites and Analysts**

Elite interviewing is a central method used in this thesis. The selection of this qualitative method for the purposes of testing the hypothesis of *how* and *why* Russian oil and gas companies are used in Russian foreign energy policy in the Caspian is primarily linked to the fact that there is little, if any information, available otherwise. The aim of using elite interviews is to analyse the motivations and the activity of the actors involved in the political processes. As Lilleker (2003:208) states, 'interviews do provide insights into events about which we know little, i.e. the activities that take place out of the public gaze, behind closed doors'. This thesis deals chronologically with the use of energy in Russian foreign policy in the Caspian from 1991 to 2008, with an emphasis on the period between 2001 and 2008. Accordingly the selection of the state elites for interviews was based on the position they held during either the Yeltsin or the Putin administration and their involvement with either the process of the consolidation of the

energy sector or the formulation of Russian foreign energy policy in the Caspian. The selection of the business elites was based on the involvement of their companies in the Caspian and their current position in the company, as the higher their position the more they would be involved in decision making processes outside the daily management of the company. The selection of academics, analysts and journalists for expert interviews was based on the degree of their involvement in the report and analysis of Russian foreign policy and energy. These conversations with the experts were very useful to this thesis as they added both local expertise and knowledge to the development and argument of the hypothesis.

In all, a total of 40 interviews were conducted in Moscow during fieldwork in two parts; the period between March and June 2008 and September and November 2008. During the first leg of fieldwork in the spring of 2008 16 interviews were conducted mainly with experts and journalists, some state officials (State Duma Committee on International Relations) and one with a major state company (Gazprom). During September-October 2008, fieldwork was completed by managing to interview state officials at the Ministerial (Ministry of Energy and Ministry of Foreign Affairs) and Parliamentary level (State Duma Energy Committee), and company executives from the other major Russian state and independent oil and gas companies (Rosneft, Transneft and one middle level gas company whose Vice President wishes to remain anonymous). The second leg of fieldwork was necessary to the research as it gave the present author the chance to interview people who were unattainable in spring 2008. During this period the present author managed to interview another 24 people.

Although energy is by no means a taboo subject of conversation in Russia, certain topics related to it, like the use of companies in Russia's foreign energy policy or state-business relations in the sector, are approached with suspicion by Russian policy makers and experts, or non-Russian analysts who live and work in the country, about the motives of the researcher and about the context in which their responses will be used in case they decide to give an interview. There are two main reasons for this phenomenon: the first one is an understandable defensive position against the stereotypes applied to the use of Russian oil and gas companies in its foreign policy in the writings of mostly western analysts, especially when referring to Gazprom. Many interviewees started the interview with statements about Russia being 'misunderstood' by the west and about Russia's 'lawful right' to use its resources as it sees fit. One of the people from the press office of Gazprom spent a long time insisting that Gazprom is a commercial company and that it is not a political actor while another academic started the interview with a comparison between British Petroleum and Gazprom to prove his point that Russia should not be judged by western countries that operate their companies in the same way.

The second point is related to the fact that oil and gas are considered to be strategic sectors of the economy and, as the present author realised during fieldwork, a state secret. Moreover it happened that during the first leg of fieldwork the TNK-BP affair took place and people were highly guarded in relation to foreigners inquiring information about the energy sector. This affected the interview process in two ways: the first one was that many mainly independent analysts or company people were reluctant to be interviewed, fearing a backlash if their quotes were used in the thesis. This resulted in many Russian experts, even from well known western-funded research institutes, to avoid meeting the present author. Some of the interviewees asked



to be sent their quotes for confirmation before using them in the thesis and others asked to remain anonymous (Lilleker 2003:212). The second one was that at the beginning of most of the interviews the interviewees would ask questions to the present author regarding her nationality and the ‘puzzling’ fact that a non-UK citizen would study Russia’s energy sector in a UK academic institution. Despite the initial suspicion almost all the people who agreed to be interviewed answered most of the questions and happily devoted more time for the interview than initially agreed upon.

There were numerous problems with the organisation of interviews, some of which can apply generally to the use of this method and others which are more specific to the Russian case. Contacting journalists, academics and experts was fairly easy and fast. The people who agreed to be interviewed responded immediately and arranged a meeting with the present author as soon as permitted by their heavy schedules. Apart from the information they shared, they also assisted in what Devine (2002:205) calls the ‘snowball’ effect, i.e. referring the present author to other experts and in one case giving contact details of business elites. Contacting state and business elites for interviews was much harder. Elite interviewing has more peculiarities than common interviews due to the elite status of the interviewees, which implies both, a rigorous schedule for them, as well as what Hertz and Imber (1995:1-4) label as ‘gate-keeping’ mechanisms, normally through secretaries or public relations representatives. In the case of Russia the problem is aggregated by a lack of information readily accessible to the public, many times including incorrect contact details, disorganised institutions with no secretaries or receptionists, a general suspicious attitude towards western academics and, in the case of the present author’s research, hesitation to discuss the subject of Russian energy policy openly (Rivera et al 2002). State elites

from all levels of the governmental and presidential administration of both the Yeltsin and Putin periods were approached through the use of several official faxes and numerous phone calls (Rivera et al 2002:684). The purpose behind that was to get as much inside information on the actual decision-making processes regarding the energy sector as possible, as well as, different views on the state-business relations in the oil and gas sector and the use of energy in Russian foreign policy making in the Caspian. Despite numerous failed attempts, the present author managed to secure interviews with Duma deputies, the head of the department on Central Asia at the Ministry of Foreign Affairs and the head of the department on Central Asia of the Ministry of Energy.

Interviews with business elites were a little bit different. Top corporate executives are easily tracked down as companies are required by law to name their top officers (Hertz and Imber 1995:4). Contacting top corporate officials was fairly easy for Rosneft and Transneft whose data were found online and their response to granting the present author with an interview with their Vice Presidents was immediate and positive. Gazprom was a much different case where many attempts had to be made in order to get a response. The first success was obtained during the first leg of fieldwork where a Gazprom press office representative agreed to be interviewed anonymously after his contact number was given to the present author by a journalist. During the second leg of fieldwork the present author managed to obtain an interview with one of the main lobbyists of Gazprom at the Duma. Lukoil was highly unreachable, even though there had been many attempts to get an interview with them. Lukoil executives explained that they could not be interviewed due to restrictions by the official policy of the company. The vice president of an independent middle sized private gas company agreed to speak to the present author

anonymously. Other interviewees included people who were representatives of oil and gas companies' lobbying instruments, like the president of Assoneft, a representative from RSPP, a member on the board of the energy committee of RSPP and the President of the Russian Gas Society.

The qualitative elite interviews were conducted in a semi-structured fashion. The choice of this type of interviews was based on the fact that while it offers a structure for the conduct of interviews, it still has 'a certain degree of flexibility which allows for the pursuit of unexpected lines of enquiry during the interview' (Grix 2004:127). As this is an area studies thesis it is concerned with the views of the policy makers or main actors in decision making and semi-structured interviews offer the opportunity for the interviewee to express their opinions outside the structure of the interview and this way bring to light different issues that the researcher hadn't noticed before and even, as a result, adjust the emphasis in the research (Bryman 2004:313). In this respect the value of the interviews is greater than just providing useful quotes to the thesis, as they can influence substantially the researcher in drawing conclusions or rethinking their hypothesis. As Mason (2002:62) notes, 'most qualitative research operates from the perspective that knowledge is situated and contextual and therefore the job of the interview is to ensure that the relevant contexts are brought into focus so that situated knowledge can be produced'. The current thesis has been significantly influenced by fieldwork and the information collected while in Moscow. State officials, business elites and experts were approached with the objective of collecting information on their views on state-business relations, especially when regarding oil and gas companies in the Caspian region, as well as their views on the use of energy in Russian foreign policy conduct in the region. Some questions included the degree of

importance of the Caspian to the Russian state, or in the case of business elites, to the company in question, in reference to the oil and gas sector, and the reason why; what are the priorities of the Russian state in the Caspian in relation to the oil and gas sector; whether or not it would be acceptable for a Russian company to pursue other than its commercial interests when national interests are involved; whether oil and gas companies should take into consideration the state's priorities abroad; whether they think that the Russian state promotes its oil and gas companies abroad and how; and whether there is enough control by the state over the oil and gas sector.

Of course there are severe limitations to conducting interviews, and in particular the semi-structured ones, mainly related to the fact that this freedom given to the interviewees might result in them leading the conversation towards issues they would like to discuss (Lilleker 2003:211). This was a very frequent recurrence during fieldwork. An example would be the fact that many interviewees wanted to refer to the TNK-BP case or the Ukrainian gas dispute. Patience and persistence on returning to the topic of the interview were the tactics followed in this case. Another issue would be the degree of bias of the interviewees and their possible tendency to exaggerate or even obscure data according to their interpretation of the events or even their memory of the events when refereeing to past episodes (Lilleker 2003:212). In the current author's experience many of the interviewees made a very sharp distinction between the Yeltsin and the Putin administration and supported strongly either side according to their beliefs or their position at the time of the interview. This problem was tackled with sufficient preparation by the present author before the interview from primary and secondary sources, as well as, by looking at the background of each interviewee. Finally, and applying to both cases, primary and

secondary data were used in the analysis of this thesis in order to triangulate the information obtained through interviews (Lilleker 2003:208).

### **2.4.3. Primary sources**

The primary sources used in this thesis are official documents deriving from the state in relation to energy, security and the foreign policy of the Russian federation. Some of the documents used are: ‘The Energy Strategy of the Russian Federation up to 2010’, which details the Yeltsin administration’s view of the role of the energy sector in the restructuring of the Russian economy; ‘The Energy Strategy of Russia for the period up to 2020’, which outlines the energy priorities of the Putin administration in relation to the oil and gas sector especially with regard to the Caspian region; ‘The National Security Concept of the Russian Federation’, which offers a link between energy and foreign policy security priorities; ‘The Speech and the Following Discussion at the Munich Conference on Security Policy’, which refers to the pivotal role of energy in the shaping of Russia as a global energy player, and several annual addresses to the Federal Assembly of the Russian Federation during the Putin administration, which refer to the importance of the Caspian region to Russia in relation to the oil and gas sector.

Access to these documents was done online through the official websites of the President of the Russian Federation and the various ministries connected to either the energy sector, like the Ministry of Energy, or foreign policy, like the Ministry of Foreign Affairs (Burnham et al 2004). In analysing the documents the issues of bias and credibility unavoidably arise. As Bryman (2002:375) states, ‘the question of credibility raises the issue of whether the documentary source

is biased [...] this point suggests that caution is necessary in attempting to treat them as depictions of reality. The issue of representativeness is complicated in that materials like these ones are in a sense unique and it is precisely their official or quasi-official character that makes them interesting in their own right'. To this end, the documents are analysed through the lens of the conceptual framework suggested by this thesis and are compared both with the interview data, as well as, the statistical data used. Other primary sources include company documents not available online given to the present author at the interviews with company executives.

#### **2.4.4. Secondary sources**

Secondary sources used in this thesis include newspaper articles on energy issues in the Caspian, company documents online through the companies' official sites, like annual reports and press releases, statistical data through reports via energy analysis websites and media reports. Finally as this thesis is essentially a suggestion of an alternative perspective on looking at both state-business relations and Russian foreign energy policy analysis, the research uses analysis and findings from existing literature. As Ritchie (2003:255) notes, 'ideas and hunches about possible explanations can also come from comparing the researcher's own study with others which have been carried out in the same or a similar field. The researcher may "borrow' concepts or explanations to see how well they fit his or her findings'. All secondary data are read through the conceptual framework outlined before and combined with the empirical and primary sources to support the argument of this thesis.

## 2.5. Conclusions

This is a methodologically research-question led area studies thesis constructed around the subject of *how* and *why* are Russian oil and gas companies used as *vehicles* of Russian foreign policy in relation to its energy security goals in the Caspian region in the sphere of oil and gas. The hypothesis is that the Russian oil and gas companies are used in its foreign policy implementation in the Caspian through their commercial activities in the region. By using a conceptual framework informed by the critical realist ontological and epistemological assumptions of Neo-Liberal positions on the role of non-state actors in foreign policy making, the main problematic in the current Russian foreign policy analysis in the Caspian is identified as being the influence of the traditional Realist positivist ontological and epistemological assumptions on the nature of security and national interests, as well as, on the nature of the analysis of international relations being state-centric with all the consequences for both the methodology of the current analysis and the interpretation of its research findings.

The research questions of the thesis are linked to the two main inconsistencies that arise from the current study linked to the legacy of Realism. The first one is the failure to explain *how* Russian oil and gas companies are used in foreign policy making in the Caspian region; a practice which results in contradictory assumptions about their role as political tools of the state (i.e. the limitations of the actions of a commercial entity inside the political environment are not explained) and in an incomplete view of Russian foreign policy processes in the Caspian. The second one is the inability to explain *why* commercial entities would be subject to a state's policy, i.e. how can political and commercial interests be harmonised.

The first methodological contribution of this thesis is that it suggests in order to understand the processes of Russian foreign policy making in the Caspian through its energy companies we first need to understand the relationship between the Russian state and the oil and gas companies in the domestic sphere and then look at the routine commercial policies of the Russian oil and gas companies in the Caspian region inside the framework of Russian foreign energy conduct. To this end a two level analysis both on the domestic and the external sphere of Russian policy is suggested. The first level analysis in the domestic sphere is comprised of the mechanisms of the *inclusion* of state companies in and the *exclusion* from private companies from access to decision making conditioned by the ability of the state to control the channels of access to power. This analysis explains *why* Russian oil and gas companies are captured by the state through their dependence on state structures or state controlled companies for their survival and thus are subject to its policy priorities. The second level analysis in the foreign policy sphere comprises of *analysis* and *synthesis* of Russian foreign energy policy priorities in the Caspian and Central Asia and the commercial activities of the Russian oil and gas companies there. This is done through the *analysis* of two case studies of the operations of Gazprom, Rosneft, Lukoil and Transneft in the oil and gas sectors of the region and the final *synthesis* of both sectors inside the framework of Russian foreign energy policy in the Caspian. The thesis concludes that the routine commercial policies of the Russian oil and gas companies in the area contribute to the major goal of the Russian state in relation to its energy priorities, i.e. the preservation of Russian economic hegemony in the Caspian.

The second methodological contribution of this area studies thesis to the analysis of Russian foreign energy policy in the Caspian is linked to the original data collected during fieldwork in



Moscow in 2008. This is an area studies thesis and as such, fieldwork has been essential to the originality of the research. The specialized knowledge on Russia and the language skills of the present author assisted in the conduct of expert interviews, as well as, in the analysis of Russian language primary and secondary sources through the conceptual framework informed by Neo-liberal ideas on non-state actors in Russian foreign energy policy. By conducting elite interviews with both Russian state and business elites, in addition to expert interviews with academics, analysts and journalists the present author was able to gather original information on the decision making process in both the domestic and external energy policy spheres in Russia. The novelty of this approach to the analysis of state-business relations in the oil and gas sector is that it offers an insider's view of the processes of the *inclusion* of state companies in and the *exclusion* of private companies from decision making from both the state and the business sides, as well as, experts' knowledge of the process of the capture of the oil and gas sector by the state. Likewise in the external sphere of energy policy making in the Caspian, the view of policy makers and that of Russian analysts offers an insight to Russian foreign policy and security priorities in the region, the importance of the Caspian to Russian foreign energy policy, as well as, official views on the use of oil and gas companies in Russia's foreign energy policy formation. The research question of *how* and *why* are Russian oil and gas companies used in the formation of Russian foreign energy policy in the Caspian is answered by combining the original material from fieldwork with the already existing literature on the subject with both qualitative and quantitative data through the lens of the conceptual framework suggested before. As a result we can get a more complete picture of Russian foreign energy policy conduct in the Caspian.

## **CHAPTER 3: Russian Foreign Policy, Energy Politics and the Caspian Region**

### **3.1. Introduction**

Russian foreign policy has changed considerably since the end of the Yeltsin era. The change is related to the growing importance of the oil and gas sector as a driver of Russian foreign policy especially in relation to specific regions where Russia's energy security interests are high like the Caspian. The new priorities of the Russian Federation under Putin in the sphere of security and foreign policy have been linked, to a great extent, with the country's economic growth and its position in the world energy markets, both as a reliable energy supplier and an influential economic actor. The link between Russian foreign policy and energy policy is evident in every major official document that influences policy making, as well as in the official rhetoric of the state (Energy Strategy up to 2020; The National Security Concept). Russia sees its place in the international order as one of the leaders of the multipolar world. The economic growth of the country is the tool for the realisation of this goal, and for the time being, economic growth in Russia is tightly linked to its oil and gas resources, their exploitation and transport to the world markets. In this respect economic and commercial priorities are added to the traditional geopolitical and military security concerns in Russian foreign policy.

As explained in section 1.3.2., current research on Russian foreign policy and energy in the Caspian identifies the new developments in foreign policy conduct in the region. The analysis offered focuses on the importance of the Caspian region to Russia both in terms of its resources and of its oil and gas pipeline system to the European markets. Research looks at the security issues arising from control over the pipeline network and the use of this advantage as political

and economic leverage in relation to Central Asian states and Europe. As discussed in section 2.2.1., there are two ontological problems related to the influence of IR Realism on Russian foreign energy policy analysis in the region which affect current literature: the first is linked to the state being the focal point of analysis and the second is linked to separating politics from economics. As a result research focuses mainly on political objectives and outcomes of Russian foreign energy policy conduct and only to a lesser degree on economic/commercial ones.

Related to this point is the idea of what constitutes Russian energy security priorities in the Caspian. As discussed in section 2.2.2.2., viewing security through the lens of Realism and thus focusing on the state as the main unit of analysis has two consequences on the interpretation of Russian security priorities in the Caspian: the first is the dominance of political and military security issues over commercial ones linked to the concept of the national interest, and the second is a lack of consideration for other actors in the pursuit of security priorities. As a result the study of current Russian foreign energy policy in the Caspian though acknowledges the economic objectives of Russia related to energy, it fails to recognise their importance as a foreign policy priority. Likewise, while current literature recognises the role of Russian oil and gas companies in the region, it fails to interpret their function within the Russian energy policy framework. Consequently, despite the fact that current analysis correctly identifies and explains extensively Russian geopolitical and military priorities in the Caspian, it fails to include the commercial dimension of Russia's foreign and security priorities, a component which would complete the picture of Russian foreign energy policy in the Caspian.

As was discussed in sections 2.2.2.1. and 2.2.2.2., a conceptual framework informed by IR Neo-liberal ideas on foreign policy analysis and the role of non-state actors in international affairs, together with the use of a Critical Security Studies informed concept of security we can observe and interpret how Russian oil and gas companies assist the state in its foreign energy policy conduct in the Caspian. This chapter functions as an introduction to Chapters 4, 5 and 6. It offers a general view on Russian foreign energy policy in the Caspian and attempts to highlight its economic priorities in the region, as well as the role of its companies in it. Chapter 4 looks at the relationship between the Russian state and the oil and gas companies. Chapters 5 and 6 offer a more detailed individual account of how Russian oil and gas companies assist in the implementation of Russian foreign energy policy in the Caspian.

This Chapter starts by looking at the main literature on the use of energy in Russian foreign energy policy in the oil and gas sector in the Caspian and Central Asia. In the second part it establishes the link between security, energy and foreign policy in the official rhetoric. And in the third part it looks at Russian foreign energy priorities in the Caspian as seen within the energy framework.

## **3.2. Energy and Russian foreign policy**

### **3.2.1. Energy's role in Russian foreign policy in the Caspian**

As discussed in section 1.3.2., current literature on the role of energy in Russian foreign policy making in the Caspian under Putin, especially in the oil and gas sector, refers to the subject of the 'economisation' of Russian foreign policy, i.e. the increased use of energy alongside military

power in order to achieve Russia's strategic objectives in the region (Lo 2003). Nonetheless, the use of energy is seen as a tool to achieve traditional Russian foreign policy goals of security, in the Realist state-centric sense of the term, in addition to great power status and geopolitical influence, which are still central in the formation of Russian foreign policy (Buszynski 2004; Oldberg 2005; Cornell 2009). Energy is seen as an additional advantage of Russia in relation to the other Caspian states to its military strength and military complex potential.

The reason behind the lack of use of energy in active foreign policy making under Yeltsin was attributed to the specific problems that the transition from the Soviet Union to a market economy brought about. During 1990s, Russian foreign policy was centred on the political survival of the newly formed state and energy, especially the gas sector as is discussed in Chapter 5, was mainly utilised by the state in the reconstruction of the economy (Energy Strategy up to 2010). It is fair to say in this respect firstly that the priorities of the Russian state under Yeltsin were different and secondly that the state, even if it wanted to, it did not have the strength to promote its natural resources. *'It is not economisation of foreign policy. It is simply that the economy takes the role that it had to take in the formation of foreign policy. During the Yeltsin administration, Russia did not have the resources to promote its own economic interests in the international markets. We did not have a sound foreign energy policy. So, it is absolutely different. We knew that oil and gas were instruments of foreign policy, but these instruments were not specified as how to use them. Under the Putin administration we understood that oil and gas could be an extremely efficient measure of foreign policy'* [Safaryan, interview by author 18 April 2008]

The choice of energy as an influential driver in Russian foreign policy making has been claimed by some to be more arbitrary than pre-planned based on the rise of the oil and gas prices in 2001 (Fredholm 2005; Kivinen 2007) while others claim that there had been a conscious plan by Putin from the beginning, usually referred to as the ‘Putin thesis’, to use natural resources in order for Russia to gain global status as an energy power (Balzer 2005). In any case, as it is difficult to know which opinion is more valid, it is safe to argue that the rise of Putin to power in 1999-2000 coincided with an increase in oil prices which led to the restructuring of the economy around the energy sector and the consequent utilisation of the sector in Russian foreign policy. *‘Putin wanted to create a strong state and he understood that this could be accomplished through the energy sector’* [Elder, interview by author 21 April 2008].

The change under Putin was attributed to the adoption of a more ‘pragmatic’ approach to Russian foreign policy as opposed to the ‘chaotic’ policy environment of the Yeltsin administration. The argument was based on the fact that despite Russian foreign policy becoming presidential under Yeltsin, the lack of control and organisation of the administration over its different departments meant that policy was not conducted properly. It was argued that foreign policy in the Soviet Union was subject to the interaction between the Communist Central Committee and the Ministry of Foreign Affairs. The problematic situation that the collapse of the Soviet Union caused created a chaotic situation when it came to the coordination of Russian foreign policy, especially with regard to the former Soviet space. Once the elaborated and specialised structures collapsed, there was a need to reallocate tasks and responsibilities among the new ministries and that proved to be challenging, particularly in the sphere of Russian foreign energy policy. Under Yeltsin Russian foreign policy became presidential for the first

time. Nonetheless during this period the power of the Presidency was still not as established as it became under Putin. The President, together with the Presidential Administration, would take a decision and communicate it to the Prime Minister and the Prime Minister would allocate the task to the Ministry of Foreign Affairs and so on (Lynch 2003; Lo 2003; Johnson 2004). As a result, the number of actors that conducted foreign policy grew steadily and varied from area to area. In the Caspian for example, which is an area where Russia always had both security and commercial interests, the Ministry of Foreign Affairs was many times outranked by the Ministry of Defence which controlled the Caspian fleet (Lo 2003).

Under the Putin administration things changed profoundly in this respect with the installation of the power vertical in the political life of Russia. Russian foreign policy became genuinely presidential. The power vertical worked in such a way that it rendered every decision-making body beneath the Presidential Administration irrelevant. *'What is under the Presidential Administration is just subjected to it; it does not work by itself'* [Subbotin, interview by author 29 April 2008]. The decisions were taken at the top and are put in practice directly at the bottom, especially with matters like energy and security which were central to the preservation of the system and for the realisation of the elite goals. As a result the role of the government in decision making was reduced to the minimum. *'One of the main characteristics of the Putin Legacy is that he has made the role of the ministries irrelevant'* [Elder, interview by author 21 April 2008].

Although this thesis deals with Russian foreign energy policy in the Caspian from 1991 to 2008, the present author would like to note that one should take into account that after the departure of Putin from the Kremlin, there is a high probability that the role of the government will grow in

importance and there are early signs to support this. It has been already stated by President Medvedev that there is going to be a lot of collaboration with the Prime Minister, especially on matters of security, and that in foreign policy and foreign energy policy, the strategy of the Putin administration will be followed. As the Prime Minister is responsible for economic policy according to the Constitution, there is a high chance Putin will be able to influence Russian foreign energy policy by definition. According to Subbotin, before leaving his post as the President of the country he made sure that some specific laws were passed that would ensure he stayed in power. One of them is the Law on strategic resources. *‘The law on strategic resources was part of a packet of changes directed to shift the balance of power between the President and the Prime Minister in favour of the Prime Minister. Putin took a lot of power from the President with him before moving to the White House’* [Subbotin, interview by author 29 April 2008].

### **3.2.2. Energy as a foreign policy tool in Russian foreign policy making in the Caspian**

Current literature on the role of energy in Russian foreign policy conduct in the Caspian refers to the use of Russian oil and gas companies, mainly of Gazprom, in maintaining economic leverage over the Caspian and Central Asia for traditional security issues, like geopolitical influence and great power status (Buszynski 2003; Oldberg 2005; Larsson 2006; Cornell 2008). The ‘special’ political interests of Russia in the CIS are highlighted, as is the importance of promoting them. Kivinen (2007:17) refers to the web of dependences between Russia and the CIS countries and comments that ‘especially during Putin’s two terms the CIS-dimension of Russian foreign policy has been promoted in many ways. Between Russia and all the CIS countries we can witness a multi-level bargaining game where political orientations and military commitments intertwine



with energy issues'. Russian foreign energy policy priorities in the oil and gas sector in the Caspian and Central Asia are principally linked to maintaining Russian control over the pipeline infrastructure. This assists Russia in preventing other oil and gas producing countries from using alternative pipeline routes, prevent foreign involvement in the region and guarantee secure energy supply to Europe (Johnson 2004; Heinrich 2006; Baev 2008; Cornell 2008; Larsson 2008; Soccor 2008; Orttung et al 2009). The commercial importance of energy in Russian foreign policy conduct in the CIS is viewed as an additional component of Russian foreign policy serving traditional political security issues instead of both economic and political security issues. In this respect the political side of Russian security priorities in the Caspian predominates over the economic one in current literature.

Russian leverage over Central Asian countries is defined inside the Realist state-centric mindset of achieving traditional military and political goals. Hedenskog and Larsson (2007) identify four levers that Russia has over the Central Asian states in its energy policy in the area: political levers, energy levers, strategic levers and tactical levers. Political levers refer to the political influence that Russia has in the region through integration initiatives. Energy levers refer to supply interruptions of oil, gas and electricity, threats of supply cuts, coercive negotiations, and terrorist attacks on the pipeline network. Strategic levers concern pipeline routes and partnerships. And tactical levers include disruption of energy flows and coercive pricing policy. According to Hedenskog and Larsson (2007:59) Central Asian countries have mainly been affected by strategic levers, a reference to issues with the oil and gas transportation system. As stated by the authors, 'Russia has used a rather high level of coercion towards these states and it

has and will use all available levers even if clashes are created' (Hedenskog and Larsson 2007:59).

Despite the fact that traditional security issues linked with political and military priorities of Russia in the Caspian and Central Asia are valid and central in Russia's foreign policy in the region, as explained in section 2.2.1., IR Realist approaches to foreign policy analysis and state-centric security concepts prevent us from acquiring a more complete understanding of Russian foreign policy priorities in the Caspian. By adopting an IR Realist ontological approach to the analysis of Russian foreign energy policy in the Caspian we are ignoring the commercial interests of the Russian state in the region and consequently the role that Russian oil and gas companies play in the implementation of the Russian state's foreign energy policy conduct in the Caspian through their commercial activities, as is demonstrated in Chapter 5 and 6.

### **3.2.3. Companies in Russian foreign energy policy**

In the current literature on Russian foreign energy conduct in the Caspian and Central Asia there is reference to the use of Russian companies' commercial activities in the implementation of Russia's policy in the CIS. Although the subject of the use of companies in the conduct of Russian foreign policy in the region is analysed in detail in Chapter 5 and 6 as case studies of the oil and gas sector, this section offers an overview of the main problems arising from current analysis through some examples in the literature.

Vahtra (2007:102) speaks about the size of Russia's investment in the CIS and comments that 'in addition to the large volume of [commercial activities], what makes Russia a significant investor in the CIS is the nature of its investments, more often than not [aimed at] the strategic sectors of

target economies. Besides being the prominent energy suppliers in the CIS, Russian companies hold considerable stakes in numerous oil, natural gas and power companies in the region. The investments in the strategic natural resource-based sectors often provide Russia with significant economic and political leverage in the target countries'. To this end Russia supports the active expansion of its leading companies and this way it 'efficiently manages its interests in the region' (Vahtra 2007:113). The combination of 'most [CIS] countries already being seriously indebted to Russia due to massive energy imports and record high energy prices with the Russian ownership of many strategic industrial assets in the CIS countries, the economic, and consequently political leverage in the region, becomes apparent' (Vahtra 2007:113, also see Kivinen 2007).

Hedenskog and Larsson (2007:112) offer a more state-centric view of the role of Russian companies in the implantation of its foreign policy in the Caspian. They argue in relation to their analysis of the Russian energy levers over Central Asian countries that the targets are Central Asian states that obstruct Russian policy and 'the levers are carried out by state loyal companies like Gazprom and Rosneft'.

There is one problem with all three cases mentioned above in relation to the use of Russian companies in its foreign policy conduct: they all fail to establish the link between the state and the companies used in foreign policy making. It is taken for granted that Russian oil and gas companies are subject to the state and can be used in its foreign policy formation. As argued in section 2.3.1., there is a need to define the relationship between the Russian state and its oil and gas companies in order to understand why a commercial entity would choose to put political

interests higher than its economic ones, as obviously the state interests do not always coincide with the companies'. This is especially true in the case of private companies, like Lukoil. Chapter 4 deals with state-business relations in the oil and gas sector through the mechanisms of inclusion in and exclusion from decision making.

### **3.3. Economic priorities in Russian foreign energy policy**

As discussed in section 2.2.2.2., traditional concepts of security informed by Realist views tend to be state-centric and thus restrictive of our interpretation of whole range of security concerns and issues arising in foreign policy formation. The state-centric security approach presents three problems: the first is the fact that security is linked to the usually ill-defined notion of the national interest of the state. The second is that security is mainly linked to the political and military survival of the state within the anarchical international relations environment. The third is that there is a separation between political and military security issues from economic ones and there is a notable separation between the domestic and the foreign policy spheres. The focus is almost always on the political and military security concerns. By adopting a wider concept of security, informed by Critical Security Studies, encompassing both political and economic security concerns we understand better the security concerns of Russia linked to its energy sector.

Likewise as discussed in section 2.2.2., the adoption of a conceptual framework informed by Neo-liberal ideas on foreign policy analysis can help us understand how Russian oil and gas companies are used in the conduct of Russian foreign energy policy in the Caspian. This is firstly done by departing from the traditional state-centric IR Realist analyses and acknowledging the importance of non-state actors in international affairs and secondly by recognising the

importance of economic priorities alongside the political ones. This section looks at the link between Russian foreign policy, security and energy and is attempting to highlight the economic priorities of the Russian state in relation to its foreign policy.

### **3.3.1. The link between energy and Russian foreign policy**

The importance of energy in the security of Russia and its role as a foreign policy driver is evident in the main official documents of the state. The Energy Strategy of Russia for the Period up to 2020<sup>10</sup> is an official document that outlined the priorities and goals of a long-term state energy policy for the Russian Federation, as well as the means to realise them. Its aim is to implement a strategy that would make the best use of the potential of the Russian natural fuel and energy resources for economic growth that would lead to Russia being a major player in the world energy markets and the improvement of the quality of life of the people of the Russian Federation. According to the energy strategy, that can be realised through the creation of a transparent energy market and with the aid of the state which will assume the role of the regulator of market relations. Its aim is to implement a strategy that will make the best use of the potential of the Russian natural fuel and energy resources for economic growth that would lead to Russia being a major player in the world energy markets and the improvement of the quality of life of the people of the Russian Federation (Energy Strategy of Russia up to 2020).

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<sup>10</sup> The document was approved in May 2003 and it is mainly based on the draft energy strategy of 1992

The link between the Russian National Security Concept<sup>11</sup> and the energy strategy is found in the opening paragraph of the latter. ‘Russia possesses significant reserves of energy resources and a powerful fuel-energy complex, which serves as the basis for economic development, [and is] an instrument for implementing domestic and foreign policy. The role of the country in the world energy markets defines, to a large extent, its geopolitical influence’ (Energy Strategy of Russia for the period up to 2020).

The Kremlin’s view of world affairs was presented by Putin in his infamous speech at the Munich Conference on Security Policy on February 10, 2007. According to it, the balance of power that existed between the United States of America (USA) and the Union of Soviet Socialist Republics (USSR) two decades ago, and which guaranteed global security, was disturbed with the end of the Cold War and the disintegration of the Soviet Union (Speech and the Following Discussion at the Munich Conference on Security Policy, 2007). Russia sees itself as being an influential actor of the multipolar world based on its natural resources. According to the Energy Strategy, ‘the new factor for the period up to 2020 will be the participation of Russia in providing international energy security, as a major supplier of energy resources’ (Energy Strategy of Russia for the period up to 2020).

### **3.3.2. Economic priorities and security issues in Russian foreign energy in the Caspian**

Economic objectives are central to Russian security. As it is stated in the National Security Concept, ‘The realisation of the national interests of Russia is only possible on the basis of the economic development. That is why the national interests of Russia in this sphere are crucial’

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<sup>11</sup> The document was approved by the Presidential Decree No. 1300 in December 17<sup>th</sup>, 1999

(The National Security Concept). According to Putin ‘a stable economy is the main guarantor of a democratic society and the very foundation of a strong nation that is respected in the world’. One of the urgent priorities at the beginning of Putin’s presidency was the reduction and final elimination of the national foreign debt. Economic effectiveness has been one of the foundations of the foreign policy of the Russian Federation (Annual Address to the Federal Assembly of the Russian Federation 2000). Russian policy makers believe that an economically strong Russia will be safe both internally and externally and it will be able to finally acquire the status of a regional or even global power and thus treated as an equal.

Economic goals are part of Russian priorities in its foreign policy conduct. The main objective of the Strategy in relation to Russia’s foreign energy policy is the integration of Russia into the world energy markets and its participation in international cooperation in the field of exploitation of fuel and energy resources. The strengthening of Russia’s position in the oil and gas markets is of a major strategic importance. During the next twenty years, Russia has to realise the export potential of its fuel and energy complex and has to invest in the economic security of the country, remaining a stable and reliable partner for the European countries and for the world as a whole (Energy Strategy of Russia for the period up to 2020).

### **3.3.3. State intervention in the energy sector and the role of companies in Russian foreign policy**

The subject of the natural resources being of strategic importance and the subsequent legitimised intervention of the state in the market comes up very often in the official rhetoric. In 2000 Putin

stated that ‘it must be admitted that the state will not be able to stop participation in several sectors of our economy for some time yet. I mean direct participation by the state. It will not be able to, and should not stop, in sectors such as the defence and industrial complex, for example. Strategically important industries will remain under the constant attention of the state’ (Annual Address to the Federal Assembly of the Russian Federation 2000).

In 2005 Putin made a point about the role of the state in restricting foreign intervention in its economy, while promoting the interests of Russian capital. He declared ‘it is time we clearly determined the economic sectors where the interests of bolstering Russia’s independence and security call for predominant control by national, including state, capital. I mean some infrastructure facilities, enterprises that fulfil state defence orders, mineral deposits of strategic importance for the future of the country and future generations, as well as infrastructural monopolies’. He added that ‘in practice, investors sometimes face all kinds of limitations, including some that are explained by national security reasons, though these limitations are not legally formalised. This uncertainty creates problems for the state and investors. We should draft and legally formalise a system of criteria to determine the limitations on foreign participation in such sectors of the economy. Simultaneously a corresponding list of industries or facilities will be determined that shall not be extended or receive extended interpretation. Some industrialised countries use this approach and so should we’ (Annual Address to the Federal Assembly of the Russian Federation 2005). The essence of the logic followed is demonstrated in this statement, ‘the state’s authority should not be based on excessive permissiveness, but on the ability to pass just and fair laws’ (Annual Address to the Federal Assembly of the Russian Federation 2006). The strengthening of the role of the state in the regulation of the economy includes limitations



placed on the transfer of deposits of strategic natural resources to foreign companies (The National Security Concept).

The key foreign economic tasks of Russia include the creation of favourable conditions for the integration of the Russian economy in the world markets, the establishment of new markets for Russian commodities, the creation of a common economic space with the countries of the CIS and the protection of the interests of the Russian national producers (The National Security Concept). The importance of the strengthening of the position of Russian oil and gas companies both domestically and abroad is mentioned as part of the first period of the implementation of the energy policy. Between 2003 and 2010 focus is given to legislation regarding the transparency of the energy market, the realisation of the export potential of the Russian oil and gas, the rise of Russian energy companies to occupy stable positions in both the domestic and external energy markets, and finally, the establishment of the role of Russia as a reliable and effective fuel and energy supplier. During the second period, between 2010 and 2020, and building on the first period, focus is given to Russian energy sectors, especially gas and oil, being more open and competitive in the energy markets, growth in other energy sectors apart from oil and gas, like nuclear power, and finally growth in the annual investment for the creation of a basis for prospective projects (Energy Strategy of Russia for the period up to 2020).

Here it should be made clear that although energy is one of the main components of the Russian economy, the objective of the state is to avoid over reliance on the sector. The problematic situation in the Russian economy is cited as a threat to the national security of the country and one of its parameters is an over reliance on fuel, energy and raw materials in Russia's exports. In

the opening paragraph of the Energy Strategy it is made clear that it is only to 'a great extent' that the role of the country in the world energy markets defines its geopolitical influence. There is a conscious attempt in the state rhetoric to promote new scientific and technological advancements in order to diversify and strengthen the economic growth of the country. It is stated clearly in the state rhetoric that Russia must realise its full potential of high-tech sectors such as modern energy technology, including production and use of nuclear energy, hydrogen and thermonuclear energy and nano-technology; transport and communications; and space and aircraft building. According to Putin, Russia should become a major exporter of intellectual services. He states that the country needs to develop 'a competitive system generating, dismantling and applying knowledge in Russia. Only a system of this kind can serve as the basis for sustainable and high-quality economic growth'. Then he goes on to add that 'the kind of intellectual resource production that we need should be not only comparable to the exploitation of our abundant natural resources in its benefits, but should ultimately exceed even these expectations'(The New Economy). As Putin declared in his last Annual Address to the Russian Federation, 'Russia's rich educational, scientific and creative heritage gives our country clear advantages for creating a competitive economy based on knowledge and intellect, an economy driven not by the rate at which natural resources are exploited, but above all by the ability to come up with new ideas and inventions and introduce them more rapidly than others into everyday life' (Annual Address to the Federal Assembly of the Russian Federation 2007).

By studying the official documents of the Russia Federation on the link between energy, security and foreign policy we can see that the economic objectives of the state intertwine with its political priorities and are considered as important. The priorities of the Russian Federation in

the field of energy are to use its full potential in order to achieve two objectives: the first is to build a strong economy which would guarantee its security both domestically and internationally. The second is to use this strength in order to become a global player in the energy markets. Both of these objectives are linked to the national security interest of Russia, which is the improvement of the lives of the Russian citizens through economic prosperity. This leads to further development of the economy, the preservation of democracy and the improvement of Russian society as a whole.

There are four points which come up in the official rhetoric which are relevant to this thesis: the first one is the acknowledgement that energy is considered to be a very powerful foreign policy tool by the Russian state. The second is the fact that Russia's integration into the world energy markets through its participation in international projects in the field of exploitation of fuel and energy resources is identified as a way of realising foreign policy objectives. Thus the commercial activities of the Russian state and its oil and gas companies abroad function within the Energy Policy framework. The third, which is connected to the previous point, is the role of the Russian oil and gas companies in the implementation of foreign policy objectives. It is stated that legislation would assist in the rise of Russian companies both domestically and internationally. In this respect the intention of the state to assist its oil and gas companies in doing so is evident. The fourth point connected to the third one is the active involvement of the state in the energy sector by controlling it. Chapter 4 refers to the way the Russian state has captured the oil and gas sector through the mechanisms of inclusion of state companies in and the exclusion of private companies from decision making and Chapter 5 and 6 show how the commercial activities of the Russian oil and gas companies in the Caspian when viewed within

the Russian energy policy framework promote the state's foreign energy policy objectives in the region.

### **3.4. Russian Foreign Energy Policy and Security priorities in the Caspian**

This last part of the Chapter looks briefly at the importance of the Caspian region in Russian foreign energy policy. Chapters 5 and 6 offer a more detailed account of the oil and gas sector separately. As discussed in sections 3.2.1., 3.2.2., and 3.2.3., the Caspian is important to Russia for a number of reasons concerning political, military and commercial issues. The main interests of the Russian state connected to its foreign energy policy in the Caspian are: maintaining its control over the pipeline network, gaining as much as possible from the exploitation and transportation of the Caspian reserves and maintaining political, military and commercial influence over the Central Asian countries.

#### **3.4.1. The pipeline network**

The oil and gas transportation pipeline network in the Caspian is based on the Unified Soviet System which transported both oil and gas to the north into Russia and from there to the European markets. For Russia maintaining control over the system was cited as a strategic goal in the Energy Strategy (The Energy Strategy up to 2020). There are three reasons for that: the first is that for the landlocked Central Asian oil and gas producing states this is the main route of export for their natural resources to Europe (alternative routes and to what extent they are used are discussed in Chapter 5 and 6). This way Russia maintains leverage over the Central Asian states as it constitutes a near monopsony for the countries in the region (Orttung 2008; Larsson

2008). The second is that once the pipeline routes enter Russian territory are controlled by the two Russian monopolies, Gazprom and Transneft. Russia gains from both companies through the transit fees paid by the Central Asian states. The third, which is connected to the previous two, is that by assuring that the Central Asian countries use the Russian route for their exports it both gains leverage in relation Europe and Central Asia (Hedenskog and Larsson 2007).



**Map 3.1 Major Pipelines to Europe**

Source: EIA

### **3.4.2. The Caspian reserves**

When it comes to the Caspian reserves, the Russian sector possesses large amounts of oil, but it is nothing compared to the huge reserves located in Siberia. Nonetheless there are three factors that make Caspian reserves important to Russian energy security. The first one is the fact that according to some analysts there is insufficient investment into new fields and developing fields like Eastern Siberia which is quite costly due to the specific weather and labour conditions. As a result Russian companies increasingly consider the offshore as an alternative for future investment [Sourzhenko, interview by author 29 April 2008]. The second factor is the decline in Gazprom's production, mainly due to insufficient investment towards developing new gas fields. The need to make up for the gas deficit in order to fulfil Gazprom's contracts with its customers Central Asian gas is used, as it is cheaper and ready for export (Milov 2006). The third factor is the use of Central Asian oil and gas within the framework of Russian energy policy and its goal to become a major player in the global energy sector. By maintaining as much control as possible over the exploitation and transport of the Caspian oil and gas reserves as a whole, Russia manages to influence heavily one of the most important oil and gas producing regions in the world as well as an energy hub to both Europe and Asia.

There has been a lot of talk about the importance of the Caspian reserves. During the 1990s, the area was treated as the most important discovery in the field of energy for two main reasons: the first was directly linked to global energy security, as the discovery of a rich oil and gas producing region would diversify the already existing resources and thus act as an alternative source for energy to both the already existing depleting oil and gas fields and to the problems

arising from depending on politically unstable regions of the world, like the Middle East. The second is related to the fact that it was the first time for about a century that the region was almost fully open to foreign companies, at least since the early Soviet times. The disintegration of the Soviet Union brought about the emergence of newly independent states around the Caspian and a newly emerged market full of opportunities for investment and exploitation. During the same period the region was swarming with foreign companies trying to get access to the Caspian. Within a decade it was clear that the reserves of the Caspian were much less than originally estimated, the conditions of extraction were not the best ones, plus the politico-economic situation of the region and ecological concerns made the area less attractive than expected (Olcott 2009).

Nonetheless the Caspian reserves are still very important to Russia for different reasons. In the official Russian state discourse the actual production of oil and gas in the Caspian was not presented as being important for the country's energy security. According to the Energy Strategy, despite the fact that the Caspian was considered to be one of the world's biggest regions in estimated energy deposits, and although it was one of the country's major oil and gas producing areas, Russia still relied heavily on Western Siberia for both oil and gas production. (Energy Strategy up to 2020) Map 3.2 below shows Russia's major oil basins and table 3.1 shows Russian oil production by region in 2009 in order to provide an example of Western Siberia's importance to Russian oil production in relation to other regions.

**Major Russian oil basins**



Source: IEA

**Map 3.2 Major Russian oil basins**

Source IEA (cited in EIA)

**Table 3.1 Russian oil production by selected region in 2009**

	<b>Oil Production Volumes (Thousand barrels per day)</b>
<b>Production by region</b>	
Western Siberia	6,750 bbl/d
Urals-Volga	2030 bbl/d
Northern Caucasus	800 bbl/d
Archangelsk	370 bbl/d
Sakhalin	310 bbl/d

Source: Eastern Block Research 2009 (cited in EIA)



As Western Siberia was the first region to be heavily exploited in Russia, its resources are being depleted. Eastern Siberia was viewed as the alternative solution to the problem. With vast estimated resources which are still undiscovered, the potential of the area is huge and is treated as Russia's safety net and future investment when it comes to energy security. The projects that were under way under Putin included the building of a pipeline to China<sup>12</sup> and the development and exploitation of both oil and gas fields by Gazprom and Rosneft in partnership with Russian private and foreign oil companies (Energy Strategy up to 2020).

There were two factors that rendered Eastern Siberian fields problematic up until the end of the Putin administration. The first one was the fact they were still undeveloped. There were two variables influencing the exploitation and development of the fields. The first one was the fact that there was little infrastructure in the area and the working conditions were extremely difficult [Elder, interview by author 21 April 2008]. The second variable, connected to the first one, was the fact that there was insufficient investment in the area by the two companies that were in charge of the area, Gazprom and to a lesser degree Rosneft. The second factor that made dependence on Eastern Siberian resources problematic was the transportation of the reserves to world markets. It was quite expensive to transport energy from the area by definition, because of the weather conditions, but also because the oil and gas fields were tied to railways, as this is one of the main ways at the moment to transport resources. Through the pipeline to China gas exports from Eastern Siberia are tied to the Chinese market. In order to supply other countries the companies will need to use the railway system [Sourzhenko, interview by author 29 April 2008]. In this sense, Eastern Siberian fields, despite the fact that they possessed huge reserves of

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<sup>12</sup> The pipeline has been in function since 2009

both oil and gas, at the time could not provide energy security to Russia. In this respect, Russia had to depend on its offshore rather than on its onshore resources for energy.

The final point connected to the importance of the Caspian reserves to Russia is that, apart from the Russian sector which contributes to the Russian reserves, importing gas from Central Asian countries plays a key role in Russian energy security with regards to the European markets, as discussed in 3.4.1. Despite the fact that Russia has more than enough reserves onshore, as discussed above, lack of proper investment and exploitation of the fields have brought about a decline in production and thus they are relying on the short-medium term on Central Asian gas to fill in the production gap which is growing. *‘Having reserves and having production are two different things’* [Independent Caspian analyst, interview by author 16 May 2008]. This is evident by a decrease in Gazprom’s production. Table 3.1 shows the annual gas production by Gazprom in billion cubic metres from 2001 to 2010. Despite the fact that Gazprom’s annual production of gas increased between 2001 and 2006, when it peaked with 556 billion cubic metres of gas produced, it started decreasing with its lowest point being 2009 when Gazprom produced 461.5 billion cubic metres of gas.

**Table 3.2 Gazprom’s annual gas production (2001-2010)**

<b>Year</b>	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
<b>Gas production in billion cubic metres per year</b>	512 bcm/y	525.6 bcm/y	547.6 bcm/y	552.5 bcm/y	555 bcm/y	556 bcm/y	548.6 bcm/y	549.7 bcm/y	461.5 bcm/y	508.6 bcm/y

Source: Gazprom

Inevitably, Gazprom depends more and more on Central Asian gas imports in order to meet its export demands. Also the fact that Russian oil is more expensive than Central Asian oil because of the difficulties in extraction in the Caspian region, it is more profitable to buy cheap Central Asian oil and sell it at least double the price abroad. In this respect the Caspian region's reserves are important to Russia not only with regard to its sector but also with regard to the Central Asian states reserves.

### **3.4.3. Central Asian Countries**

The final dimension of the importance of the Caspian for Russia is the fact that the littoral states that are mainly countries of the CIS, apart from the Islamic Republic of Iran, are part of Russia's immediate neighbourhood. That means that the area is vital to Russia's security and national interests, including border security, terrorism, drug trafficking and the protection of Russian minorities (Lo 2003; Hedenskog and Larsson 2007). According to Moscow's view, an economically strong Russia that could lead the economic cooperation in the region would be a guarantee to Russia's national security and interests. Of course, all the above mentioned reasons intermingle and are mutually dependent, so control of Central Asian countries results into control over pipelines and reserves, and control over pipelines and reserves assures influence in Central Asia. As explained in detail in Chapter 5 and 6, by maintaining its economic hegemony in the region through the commercial activities of its companies, Russia manages to exert considerable influence in the area and achieve its foreign energy policy objectives.

### 3.5. Conclusions

Under the Putin administration energy became an integral part of Russian policy as an important driver and tool of foreign policy conduct. Current literature on the use of energy in Russian foreign policy making in the Caspian and Central Asia while acknowledging this shift interprets it within a framework influenced by IR Realist state-centric ideas on international affairs. As a consequence it focuses mainly on the role of the state in Russian foreign energy policy and looks primarily at the political outcomes of the state's actions. Related to this point security priorities are viewed through the traditional military and political lens. This approach has two outcomes: the first is that commercial interests are not seen as Russian energy security priorities in the region and the second is that routine commercial activities of the Russian oil and gas companies are not interpreted within the framework of Russian foreign energy policy in the region and thus we cannot fully understand how oil and gas companies are used in Russian foreign energy policy in the Caspian. In this respect current analysis focuses on crisis events when the state's intervention is obvious and ignores the other side of Russian foreign energy policy making through its companies' routine commercial activities, or when there is reference to the companies' commercial activities in the Caspian and Central Asia there is no interpretation either of the relationship between the state and the oil and gas companies (explained in detail in Chapter 4) or of the significance of their actions in the implementation of Russian foreign energy objectives.

As suggested in sections 2.2.1., and 2.2.2., by adopting a conceptual framework informed by Neo-liberal ideas on the role of non-state actors in foreign policy conduct and the combination of

both politics and economics we can understand better the use of oil and gas companies in the formation of Russian foreign energy policy. Likewise when using a broader concept of security informed by Critical Security Studies we can have a more complete picture of Russia's security priorities in the Caspian region.

In the official rhetoric of the state energy is presented as a foreign policy tool in order to achieve great power status in the world energy markets and safeguard its national interests of developing its economy and improving the living conditions of the Russian population. With the active role of the state in the oil and gas sector and by assisting in the ascendancy of the Russian oil and gas companies both domestically and internationally Russia can pursue its economic policy with the objective of integrating the country in world energy markets through its companies. As Safaryan noted *'the only thing in order to achieve national interests in a foreign economy is to invest and to have national companies there and to have enough money, enough experience and enough technology and compete with other companies in the foreign markets'* [Safaryan, interview by author 18 April 2008].

The Caspian, which is pivotal to Russia's energy security because of its pipelines that give access to the European markets and its resources, not only of the Russian sector but also of the other Central Asian countries, is a great example where Russian foreign economic policy in the energy sector is demonstrated. As explained in more detail in Chapter 5 and 6, Russia tries to maintain its economic hegemony in the Caspian which would guarantee access to both the oil and gas resources of the other Central Asian states, as well as the use of the Russian oil and gas

pipeline network. Through legal and contractual monopolies the Russian oil and gas companies assist the Russian state towards this goal.

## **CHAPTER 4: State Business relations in the oil and gas sector**

### **4.1. Introduction**

Since the collapse of the Soviet Union state-business relations in the Russian oil and gas sectors have been subjected to the changes in the presidential administration and the different dynamics in the interaction and intermingling between the state and business elites. As discussed in sections 1.1.2.1., and 1.1.2.2., current literature on state-business relations is based on 2 points: The first is the distinction between the weak state under Yeltsin, which resulted in the capture of the state by business elites, and the strong state under Putin, which resulted into the business capture of the oil and gas sector by the state. The second is the reference to the Yukos case as the milestone event that radically changed the nature of state-business relations in the Russian oil and gas sector (Hanson 2005, 2007; Shleifer and Treisman 2005; Yakovlev 2006; Larsson 2006). The relationship between the oil and gas sector and the state is looked through connections that the oligarchs have with either the Yeltsin or the Putin administrations. Access to power is achieved through a web of interdependences between the state and the oligarchs including: financing political campaigns, regular meetings with the President, and personal connections between business people and decision makers (Schroder and Bell 1998; Fortescue 2006).

As discussed in section 2.3.1., despite the fact that current analysis on state-business relations mentions both the connection between the consolidation of the state and the consolidation of the oil and gas sector, and the Yukos case, which was pivotal in the state demonstrating its power

over the business sector, it fails to demonstrate how the state maintains its grip over the oil and gas sector. Likewise, in the literature where state-business relations are used to justify the use of Russian oil and gas companies as foreign policy tools in Russian foreign energy policy making, it has not been clarified how and why state interests and commercial interests are compromised (Kivinen 2007; Orttung 2008; Sakwa 2008; Hanson 2009).

As explained in section 2.3.1., the present author suggests that by looking at the mechanisms of the *inclusion* of state companies in and the *exclusion* of private companies from decision making, the state maintains its grip on the oil and gas sector and as a result is able to use its companies in its foreign energy policy making. The logic of the mechanisms of *inclusion* in and *exclusion* from decision making is based on the analytical framework of the second face of power by Bachrach and Baratz (1962). The present author argues that in current literature on state-business relations we see the first face of power of making and implementing decisions, which identifies the directly observable use of the state over the oil and gas sector (Lukes 1974). Although this approach correctly analyses the milestone events which have determined the relationship, it fails to explain how the Russian state maintains its grip over the oil and gas sector. Likewise, the accounts of the personal connections between business people and decision makers, although they show the informal links between the state and the oil and gas sector, they do not show how the state has secured its grip over the oil and gas sector officially.

By looking at the mechanisms of *inclusion* of state companies in and *exclusion* of private companies from decision making we can have a more complete picture of state-business relations in the Russian oil and gas sector. This Chapter looks at state-business relations in five



phases through the different Dumas from 1991 to 2008. It starts with background information on the oil and gas sector and then it analyses the relationship between the Russian state and the oil and gas companies from the state capture by business of the Yeltsin years to the gradual business capture of business by the state. It concludes that the parallel processes of the consolidation of the state and the consolidation of the energy sector resulted on the one hand in the rise of state companies and on the other hand the subjection of the private companies to the power of the state or the state companies. When this is viewed within the framework of Russian energy policy official priorities, as discussed in section 3.3.2., we can see that the state achieves two of its goals in relation to the oil and gas sector: the active involvement of the state in controlling the oil and gas sector and the rise of the state companies domestically with its assistance. This Chapter is mainly based on interviews with lobbyists, business elites and experts on Russian lobbying activities at the Duma in order to present an insider's view on the subject of the access of oil and gas companies to decision making.

## **4.2. Background to the creation of companies in the oil and gas sectors in Russia**

### **4.2.1. The case of the Gas Sector**

Under the Soviet Union the oil and gas sectors were under the state control. The gas sector was regulated by one ministry, the Ministry of Gas, while the oil sector was regulated by various ministries, like the Ministry of Oil or the Ministry of Geology. During the Gorbachev administration it was decided to turn them into vertically integrated companies. It was much

easier to turn the gas ministry into a vertically integrated joint stock company than to do the same in the oil sector. *'It was easier for Gazprom to restructure the industry because there were only three fields, three amalgamations, interconnected with each other and with one central pipeline'* [Kryukov, interview by author 25 September 2008].

But that is not to say that Gazprom was privatised as a single unit, as has been claimed in the past. *'The gas sector of the Russian economy has been formed not as a result of a single act of privatisation of the whole Soviet gas sector, but within the Gazprom framework. I mean that the gas segment of the economy has been integrated into Gazprom'* [Member of the Managers Board of a Russian Gas Company #1, interview by author 21 October 2008]. So at the same time as Gazprom was working on big gas fields, licences to exploit smaller fields were given to private companies and this is how small and medium companies in the gas sector were created. These companies became very quickly dependent on the rapidly expanding Gazprom because of the lack of capital in order to exploit fields or build or maintain pipelines. *'Small and medium size companies do not have the necessary capital to buy big fields. Of course it is necessary to find a niche for them and perhaps the solution would be to offer services for big oil and gas companies or to work on poor or low profitable fields'* [Yazev, interview by author 25 September 2008]. The services that these companies offer to Gazprom are connected to the main pipeline system. *'Around the strategic main pipelines there are networks of collateral pipelines that provide gas redistribution for regional and local needs. The pipelines of these redistributive networks are not completely in the ownership of Gazprom. Some of them are property of private gas companies. And this is how we understand services for small and medium size businesses in the gas sector'*

[Member of the Managers Board of a Russian Gas Company #1, interview by author 21 October 2008].

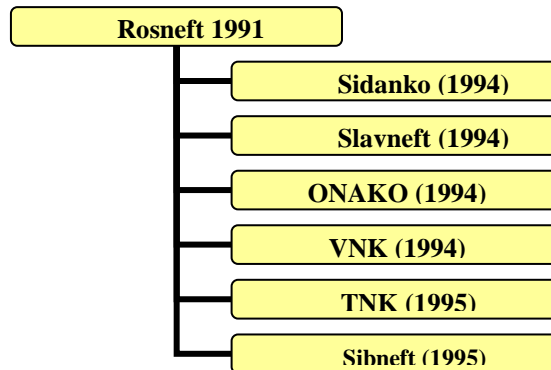
The hegemony of Gazprom in the gas sector suffocates small and medium private companies and in reality there are no gas companies in Russia today that are completely independent of Gazprom. *'Small and medium size companies do not survive in the gas sector'* [Novikov, interview by author 22 September 2008]. Even medium size companies like NOVATEK, ITERA and Sibur, were all forced to integrate to a degree with Gazprom. *'Itera is a company that has been closely affiliated with Gazprom. So the level of its independence is very small and very questionable and NOVATEK although it was really an independent company until 2003-2004 and then Gazprom took over. Now Gazprom possesses about 20% of its shares and in principle Gazprom controls the main activities of NOVATEK, and by that I mean the company's main strategic goals. NOVATEK gains from this relationship as it has certain guarantees from Gazprom'* [Member of the Managers Board of a Russian Gas Company #1, interview by author 21 October 2008].

The hegemonic position of Gazprom in the gas sector is in line with the policy goal of the state to control access and profits in the gas sector. *'If small and medium companies find capital and buy big fields, they will start developing into big companies. Why do we need this if we already have vertically integrated companies which everybody recognises? I believe that all preferences for small businesses should be based on rational estimations of their effectiveness for the national economy'* [Yazev, interview by author 25 September 2008]. Gazprom is the main muscle of the state in order to assert control over the gas sector. *'The state took control over the*

*gas sector and Gazprom is the main entrepreneur*' [Member of the Managers Board of a Russian Gas Company #1, interview by author 21 October 2008].

#### **4.2.2. The case of the Oil Sector**

Companies in the oil sector were created under completely different conditions. The process of creating both vertically integrated and small and medium companies was much more complicated than in the gas sector. This is because of two factors: the first was that the oil sector had been under many different Ministries in the Soviet Union and thus it was difficult to unite them and then divide them up again into joint ventures or vertically integrated companies. The second was the fact that oil production was geographically constrained as all of its different stages, from exploitation of the fields to the refineries, were linked to specific territories. Attempts to create vertically integrated companies started during the Gorbachev period but unlike with the example of Gazprom, they failed due to the specific peculiarities of the sector. During the early stages of the first Yeltsin administration, the first big vertically integrated companies were created, Lukoil, Yukos and Surgutneftegas. Rosneft at that time was not a vertically integrated company, but rather a collection of assets that were not integrated with the three companies. *'When the oil companies were created it was as if there was a big pie and everyone got a piece. The leftovers were left to Rosneft for future use'* [Subbotin, interview by author 29 April 2008]. Rosneft was divided further into more vertically integrated companies.



**Figure 4.1 Rosneft divided into vertically integrated companies**

Source: (Goldman 2008)

With the privatisation process under way in the 1990s, many small and medium size private companies were created as well. These companies faced the same problem as did the small and medium independent gas companies, lack of capital to buy and exploit big fields. Actually most of the time, small and medium oil companies were a façade for on the side activities of CEOs from big companies. *‘The role of these companies was pocket money for the various directors of industrial associations. They were never independent, they were just a window to have access to the West to allocate money and export products’* [Kryukov, interview by author 25 September 2008]. With the rise of Putin to power and the beginning of the state control over the oil sector the number of these small and medium private companies started decreasing, as did the number of the big oil companies. *‘At the beginning we had ten such companies [vertically integrated private oil companies] and now we have four or five. At the same time we can see a decrease in the number of small and medium size companies. Their share of production in the mid 1990s was*

*15% and now it is only 3%* [Kryukov, interview by author 25 September 2008]. The policy goal of the Putin administration for the oil sector was the same with that of the gas sector, state control and hegemony of the state companies in the oil sector. The rise of Rosneft in the second term of the Putin presidency and its hegemony over the private oil companies signified the capture of the oil sector by the state. The two different backgrounds in the oil and gas sectors formed the basis of the different kinds of relationship these two areas have with the state. The gas sector through Gazprom has been much more integrated within the state structures, while the oil sector through Rosneft and the big private companies, like Lukoil and Surgutneftegas, despite the obvious links to the upper echelons of the state hierarchy, has not been integrated as much into the lobbyist structures as traditionally the oil companies used to lobby on the individual level.

### **4.3. Access of the oil and gas companies to decision making at the Duma**

#### **4.3.1. The first Duma (1993-1995): State capture by the business**

The period from 1991 to 1996 saw the liberalisation of the Russian economy and its effects on the privatisation of big state companies, including those of oil and gas. The privatisation process brought about the rise of the business elites to power and their subsequent influence on state policies. 'In a sense, the state has been privatised by these nouveaux riches and thereby operates in the interests of its new owners rather than society at large. Consequently, it was not the consolidation of democracy that was the central focus of the political processes in Russia but the deformation of the presidential democracy legitimated by elections and the constitution by

incorporating commercial interests into the actions of the executive' (Schroder and Bell 1998:990).

Lobbying during the first Duma of the Russian Federation was multilevel. Despite the fact that under the first years of the Yeltsin administration the executive prevailed over the legislature and the basis for a strong presidency was put in place, there was a multiparty system and the legislature was independent from the executive, with the party of power being a minority inside the Duma. The Duma was the place where the main lobbying activities took place. As was discussed in section 4.2., the privatisation process was under way and as a result vertically integrated companies were created. Because of that companies were competing mainly about the privatisation auctions [Subbotin, interview by author 29 April 2008]. Both Russian private and state companies, as well as, Western companies were attempting to influence the state in order to get financial privileges. The business elites, both Russian and foreign, had access to every level of the state structure, from the President to the Duma, mainly through financing state or party activities through indirect bribes (Rutland 2009).

Inside the Duma, different parties supported different types of companies in the oil and gas sector. *'Oil and gas lobbyists were in every faction, every level and in every group at the Duma'* [Mahortov, interview by author 29 October 2008]. Generally, the main factions that supported the different oil companies were Yabloko, which was backing up foreign oil companies and SPS, which through its leader Chubais was representing Russian oil companies. State oil companies were represented by Rosneft and its network of lobbyists within the Duma, although the main competition was between Russian private and foreign companies, instead of state and private

Russian companies at that time, as obviously as explained in section 4.2.2. Rosneft was still in a very weak position in relation to the Russian private companies. *'The main competition at the Duma at that point was the fierce fight between Russian private and foreign companies on issues like for example Production Sharing Agreements [PSA]. Competition between state and private companies had not yet started'* [Mahortov, interview by author 29 October 2008]. In the gas sector Gazprom had the privilege of lobbying at different levels of the state structure and be protected from foreign companies from the beginning. *'Gazprom has always been a national value. It has always been a priority on both the legislature and executive levels. Even when Chubais [founder of the SPS] wanted to divide it up, the then Prime Minister Chernomyrdin protected it'* [Mahortov, interview by author 29 October 2008].

In all, due to the openness of the economy, the fact that both the state and market structures were developing and that the state was still weak, during the First Duma lobbying was possible and both Russian and foreign companies had access to the state. Lobbying was done at different levels as the legislature was still independent from the executive and the Duma had still power over decision making, and the business elites were from backgrounds, both exclusively business people and people with both political and economic power. Lobbying was different for the oil and gas sectors due to the different privatisation processes. In the oil sector foreign, Russian state and private companies had all access to the Duma, mainly over PSAs and acquisition of assets. In the gas sector Gazprom had access to all levels of power and was especially favoured by Viktor Chernomyrdin's long primeministership in the Yeltsin administration. During this period the foundations for the state capture by business were laid.



#### **4.3.2. The second Duma (1995-1999): The height of the capture of the state by business**

From 1996 to 2000, the power of the business elites was at its zenith. The key events that mark this period are the re-election of Yeltsin and the start of Putin's presidency. The re-election of Yeltsin is important as it was hugely based on the support of the business elites in the form that they had during the 1990s (Shleifer and Treisman 2005). The reason for doing so was because they were 'extremely interested in the protection of the existing political system, to which they owed their existence and their position' (Schroder and Bell 1998:990). Due to the backlash effect of the economic reforms and the first Chechen war, Yeltsin was due to lose the re-election, save by the fact that a huge negative campaign against his main opposition, the Communist Party, supported, in a big part, by the oligarchs through the use of mass media resources and a lot of funding, ended in victory for Yeltsin. Schroder and Bell (1998:970) argue that 'Yeltsin's success was certainly not based solely on the intervention of the financial groups, the federal executive and the regional leaders, the 'party of power', played an equally important role, but without the financial support of the financial groups and without the help of the media Yeltsin would have had significantly more serious problems in collecting the necessary votes at the first ballot'. This period was the height of the business elite's power as it has been the only time after the creation of the Russian Federation, until the present, that they have been able to influence directly the election of a President.

During this period in the oil sector there was the rapid and steady development of the Russian private companies, which were becoming stronger and stronger. There were two types of oligarchs created, the more aggressive towards the state, western style, self-made ones, like

Khodorkovskii and Abramovich, who controlled Yukos and Sibneft respectively, and the ex-bureaucrats, often called “Red directors”, who were very loyal to the government and followed the state line, like Alekperov and Shafranik, heading Lukoil and Surgutneftegas respectively (Hanson 2005).

Lobbying in the second Duma was done by the same people as in the first Duma, although lobbying activities increased with more oil lobbying groups created and more Duma deputies taking part in it. There were two ways for oil companies to lobby in the Second Duma: *‘the first one was to make agreements with existing Duma deputies that would agree to represent their interests and the second one was to push their own people in the Duma’* [Mahortov, interview by author 29 October 2008]. At this point the private Russian oil companies, mainly Yukos and Sibneft, were in a position of power in relation to the state, and they were able to influence both economic and political decisions. Furthermore despite the fact that foreign oil companies were still represented at the Duma level, by 1999 there was an understanding that *‘the interests of the Russian companies were higher than the interests of foreign companies’* [Mahortov, interview by author 29 October 2008].

As a whole, in the second Duma the dominance of business over the state was asserted. The state’s authority was quite weak and there were still enough state assets to be distributed among the business elites. Using the wealth that they accumulated during the economic reforms of the first Yeltsin administration, the oligarchs made up the power base of Yeltsin’s second administration, helping him to get re-elected by sponsoring his campaign and occupying positions in the higher echelons of the state. At the same time, the Duma continued to be

independent from the Presidency and to play an important role in policy making. The influence of the oligarchs inside the Duma grew as there were both more lobbyist groups for the oil sector and more Duma deputies willing to become lobbyists for the companies. The influence of the oligarchs over both the economic and the political spheres of Russia continued to increase into the Putin Presidency.

#### **4.3.3. The third Duma (1999-2003): The basis for the mechanisms of the inclusion of state companies in and the exclusion of private companies from decision making**

After the economic crash of 1998 and the end of Yeltsin's term, the momentum of the liberals was slowed down and consequently that of the business elite as well. The rise of Putin to power in 2000, and the infiltration of the *siloviki* into the political and business elites, introduced a new era in the relations between business and state. Hanson (2007:31) remarks that during this period 'there was an impressive series of liberal reforms, ranging from the firmer establishment of private ownership of land to cuts in business-tax rates and the introduction of a flat personal income tax'. Nonetheless, he adds that during the same period the process of introducing institutional developments towards "state-capitalism" started (Hanson 2007). Throughout the period between 2000 and 2003, the business elites seemed to still be openly influential, although to a lesser degree. Yakovlev (2006:20) comments on the period 2000-2002, 'in relations with big business the federal government declaring the principle of equidistance tried to avoid direct informal contacts with business tycoons', a fact that led to a greater use of lobbyist organisations by businesses for accessing decision making, like the RUIE or The All Russian Non-Governmental Organisation of Small and Medium Business (OPORA). He continues that: 'Nonetheless, the priority in this hierarchy was openly given to the upper "oligarchic" level

which was manifested in the newly established institution of regular meetings of President Putin and with members of the Bureau of Executive Board of the RUIE' (2006:20). The Yukos affair in 2003 is the key event which brings this period to an end. During the incident, the reaction of the business elites was numb, and even the RUIE only complained weakly (Hanson 2005). The aggressive manner in which the state took over Yukos and the official rhetoric on Putin's war on oligarchs created an image of an all-powerful state that controls the business elites (Address of the Federal Assembly to the Russian Federation 2005). In the aftermath of the affair, many business people left Russia or turned their interests in activities other than the production and transportation of oil and gas, like foreign direct investment [Elder, interview by author 21 April 2008].

The change of presidency brought about a transformation in the state and consequently business elites, as the *siloviki* were added to the old elites, as well as, a new factor in the political life of Russia, the creation of the new party of power, a reincarnation and continuation of the past parties of power, United Russia. Putin's main goal was to assert the hegemony of the state over both the political and economic spheres of Russia and as the oil prices started rising in 2001 and oil and gas became the basis for the building of the Russian economy, the state elites started trying to obtain power over the energy sector [Elder, interview by author 21 April 2008].

In 2000 Putin held a meeting at the Kremlin with 21 members of the state elites, mainly from the energy sector, in order to lay down the rules of the relationship between the state and the business community. Sakwa (2008:187) states that the goal of this meeting on the part of the state was to 'ensure that the business leaders did not gain the impression that they were equal

political interlocutors with the elected presidency'. The business elites on their part presented a three point declaration which stated that: 'first, the Kremlin must declare a moratorium on any investigations into the legitimacy of privatisation over the preceding decade and not initiate any redistribution of former state property; second, the business community must undertake to play by the rules, pay taxes and scrupulously obey the law; third, the government must rid itself of corrupt bureaucrats, while the business tycoons on their part must undertake not to use government institutions or bribe state officials to fight their competitors' (Sakwa 2008:187; see also Rutland 2009).

Nonetheless despite Putin's attempts to restrict the oligarchs, starting with Berezovskii and his media empire, or the oil barons, the oil companies proved to be too strong to submit to the state. *'During the third Duma the lobbying activities of the oil companies were colossal. Despite the harmonisation of the relationship between the executive and the legislature, the power of Yukos and Sibneft was growing at the Duma. Yukos was planning to 'buy' 2/3rds of the Duma in 2003. Up to 2003 Putin had no power over economic interests and no real possibilities to exert any'* [Mahortov, interview by author 29 October 2008].

The Yukos affair in 2003 marked the beginning of a new era where business was captured by the state. Actually, something that is very often left out is that the Yukos affair was a two-company capture by the state and not one. When the cherry picking process was under way, two western-style oligarchs were chosen to be made an example of, the head of Yukos, Khodorkovskii, and the head of Sibneft, Abramowitz. While Khodorkovskii refused to back down and cooperate with the Russian state, and consequently lost his company, went bankrupt and was put in jail,

Abramowitz went along and 'sold' his company but still retained his wealth and his political power, as he is still a governor [Independent analyst on the Caspian, interview by author 16 May 2008]. The Yukos-Sibneft affair marked the end of the oligarchs' power over the state and the beginning of the business capture by it.

Despite the fact that the imprisonment of Khodorkovskii was hailed as a success of Putin over the corrupted oligarchs and their consolidation with the state, in reality it was an exercise of hegemony on the part of the state elites over the business elites. This is evident in both the type of oligarchs that were selected and the alternatives that they were presented with. In the first case, the oligarchs that were cherry picked, were the ones belonging to the new western-style breed of businessmen who had acquired enough economic and political power to actually start influencing decision making. The main thing that separated Khodorkovskii and Abramowitz from Alekperov and Shafranik and was actually the crucial point in choosing them was the lack of loyalty to the state and the state elites' interests, like for example when Khodorkovskii wanted to build private oil pipelines for exporting oil, a service that was controlled and offered only by the state (Kivinen 2007). In the second case, the alternatives offered to them were two; siding with the state and losing only the company but not the personal wealth, or not conforming with the state and losing both the company and the personal wealth [Elder, interview by author 21 April 2008].

During the third Duma lobbying activities of the Russian oil private companies were massive and the oligarchs started influencing the majority inside the state Duma. Russian state companies in both the oil and gas sectors were represented, but in the case of the oil sector, the Russian private companies managed to secure greater advantages. Foreign companies were still represented, but

not as they used to be in the past. The Yukos-Sibneft affair in 2003 marked the end of the Russian private oil companies' rule over the state and asserted the hegemony of the state elites over the non-loyal-to-the-state business elites. The Third Duma was the last Duma in which lobbying activities took place. *'The last real big lobbying event was at the Third Duma when Dubov and his team introduced the flat taxation'<sup>13</sup>*, [Tolstikh, interview by author 29 October 2008].

#### **4.3.4. The fourth Duma (2003-2007): The mechanisms of inclusion and exclusion set in motion**

The period after the Yukos affair, between 2003 and 2008, was marked by an apparent business capture by the state, where companies, both state and private, have been seemingly used by the state in order to achieve its policy goals. Company policies seemed to have been driven by both economic and state national interests (Kivinen 2007). Putin's main goal was to reinstate the power of the state over every sector of the economic, political and social life of Russia [Elder, interview by author 21 April 2008]. His objective was not to create a monopoly of state power but hegemony, and that is exactly what has been, to a large extent, accomplished. Putin's so called consolidation of the oligarchs was a cherry-picking process that resulted in the consolidation of the business elites. As a consequence a new kind of oligarchs came to power, people with both political and economic power, in addition to the oligarchs of the 1990s who consented to the power of the state over them [Satarov, interview by author 15 April 2008]. The combination of high oil prices and the fact that oil and gas can be used as political tools, made the two sectors extremely attractive to the state elites for both the purposes of financial gain and for assertion of political power (Hanson 2009). The concentration of power in the two sectors

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<sup>13</sup> The flat taxation was a law put forward by Yabloko, which imposed 13% taxation on all Russian citizens regardless of their income. The law was in favour of big private businessmen.

whose structures and relations with the state do not resemble each other due to their different formation during the late Gorbachev and early Yeltsin periods (as discussed in section 4.2.) created two rival blocks in the energy sector that could be divided into the Gazprom block and the Rosneft block. Private oil and gas companies of any size are forced to ally with each block in order to gain protection from the other. Through this the hegemony of the state is maintained and reproduced as the state companies acquire the role of the state in controlling the oil and gas sectors.

From the second Putin administration onwards the hegemonic structure of the power vertical was firmly put in place. State-business relations in the oil and gas sectors were affected by that in two ways; firstly Russian state companies were included in decision making while private Russian and foreign oil companies were excluded from decision making. The consolidation of the legislature through the 37% plurality that United Russia secured in the 2003 elections restricted the lobbying activities of private Russian and foreign oil companies at the Duma level in favour of state Russian oil and gas companies. *‘The relations between state and private companies at the legislature level could not be called “cooperation” as the term implies that the partners are equal. The situation at the Fourth Duma was far from that. There was the “state mainstream” and when a law was under consideration the majority in the Duma [United Russia] made all the decisions, so when the interests of private companies were not restricted from the specific law, the private companies were lucky, but if they were restricted, they had to adjust to the law and tolerate it. It is possible to consider the relationship between state and private companies as that between a senior and a junior partner’* [Mahortov, interview by author 29 October 2008].



Both the concentration of power within the Presidency and the plurality of United Russia in the Duma meant that no effective decisions were made at the legislature level that had any real power in pushing for interests that were not in line with the ones in the Presidential administration. *'Companies still had a couple of their deputies in the Duma, Lukoil was keeping Prozorovskii in the Duma and Surgutneftegas Seleznev, but they were not able to lobby anymore. They just represented a company'* [Mahortov, interview by author 29 October 2008]. For foreign companies it was even worse; *'Since 2003 it has been impossible for foreign companies to lobby at the Duma level. TNK-BP, for example, despite the fact that it had been very well represented at all the previous three Dumas, in the Fourth Duma it was impossible for it to be represented as since 2003 it was not just a private oil company, but a foreign company'* [Mahortov, interview by author 29 October 2008].

The same happened at the presidential and governmental levels. At the presidential level private companies had to have access to Putin or his presidential administration where people who controlled state companies were members, like the head of Rosneft Sechin. At the governmental level lobbying was ineffective as under Putin all decisions were taken at the presidential level and consequently the Ministries became redundant. *'The Ministries and the Government were just nominal structures that played the role of technical services from initiatives that were coming from the above, from the Presidential administration. For example the Ministry of Industry and Trade was told that it was necessary to pass the law on gas export and of course the procedure is that the Ministry has to introduce the law at the Duma committees etc. The Ministry did the technical job but the main concept of the law came from the Presidential*

*administration*' [Mahortov, interview by author 29 October 2008]. These developments in the political sphere favoured the advancement of state companies in the oil and gas sectors.

**Table 4.1 Structure of oil industry ownership (1997-2005)**

<b>Year</b>	<b>Company name</b>	<b>Company acquired</b>
1997	BP	Sidanko
1997	Yukos	VNK
1997	TNK	Slavneft (50%)
2001	TNK	ONAKO
2002	Sibneft	Slavneft (50%)
2003	TNK-BP (50-50 partnership)	Sidanko, Slavneft (100%), ONAKO
2004	Rosneft	Yukos
2005	Gazprom	Sibneft (turned GazpromNeft)

Source: (Goldman 2008)

As shown in table 4.1 the dominance of private oil companies in the Russian oil sector in the late 1990s and up until the second Putin term was reversed in 2004 with the acquisition of Yukos by Rosneft. The Yukos and Sibneft takeover by state controlled companies signalled the reinstatement of state control in the Russian oil sector.

The need for private companies to work through these two blocks did not only come from the fact that it was only state companies that had access to the state, but also by the fact that it was only state companies that had access to big and profitable projects. *'When there is a project on the exploitation of a new field, like for example the new projects in East Siberia, it is natural for the state to favour state companies. The projects are divided between us [Rosneft] and Gazprom and then it is up to us to decide whether or not we would like to cooperate with any other Russian or foreign private company'* [O'Brien, interview by author 30 September 2008]. But the degree to which the relationship between state and private companies can actually be called

cooperation is debatable. *'When a state company starts developing or planning a project, or when a private company addresses a state company with an idea for a project and the state company finds the idea profitable, the private companies might latch on the state company. When private companies work with state companies they just follow orders. State companies never meet the wishes of private companies'* [Mahortov, interview by author 29 October 2008]. In this respect there is a visible shift from the state using state companies to control the oil and gas sectors, to the state companies becoming a muscle of the state, replacing the state structures in the management of the oil and gas sectors and still maintaining and reproducing state hegemony over private companies.

In total, during the Fourth Duma, the business capture by the state through the mechanisms of inclusion of the state companies in and exclusion of the private companies from decision making were put in place. The hegemonic structure of the power vertical in the political life of Russia was reflected in the energy sector in two ways; first with the rise of the state companies in a hegemonic role in the oil and gas sectors and second with the restricted access of Russian private and foreign companies to lobbying structures. The involvement of the state elites in the energy sector created two rival blocks between the older state company, Gazprom, which had been integrated into the state structures from the start, and Rosneft, which was created at a later stage and began questioning Gazprom's monopoly of power in both sectors. Lobbying at the Duma or the Ministerial level was restricted as the United Russia started controlling the Duma. Thus private companies started lobbying in the Duma through either Rosneft or Gazprom for both legislature initiatives and access to profitable fields. The hegemony established by the state

companies over the private ones created meant that the survival of private companies depended on the state ones.

#### **4.3.5. The fifth Duma (2007-2008<sup>14</sup>): The results of the mechanisms of inclusion and exclusion: Lobbying channels under the Medvedev administration**

##### **4.3.5.1. The oil sector**

In the fifth Duma there was not so much change in the structure of the hierarchical access that companies had to the state as there was in distribution of power within the state. In this sense the only real change that took place in state-business relations in the oil and gas sectors was that the balance of power shifted from the presidential administration to the government with the shift of the elites who control the energy sector from the presidential administration to the Putin government. *‘There are no people from the energy sector that work at the level of the presidential administration anymore’* [Mahortov, interview by author 29 October 2008].

The obvious example would be the head of Rosneft, Sechin, who was chief of the presidential administration under Putin’s presidency and then became first deputy prime minister for the energy sector under the Medvedev presidency and the Putin primeministership. In practice this means that for example the Ministry of Energy which under Sechin does not have more power in decision making, it became a lobbyist structure for the oil companies that are under the Rosneft block.

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<sup>14</sup> The fifth Duma is included in this thesis as in the first year of its function Putin was still in power. Nonetheless as this thesis looks at the period between 1991 and 2008, the information used in this section concerns the Duma up to November 2008 and covers the first months of the Medvedev administration.

The access of the oil sector to the state structures through lobbyist unions differs to that of the gas sector. The experience of the oil sector having been privatised during the 1990s and then recaptured by state-controlled companies during the 2000s led to a tradition of lobbying at the individual level. When the process of re-nationalisation started at the end of Putin's first term, specific lobbyist structures did not exist, so they had to lobby for themselves. *'Despite the fact that there are quite a few oil companies in Russia, we only have a few that are big ones, around five or six, and we directly work with these companies. There are no associations or unions that are real representatives of oil companies' interests and take part in the dialogue between the companies and the Ministry. Not even the Union of Oil Industrialists. There is RUIE, of course, but they represent business in general without taking into account the peculiarities of particular sectors of the economy'* [Peshkov, interview by author 23 October 2008].

Lobbying for big private oil companies is done either through the Gazprom or Rosneft blocks or through lobbyist structures built by the companies themselves. Lukoil for example, when it does not work through the state companies, pushes its interests through non-state structures or on the personal level with Putin. Lukoil does not have its people incorporated into state structures and apart from Prozorovskii, who had been an active lobbyist for Lukoil in the past Dumas, and is still there. *'Today the only purpose of Lukoil's lobbyists in the Duma is to maintain the properties of the company'* [Tolstikh, interview by author 29 October 2008]. The main lobbyists for the company are Alekperov and Fedun, the vice president of Lukoil. *'Alekperov, a former bureaucrat, having been a deputy Minister for the Gas Ministry of the USSR, is a very powerful lobbyist'* [Mahortov, interview by author 29 October 2008]. Apart from the private meetings with Putin, he is a member of Sechin's committee and the head of the RUIE Energy Committee.

*'RUIE's Energy Committee is full of Lukoil people and they push for the company's interests'* [Mahortov, interview by author 29 October 2008]. Here it must be noted that the fact that Alekperov used the Energy Committee of the RUIE in order to lobby, did not mean that the RUIE had considerable lobbying power in the energy sector but rather, that this committee gave Alekperov and his people another chance to lobby in person for Lukoil.

Lukoil has always been loyal to the state elites and it has been for a long time one of the most profitable companies in Russia. Its survival is guaranteed by three factors: the first one is that it is too expensive for the state companies to buy it, as they have quite a lot of external debts to pay off; second, that 20% of the company is owed by Conoco Philips, an American foreign company, which means that there would be an international scandal in case they tried to "integrate" it, and finally, the fact that it always works with both blocks. *'It is not easy to get LUKoil because if one side attempts to do it then the other side will protect the company. Alekperov balances between the two blocks'* [Mahortov, interview by author 29 October 2008]. Cooperation with state companies is pivotal to the survival of private companies like Lukoil. *'Lukoil was lobbying for its off-shore territories to get into the taxation free zone during the Fourth Duma. It managed to succeed because it went into a joint-stock agreement with Gazprom Neft. The new economic and political situation forces companies like Lukoil to share their profits or to put it more bluntly, they cooperate with Gazprom or Rosneft so that they can keep their profits'* [Tolstikh, interview by author 29 October 2008].

Small and medium oil companies are represented by the Association of Small and Midrange Oil and Gas companies (Assoneft), which was created in 2004, and is the only association which

unites small and medium independent<sup>15</sup> oil companies and represents them at the state level. Assoneft and therefore small and medium size oil companies have access to the state through the Committee on the Problems of the Fuel and Energy Complex and the Reproduction of the Mineral Resources Base, which is again headed by Sechin *‘Sechin is the person who takes most of the decisions on small and medium companies’ issues. This commission is created as a kind of a legitimate body for lobbying for these companies. Mega projects like the construction of the East-Siberia-Pacific Ocean pipeline or the redistribution of the biggest oil and gas fields between companies without competition are not the issue of this commission. Such issues are dealt with on the individual level, first with Putin and then with Sechin. It is fair to say that decisions are made between Putin and Sechin’* [Mahortov, interview by author 29 October 2008]. Actually Assoneft seems to be a very loyal supporter of the Rosneft through Sechin they have some access to the state and also can be protected from Gazprom. As the President of Assoneft stated: *‘We have many opportunities to lobby; we are members of the Sechin’s committee, we discuss our problems with the Ministry of Energy, Duma etc and we are very active with OPORA Rossii’*<sup>16</sup>, [Korzun, interview by author 29 October 2008].

Apart from Rosneft, the oil sector is also controlled by the state through Transneft. *‘In the oil sector the state regulates private companies’ activities through access to the transportation system, as the whole of the transportation infrastructure belongs to state companies Transneft and TransneftProdukt. The state decides on volumes from oil and gas transportation’* [Yazev, interview by author 25 September 2008].

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<sup>15</sup> The term ‘independent company’ was used by the President of Assoneft to refer to the fact that these companies that are members of Assoneft are not integrated into the structures of big oil companies.

<sup>16</sup> OPORA Rossii is the biggest association in Russia which represents small and medium size businesses. They cooperate with RSPP and within it they work on different issues that concern small and medium size businesses. At the moment they work with Assoneft within the RSPP framework on taxation.

Figure 4.2 is a diagram of the access channels that oil companies have to decision making in the Russian oil sector.

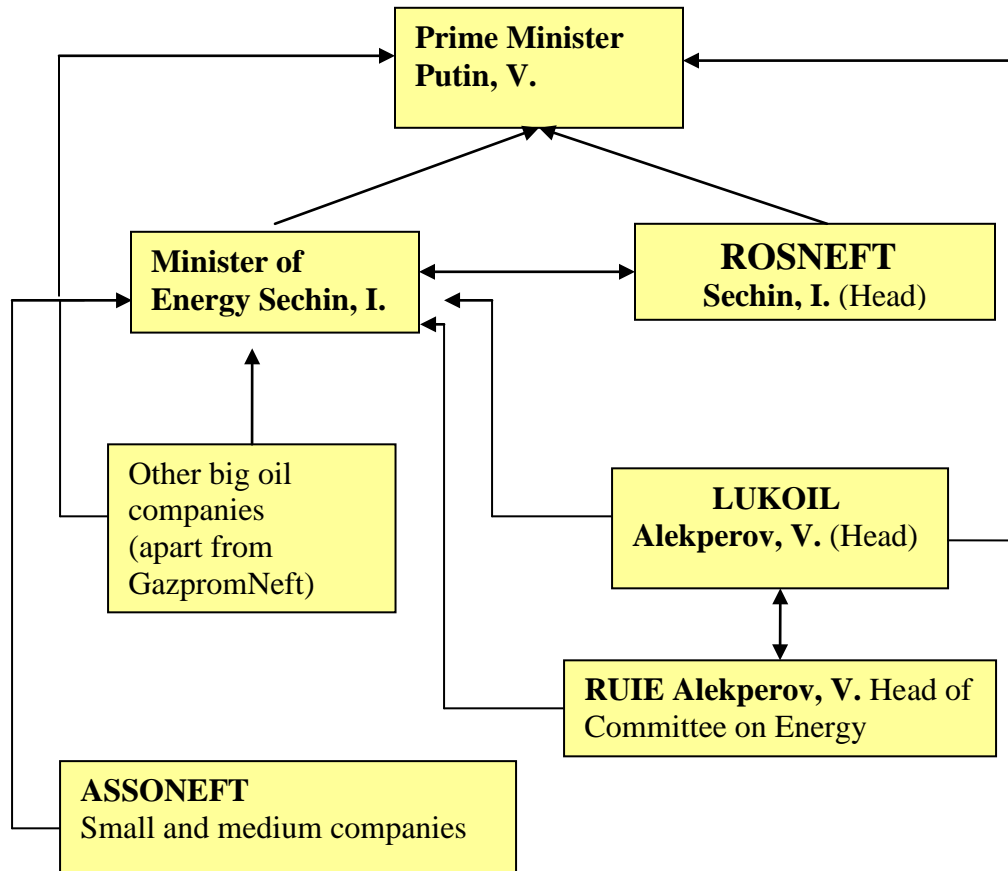


Figure 4.2 Access to decision making in the oil sector

#### 4.3.5.2. The gas sector

The situation in the gas sector is completely different. Gazprom does not just have hegemony in the gas sector, it rather dominates it. *'The state makes all the decisions in the gas sphere being the major shareholder of Gazprom, from the internal market prices to gas exports'* [Yazev, interview by author 25 September 2008]. Both small and medium size gas companies are



subjected to the state either through Gazprom being a shareholder in their companies or through the regulation of their access to pipelines or tariffs. *'If we consider the fuel and energy complex as a whole, it is still possible to enhance the state's presence, but if we just consider the gas sphere then we will see that state regulation in this sphere is massive, large-scale'* [Yazev, interview by author 25 September 2008].

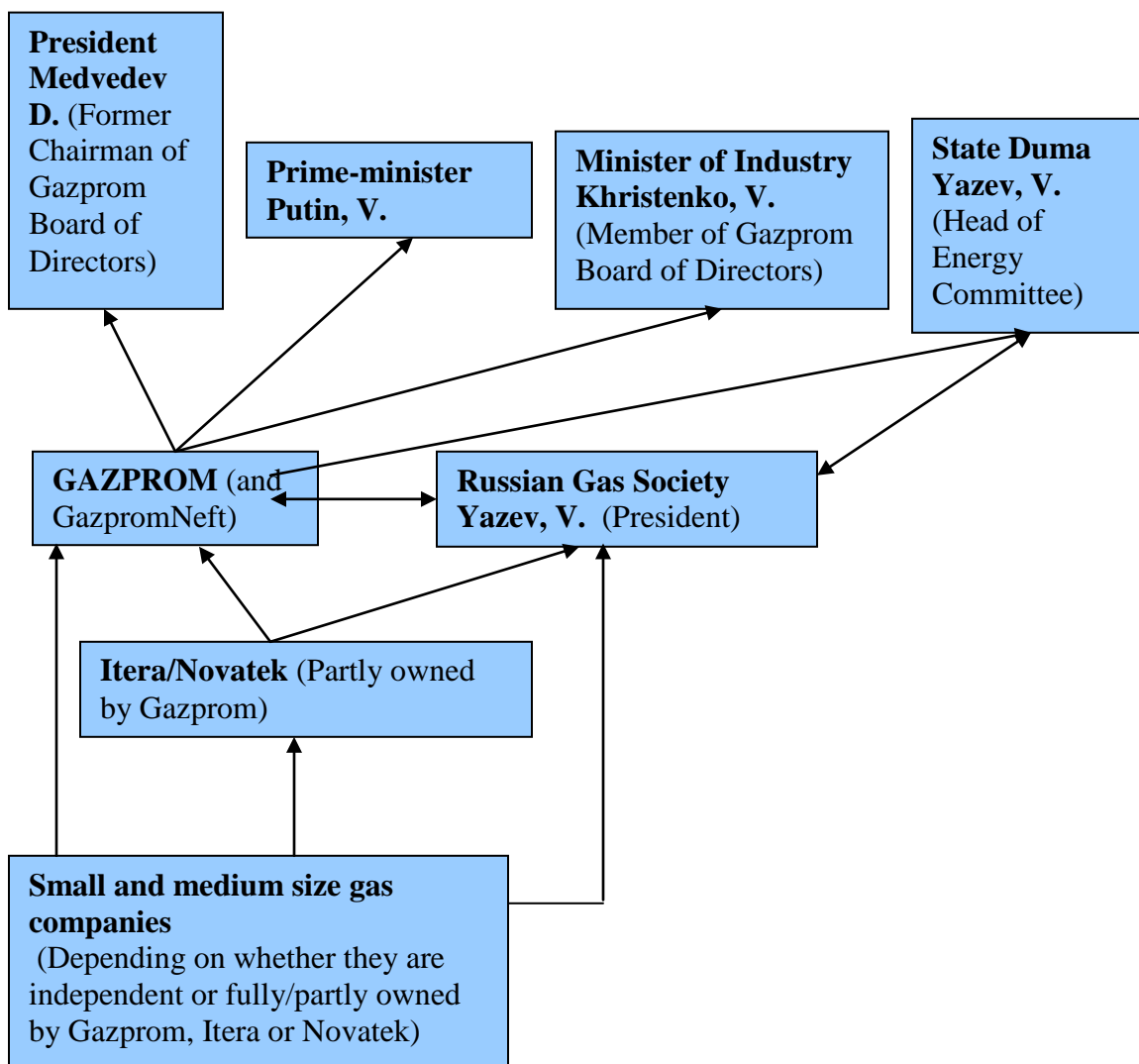
Gazprom's access to the state structures is phenomenal. Due to its long history of not only being a state controlled company, but also an extremely profitable one, a national asset as it supports the economy, as well as, one of the bastions of Russian energy politics and security, it has infiltrated all the state structures. *'Lobbying is done on all levels. Our President came from Gazprom and our Prime Minister has links with it too. There is a non-transparent story about black financial flows. Presidential campaigns are financed by Gazprom in our country. The Ministerial level is involved in lobbying too. Khristenko, for example, the Minister of Industry and Trade is affiliated with Gazprom too'* [Member of the Managers Board of a Russian Gas Company #2, interview by author 21 October 2008]. Another consequence of Gazprom's close relationship with the state is that in many ways its interests are identified with those of the state. *'Gazprom is not represented at the governmental level by an official lobby. There is a mass of people that support not Gazprom but its line. Gazprom is this super-structure that just does not need "official" representation anymore because it is the state itself or we could say that it has infiltrated every possible post in the state structure, thus it does not need anyone in particular. It represents the interests of too many people in the state hierarchy that it is to everybody's benefit for Gazprom to be a priority'* [Mahortov, interview by author 29 October 2008].

Apart from the obvious relationship between Gazprom and the Russian President or the Prime Minister and his government, including Ministries, the company has a very strong hold on the Duma. Despite the fact that it seems that Gazprom wouldn't really need anyone to lobby for it at any level lower than the primeministership, this lobbyist structures, remains from older Dumas, show the level to which Gazprom has infiltrated the state. *'Historically Gazprom people have been controlling two of the most important committees at the Duma connected to energy; the Committee of Natural Resources, where Natalya Komarova is the chair, and the Committee on Energy, where Yazev used to be the chair, and now is a member of'* [Tolstikh, interview by author 29 October 2008].

In addition to this, Gazprom lobbyists push for the company's interests at the Duma through the Russian Gas Society. The Russian Gas Society is the biggest gas association where Gazprom, private gas companies and oil companies that deal with gas are members. *'The Russian Gas Society is an active lobby structure that stands for the interests of Russian gas businesses in their dialogue with the government of the Russian Federation, as well as, at the international level'* [Yazev, interview by author 25 September 2008]. But as the Russian gas sector is subjected to the control of Gazprom, many experts view the Russian Gas Society with scepticism: *'The Russian Gas Society only creates a certain public image in the interests of Gazprom. In principle they try to take under consideration the interests of all gas companies but gain from Gazprom's point of view-First of all from Gazprom's point of view'* [Mahortov, interview by author 29 October 2008].

Gazprom's lobbying at the Duma level is very efficient and extremely effective. The President of the Russian Gas Society and main lobbyist for Gazprom, Yasev, was asked how lobbying was done at the Duma, he stated the following: *'There is a very big expert community in the Russian Gas Society. There are analytical departments in the organization which give recommendations to the government of the Russian Federation, in particular when it regards taxation, programmes of development etc. These recommendations influence political decision making. The analytical departments of the Russian Gas Society write draft laws and then I, being a Deputy at the State Duma, introduce these draft laws at the level of the State Duma. I am the author of the law on Gas Supply in the Russian Federation. This is the basic law which determines work and activities of the entire gas sector in the country. Also I am the author of the law on Natural Gas Export and the co-author of a several dozens of laws regarding the reform of electric energy, transport and communication systems, and in every law we participate, we push the position of the Russian Gas Society'* [Yasev, interview by author 25 September 2008].

Figure 4.3 shows the channels of access to decision making in the Russian gas sector.



**Figure 4.3 Access to decision making in the gas sector**

In all, in the Fifth Duma the same pattern in state business relations exists as in the Fourth Duma. The oil and gas sector is captured by state companies, thus by the state and more specifically by the state elites who are involved in the energy sector. The only real change in the Fifth Duma is that the centre of power has moved from the Presidency to the Primeministership with Medvedev as the President and Putin as the Prime Minister. Private companies have to lobby through these two blocks in order to be effective. The oil block has access to the state structures mostly through

personal networks, i.e. Sechin being the Deputy Prime Minister for Energy and the Head of Rosneft, thus turning all the structures that are under him, like for example the Ministry of Energy, into lobbying areas. On the other hand Gazprom has infiltrated the state structures and its powerful influence on decision making can be seen at all levels of the state, from the President to the Duma and unions on gas. Lobbying is to a large part institutionalised as it can be done mainly through people who are part of the state elites who are involved in the state energy sector. Lobbying outside the state structures is done informally through personal contacts with the state power, like in the case of Lukoil through its director Alekperov.

#### **4.4. Conclusions**

As discussed in section 3.3.2., two of the main objectives for achieving Russia's foreign energy goals are asserting control over its energy sector and assisting the state oil and gas companies in becoming dominant players both domestically and internationally. By looking at state-business relations in the oil and gas sector we can see how this goal is achieved. Nonetheless, while current literature on the relationship gives an accurate account of the business capture by the state, it fails to explain how the state maintains its tight grip over the sector at the official level. As a consequence in current literature looking at the links between the state and oil and gas companies in Russian foreign energy policy making, it is not clear why a company, especially a private one, would follow the state line instead of pursuing its own commercial interests.

In this Chapter it is suggested that by looking at the degree of access that oil and gas companies have to decision making we can obtain a more complete picture of state-business relations in the

Russian oil and gas sector. The current author suggests a framework of analysis based on the second face of power of Bachrach and Baratz (1962), which refers to the concept of non-decision making. This concept is based on the state using its power to restrict access of other players in politics to decision making. By looking at the mechanisms of inclusion of state companies in and the exclusion of private companies from decision making through the five Dumas we can observe the correlation between the consolidation of the state and the consolidation of the oil and gas sector. As a result we can understand better how the state promotes its state companies while capturing the private ones in the oil and gas sector through the five Dumas. As a consequence state companies become stronger while private companies become to a great extent depended on the state ones for their survival. The continuous grip of the state over the oil and gas companies makes it possible to use them in its foreign energy policy making.

Chapter 3 analyzes the economic priorities of Russian foreign energy policy in the Caspian. The means through which Russia's economic hegemony can be obtained in the region are control of the Russian state over the oil and gas sector domestically, the strengthening of the position of the Russian state oil and gas companies, both domestically and abroad, and the infiltration of Russia in the international energy markets through cooperation in the exploitation and transport of energy. This is done through the commercial activities of Russian oil and gas companies in the Caspian region. Chapter 4 demonstrates the assertion of state control over the energy sector, which has two results related to its energy policy priorities: the strengthening of the state oil and gas companies and the capture of the private ones. This Chapter is the final part of the analysis on Russian foreign energy policy priorities in the Caspian region. It links the official economic priorities of the state in the energy sector with the actions taken at the official level in order to

implement them. After defining the capture of the state over the oil and gas companies, Chapter 5 and 6 will demonstrate how Russian oil and gas companies are used in the implementation of Russian foreign energy policy in the Caspian, i.e. the infiltration of the regional energy markets, through their commercial operations.

## CHAPTER 5: Russian Foreign Gas Policy in the Caspian

### 5.1. Introduction

As discussed in Chapter 3 the Russian state's priorities in the area of the Caspian are a mixture of economic and political issues within the security mindset of the foreign policy framework, which in the case of Russian foreign energy policy are closely linked. The economic priorities of the Russian state in its energy policy conduct in the area are linked to the use of its companies in order to infiltrate the energy sectors of the Central Asian states. Russia's objectives in the Caspian region in the gas sphere are principally to control gas production and gas transportation, mainly to European markets, where Russia's energy priorities and goals are firmly established, but also to Asia, which is a relatively recent market for Caspian/Central Asian gas<sup>17</sup>. By achieving this goal, the Russian state accomplishes part of its target of being an influential player in the global energy market.

Attainment of these objectives leads to two desirable gas policy goals, which Russia has in the region and which are both financial and political, and in essence, mutually reciprocal; the first is for Gazprom and thus as a consequence for the Russian state to maintain its economic hegemony

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<sup>17</sup> Due to the specific physical restrictions that apply to the gas industry, i.e. the need to build pipelines in order to carry gas to the consumers, it is quite expensive to sustain two geographically different markets. When Russia, then the USSR, made the strategic decision to supply Europe with gas from the Caspian region the Asian market automatically became secondary to its energy policy priorities. Asia became a new target for Russian foreign energy policy recently, mainly for the gas produced in the gas fields of Siberia. The Asian markets from the Caspian region might be an indirect target for Gazprom through shares in and joint ventures with companies working in other Central Asian gas producing states, which supply the Asian market.



in the Caspian region. This ensures that Russia will continue to obtain maximum profits from all forms of gas sales and transportation as competition for the European market from other gas producing countries will be kept to a minimum.

The second goal is the use of this economic power over Central Asia in order to preserve and extend the already existent politico-economic leverage that Russia has over these countries and consequently use it when desirable and possible in order to achieve its energy policy goals there. As a consequence, Russia is, on the one hand, able to have maximum profit from both its own gas resources and those of other Caspian littoral states' and to have a share in any new activities which the Caspian states might be involved in outside the traditional gas projects shared with Russia. In this way, Russia tries to deal with the unavoidable fact that its monopoly on the transportation and export of gas from Central Asia to the European markets is going to end sooner or later.

The mutual reciprocity of these two goals lies in the continuous cycle between political power supporting economic power and vice versa, economic power reinforcing political power, which is the result of the adoption of a more economic approach in Russian foreign energy policy. In the gas sphere the interplay between the state and business is more direct and effective than in the oil sector. As discussed in section 4.2.1., Gazprom controls both the production in major gas fields and the majority of gas transportation inside Russia and most importantly has a legal monopoly on the main export routes to Europe for Central Asian gas; a privilege which Russia inherited through Gazprom from the USSR and the Unified Gas Transportation System. Equally, by having the state backing up its expansion both domestically and abroad, Gazprom gains from

having special privileges when it comes to acquiring shares or participating in big projects in the region (Vahtra 2007).

The objective of this chapter is to demonstrate how Gazprom fits into Russian foreign gas policy in the Caspian and the policy repercussions of Gazprom's commercial activities for achieving Russian foreign energy policy objectives in the area. It will look into the actual processes of Russian foreign energy policy making in Central Asia and how Russia's political and economic hegemony is aided by both legal and contractual monopolies, which Gazprom manages to win through its commercial activities with the backing of the Russian state.

## **5.2. Russian Foreign Gas Policy in the Caspian**

As was discussed in chapter 3, the use of energy as a driver of Russian foreign policy in the Caspian is partly linked to the use of economic means in obtaining access to international energy markets through cooperation on the exploitation and transport of Central Asian oil and gas resources. This is accomplished through the commercial activities of Russian companies abroad. In the case of the gas sector this is done through Gazprom. Security, for Russia, in the gas arena in this respect goes beyond the typical business concepts of meeting production quota and guaranteeing the safe transportation and delivery of the hydrocarbon. It involves concepts such as securing Russia's national interests, both domestically, for example raising the living

standards of the Russian population, and internationally, for example paying back the national debt and playing an important role in world affairs as an energy superpower<sup>18</sup>.

### **5.2.1 Gas and foreign policy in the USSR**

In the Soviet period, energy policy was not viewed in the same way as it is today. There are however certain shared characteristics, such as the obvious link at the elite level as Gazprom was back then the USSR Gas Industry Ministry<sup>19</sup>, i.e. the state itself, and the fact that gas was used for both commercial gains and security reasons. Domestically one of the objectives of selling gas was initially to subsidise domestic gas markets, covering the needs of the USSR as part of the ‘requirements’ of the Soviet regime, as well as being part of the financial measures in favour of Moscow and at the expense of the Soviet Republics in relation to the exploitation of gas resources<sup>20</sup>. Likewise, an early form of foreign energy policy from the 1940s onwards included subsidised gas being sold to Eastern Europe, a practice which by definition constituted a dependency of the periphery of the Soviet bloc on the centre, i.e. the USSR itself. In this case the objectives of selling gas were much more security/policy oriented than commercial. From 1968 onwards there was an opening of gas sales from the USSR to the Western European countries, mainly Germany through a contract with Austria’s OMV and Italy through ENI (<http://eng.gazpromquestions.ru/?id=4#c320>).

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<sup>18</sup> See chapter 3. Also there are many official documents where these ideas are developed. Apart from the National Security Concept other documents that could be cited are the Annual Addresses to the Federation Council especially from Putin’s second term as the Russian President and of course the Munich Speech.

<sup>19</sup> Initially the Natural Gas Production Head Department was set up as part of the Ministry of Oil Industry in 1948, as the first state gas producing organization. In 1956 it was reorganized into the Head Department of the Gas Industry at the Council of Ministries of the USSR and in 1963 the State Production Committee of the Gas Industry of the USSR was established. The Ministry for the Gas Industry was established in 1965 ([www.gazprom.com](http://www.gazprom.com)).

<sup>20</sup> Apart from the gas resources which were located on Russian soil, the rest of the gas rich Soviet republics had minimal or no power over having an input into the energy policy of the USSR’s Ministry for the Gas Industry.

There are some obvious differences between the Soviet and post-Soviet era, which influenced the formation of the Russian gas policy area both domestically and internationally. The first is the different politico-economic system and the second is the different foreign policy orientation of the USSR. The centralisation of the political and economic power under the Soviet regime meant that the state controlled the whole gas sector through the Soviet Ministry for the Gas Industry [Kryukov, interview by author 25 September 2008]. In this respect we cannot yet talk about business capture by the state as the state was the only investor and developer of business in the USSR. The people who were taking the decisions on the formation of gas policy were the same who were running the industry through the ministry, and of course the decisions were made based on meeting the quota set by the government rather than on meeting market demands. Perhaps in this respect we can speak about identification between the state and business rather than capture, as the commercial part of the equation was to a large extent missing and gas was mainly used to sustain and reinforce the Soviet regime.

In the sphere of foreign energy policy despite the fact that gas was used as a leverage to keep the Soviet bloc under the power of the USSR by imposing a monopoly of gas supplies and thus creating dependency on its resources, it was neither the pillar nor the main objective of Soviet foreign policy (Lavigne 1983). In a way it is evident in the fact that there is no mention or concept of 'Russian foreign energy policy' in official Soviet documents. The very strong zero sum military oriented foreign policy mindset of the bipolar world overshadowed softer types of power like energy. It also has to be kept in mind that especially in the case of gas because of the fact that its transportation is restricted by geography it was probably difficult to envisage it as a

strong foreign policy tool, particularly if one considered the size of the reserves that were known and exploited at that time and the priority of the gas sector to cover the needs of the Soviet bloc in subsidised prices in line with the soviet doctrine of self-sufficiency and energy independence.

Before the 1940s, oil and coal were the main energy fuels that were used in the USSR. Gas was found in the oil wells but was not exploited for mass consumption. In 1943, the first Soviet gas pipeline of 160 kilometres was commissioned between Bouguruslan and Kuibyshev and in 1946 the commission of the 843 kilometres long pipeline between Saratov and Moscow began the era of 'large gas' for the USSR. More pipelines were built and during the same period the development of Central Asian gas fields started, which was followed by the construction of the Central Asia Centre Pipeline In the 1960s, the 'Siberian period' began with the development of gas fields in Western Siberia. This shift actually caused a backlash in the gas sector as exploitation in Siberia was too costly because of the specific working conditions there and also because of the lack of new technology, as was mentioned previously, to exploit the fields. By 1986, the 160,000 km United Gas Transmission system was in place and the gas transportation system started operating ([www.gazprom.com](http://www.gazprom.com)).

The Soviet investment strategy over-emphasising heavy industry and the imposition of high output targets in the domestic sphere in combination with the 'arms race' in foreign policy from the 1960s onwards resulted in a decrease in the growth rate, investment and research and development in the non-military sector. The energy sphere, which was the priority sector of civilian industry, suffered from inadequate industrial support which in return affected its production rates. The gas sector especially did not just suffer from a lack of exploitation of new

fields but also from an outdated natural gas transportation system, which needed maintenance and upgrade (Allen 2001).

An indicator of the size of the gas sector of the USSR can be found in the statistical data from the Energy Information Administration where for the year with the most gas production for the Soviet Union, 1990, 28.8 trillion cubic feet per year of natural gas were produced, 78% of which was produced in the Russian Republic, which would be around 22.4 tcf/yr, as opposed to 23.1 tcf/yr being produced in Russia in 2007 and the 31.1 tcf/yr which is the estimated production for 2020 (www.eia.gov). There are two conclusions that can be drawn here; the first is that the main gas fields that were used in the USSR are the same that are used today by Russia, i.e. Western Siberia, which as it was discussed in chapter 3, is one of the indicators of lack of investment by Gazprom in the gas sector and is closely connected to the dependency of Russia on Central Asian gas to fulfil Gazprom's contracts. The second is that the volume of natural gas that was used in order to cover the energy needs of the USSR, plus some of Eastern and Western Europe's after the collapse of the USSR became available for sale at market prices abroad.

### **5.2.2. Gas and foreign policy under Yeltsin**

With the fall of communism and the creation of the newly independent states the task for Russia regarding foreign energy policy in the Caspian was to both convert a part of its domestic economy into a part of the international environment of the region and to protect its economic and energy security interests. Before the collapse of the USSR, the Caspian gas resources were controlled by the USSR and Iran, about 80% and 20% respectively. That meant that all the

resources of the CIS gas producing Central Asian states, Turkmenistan, Uzbekistan, Kazakhstan and Azerbaijan, plus its own resources were controlled from the same centre. As it was mentioned previously the Soviet Ministry of Gas was responsible for the exploitation, production, transportation and sale of Central Asian gas to Europe from the 1940s.

In the last years of the Soviet Union, with the Perestroika economic reforms the Soviet Ministry for the Gas Industry became the basis for the state gas concern Gazprom. In 1993, it was reorganised into the Russian joint stock company Gazprom RAO and in 1998 it was renamed Gazprom Open Stock Company ([www.gazprom.com](http://www.gazprom.com)).

In 1992, the first attempts were made to formulate an official national energy policy for the newly founded state of the Russian Federation. The idea was approved by the government in the same year and the Interagency Commission was established in order to work on the 'Main Directions of Energy Policy and Restructuring of the Fuel and Energy Industry of the Russian Federation for the Period up to the Year 2010'. This document formed the basis for the first post-Soviet national energy strategy, which was approved by Presidential decree as the 'Main provisions for the Energy Strategy of the Russian Federation' in October 1995. The current Russian Energy Strategy up to 2020 and the future Energy Strategy up to 2030 are based on this earlier document.

Under Yeltsin, the objectives of Russian foreign energy policy became much more commercial than in the USSR. Of course the element of security was still present in the logic of energy policy making but, especially in the gas sector, it was linked to security but referred to the

restructuring of the economy, as there was a transition from the communist regime to capitalist economy, and security of supply in the domestic market, where the prices continue to be subsidised until 2011. The gas sector would become the main source of capital in order to help the Russian state through its transition from the communist regime to a capitalist economy. According to the 1995 energy policy up to 2010 the priorities in the energy sector were: ‘the stable guarantee of the country’s energy distribution, the increase in the use of fuel-energy resources and the creation of the necessary conditions in order to carry the economy of the country down the path of the development of energy saving, the creation of a reliable raw base and security of the stable development of the fuel-energy complex formulated in respect to the market conditions, maintenance of the export potential of the fuel-energy complex and the expansion of the export of its production, the maintenance of energy independence and provision of the security of the Russian Federation’ (Energy Strategy up to 2010).

From the official Energy Strategy up to 2010 there are two trends that are distinct; the first being that the energy sector and especially gas would play a major role domestically. The major goal of the energy strategy lies in: ‘securing the most effective use of the energy resources of the country and of the production potential for the improvement of living standards and the national socio-economic revival. Other key targets include; securing uninterrupted supply of energy supplies, better security of energy supplies in the common domestic sector, greater protection of the environment and safe uninterrupted energy independence of Russia [...] Success in attaining these goals will depend on the success of restructuring the energy sector in the course of the next 10 to 15 years. In accordance with this strategy, the structure of the restructuring of the energy economy will be based on the best or more effective use of gas, oil and the increase in the



production of light oil products, exploring more centres of oil production like Eastern Siberia, which is a key area, stabilising oil production' (Energy Strategy up to 2010).

And the second trend was that there were some suggestions towards a more active role for Gazprom in the foreign markets: 'The potential of entering foreign markets should be examined' (Energy Strategy up to 2010). In any case, Gazprom was still not viewed as a foreign policy tool in the same way as under Putin. However, gas cuts in the former Soviet space under Yeltsin were not a new thing, especially during his early years towards the 'Near Abroad', though they were limited and occurred rarely. In 1991, soon after Lithuania gained independence, Russia ceased energy deliveries. In 1993, Russia cut 25% of Ukraine's gas supply officially due to non-payments but coincidentally one week before important talks were to be held over nuclear weapons and the Black Sea Fleet, and again in 1995 in order to threaten Ukraine into joining the CIS. In 1998, Russia threatened to cut gas supplies to Moldova over issues with Transnistria (Fredholm 2005). There is no mention of either the Russian sector in the Caspian or Central Asian gas in general. The areas which were deemed important were East and West Siberia.

Nonetheless, as discussed in section 3.2.1., when looking at the Yeltsin administration and foreign policy making it should be taken into consideration that Russian politics were in a general state of chaos in the sense of having to go through a complete restructuring of both its political regime and its economy. As it was discussed in chapter 3 the consequences of the domestic situation on foreign policy formation, especially in the former Soviet Union, were felt even more strongly as under the USSR there was a plethora of different ministries and

committees dealing with other Soviet republics - a task which after the collapse of the USSR became officially the sole responsibility of the Ministry of Foreign Affairs (Fredholm 2005).

In the case of the Caspian region, matters were even more complicated for several reasons. The first was that an economic issue, i.e. energy, entered in the equation of foreign policy making. The second was that because of the importance of the pipeline network that now had to be 'protected' from threats ranging from terrorist attacks to other states building alternative pipelines, the Caspian became a state security priority (Lynch 2003; Johnson 2004; Libman 2007). And the third was that now the state had to collaborate with a commercial entity in the sphere of foreign policy making.

In this sense it would be easy to assume that if one spoke of an identification between the state and the gas sector instead of a capture during the USSR, they would continue to do so in the Yeltsin period too because of Gazprom's background and because of its close relations with the government through the then Prime Minister Viktor Chernomyrdin, who was also the founder of Gazprom. As discussed in section 4.2.1., in the sphere of gas it is still difficult to speak of state capture by business even during the Yeltsin years. That is because gas has always been a strategic resource for Russia and Gazprom has always maintained the transportation system, which by definition is a state monopoly, so its relations with the state have always been very close, as opposed to the oil sector. It seemed more that during that time Gazprom was struggling not to be divided into different departments - an idea which was pushed for by different elites and which was fought by Chernomyrdin [Independent analyst on the Caspian, interview by author 16 May 2008].

With regards to Russian foreign energy policy in the gas sphere there were different views associated with the separate elites also. Two prominent perspectives were to either be in favour of opening up to foreign investment or be in favour of a more conservative, security oriented policy with the objective being to keep foreign direct investment away from the Caspian region and keep Central Asian countries from making such deals, to maintain control over gas exports to Europe and also control over Central Asia in general (Bowker 1997; Goetz 1997; Trenin 2001).

A good example is the secret directive ‘On protecting the interests of the Russian Federation in the Caspian Sea’ which Yeltsin reportedly signed in July 1994 encouraged by former Foreign Minister Kozyrev and foreign intelligence service director Primakov. The directive called for Russia to maintain its sphere of influence in the Caspian by preventing foreign investment in the CIS. The directive was opposed by Chernomyrdin. This example demonstrates the confusion in Russian foreign energy policy under Yeltsin, how military and security oriented in the cold war way policy was and the weakness of Gazprom to defend its interests (Fredholm 2005).

### **5.2.3. Gas and foreign policy under Putin**

Putin’s rise to power coincided with an increase in oil and gas prices. According to many analysts this was the main incentive behind the shift in Russian foreign policy from military to energy oriented (Fredholm 2005; Kivinen 2007). As discussed in chapter 3, the link between Russian foreign policy and energy can be found in every important official document. The gas

sector plays a pivotal role in foreign policy making as it is the basis for Russia's aspirations to become an international energy power and guarantee the security of supplies both internally and externally. 'Gazprom plays a special role in the broadening sphere of influence of the Russian capital and the Russian state. The monopoly on the transit of gas through Russian territory constitutes a direct lever of Russian power in the international arena' (Centre for Political Information 2008:4; also see Oldberg 2005).

As discussed in 4.2.1., it is difficult to speak of business capture by the state or vice versa in the gas sector as it always had strong links with the state due to being a natural monopoly. But what was extremely evident during both the Yeltsin and Putin administrations was the power struggle at the elite level over the gains from the gas sector. The virtual drainage of Gazprom's resources and profits in order to sustain the Soviet and later Russian economies, in addition to providing subsidised energy security to the Soviet bloc and later to the CIS, topped with attempts to divide the company up into different departments had weakened Gazprom considerably by the end of the 1990s [Independent analyst on the Caspian, interview by author 16 May 2008]. The 1998 crisis worsened the situation further and during the first years of the Putin administration there were serious discussions over merging Gazprom with Rosneft and thus creating a state controlled energy sector covering both oil and gas, as in the case of Kazakhstan's KazMunaiGaz, proposed by the then Minister of Economic Development and Trade German Gref [Independent analyst on the Caspian, interview by author 16 May 2008].

With the appointment of Aleksei Miller as the head of Gazprom, Putin put an end to the speculations and re-asserted the state's direct control over Gazprom. Putin pointed out that

Gazprom was an important strategic resource and should not be divided. At the 10<sup>th</sup> anniversary of the founding of Gazprom in his reception speech he underlined that ‘Gazprom, as a strategically important company, should be kept, as a single body [...] Gazprom is a powerful political and economic lever of influence over the rest of the world’ (Fredholm 2005:19).

As discussed in Chapter 4, the ‘harmonisation’ between the interests of the state and those of the gas industry was reinforced by the instalment of the power vertical in the political life of Russia, which helped the Putin administration capture both political and economic sphere. Following the strategy of acquiring assets, Gazprom has obtained most of the Russian companies operating in the Caspian region, starting with Abramovich’s Sibneft and Gas and Surgutneftegas. Apart from the obvious increase in market capital for Gazprom, the Russian state earns additional revenues from taxation and greater control over the energy sector: ‘The leading position of Gazprom in the foreign policy of the Kremlin depends on its dominant role in the Russian economy’ (Centre for Political Information 2008:5).

In Russian foreign policy Gazprom is used not only as a muscle of the state, in a sense continuing the legacy of the Soviet Gas Ministry, especially in the CIS [Elder, interview by author 21 April 2008]. This, though, does not imply that Gazprom is under the control of the Ministry of Foreign Affairs. ‘*The Ministry of Foreign Affairs has no authority over the energy sector in the Caspian or anywhere else*’ [Peshkov, interview by author 23 October 2008]. Neither does the Ministry of Energy, ‘*The Ministry of Energy has no dealings with Gazprom*’ [Pleshin, interview by author 23 October 2008].

As explained in chapter 4, the tone of the legacies of the Putin administration, especially after 2003, was that many state structures became redundant because of the direct control that the Kremlin exerted on strategic sectors, of which the gas sector was one. *'State corporations in Russia are not accountable to anyone. Even the former leadership of United Russia admitted that. In the recent congress of United Russia, Boris Gruzlov, the chair of the party, said that one of the most important tasks should be to change the situation and to force state corporations to become accountable to at least one body. It was a big demonstration of bravery on the part of Gruzlov as Putin's personal friends are the heads of all state corporations'* [Subbotin, interview by author 29 April 2008].

Speaking of Gazprom as an entity separate from the state is impossible. *'The state regulates taxation, the state determines export tariffs, the state approves programmes for the development of the gas branch at the meetings of the government. The state approves investment programmes. The state makes all the decisions in the gas sphere being the major shareholder of Gazprom, including exports'* [Yasev, interview by author 25 September 2008]. By controlling effectively only one company gives control over the most profitable areas of the gas sector. In essence, when we are looking at the Russian foreign gas sector we are looking at Gazprom's external policy.

In this respect, as discussed in section 3.3.2., under Putin the use of energy as an influential driver in Russian policy has added new actors to the foreign policy making environment. As discussed in Chapter 4, both state and private companies, which have been brought under state control since 2003, mostly through state companies acquiring shares in the private sector or the

state providing the legal framework in order to restrict private companies' access to highly profitable projects unless they would participate in joint ventures with state companies, have at times acted as a muscle for the Russian state in foreign policy. *'The state works in the Caspian region both directly and indirectly, through companies'* [Yasev, interview by author 25 September 2008].

The importance of the Caspian to the Russian energy sector in general and the gas sector more specifically has always been highlighted when it came to the use of Central Asian resources and the imperative to continue using the Central Asian Centre pipeline for its transportation to the European markets: *'The Caspian zone is very important both in terms of its resources and as a transit region. Very important. Currently we have been working on the development of the most effective transportation system in the Caspian zone. We are working on the system of transportation both from the Caspian region and Central Asia. There is investment in the Caspian region and there are big plans for future investment there. Gazprom is very active in the region'* [Yasev, interview by author 25 September 2008].

This coincides with Gazprom's strategic plans to focus on exports as they are much more profitable than the domestic market where the company obviously is expected to subsidise gas prices for domestic consumption for at least several more years. The significance of having access to Central Asian resources is reflected in Gazprom's strategy: 'as the groundwork for sustainable gas supply in the future, Gazprom is looking to tap into new fields in Yamal and the offshore fields in the Barents and Kara Seas. All these areas have exceptionally challenging climatic and geological conditions. Gas will cost much more to extract there compared to other

regions. Meanwhile, Gazprom is keen to use the huge gas resources of Central Asia to optimise its gas supply for export. In 2006, Gazprom transited around 56.8 bcm of gas originating in Central Asia and Kazakhstan' (IEA 2008:16).

The importance of utilising Central Asian gas has changed over the years due to the variability of gas prices. In the past, Russia used to buy Central Asian gas at very low prices and then sell it to Europe at market prices. This practice had two purposes; the first was to fill in the gap of gas deficiency which Gazprom had been experiencing since 2006 and thus fulfil Gazprom's obligations towards its customers. As discussed in chapter 3, the fact that Gazprom has arguably not been concentrating on the development of new gas fields but rather on the diversification of its business into the banking sector, media etc. Many attribute the decrease in gas production to this very fact '*Gazprom's production is stagnating and that is what alarms the experts, because Gazprom is investing in business that is not directly linked to gas development and gas production*' [Sourzhenko, interview by author 29 April 2008]. Consequently, gas from Central Asia became even more important to Gazprom in order to keep delivering the agreed volumes of natural gas to its customers: '*Gazprom needs Central Asian gas. The production is declining and they have all these projects lined up but having reserves and having production are two different things. So they are relying in the short-term on Central Asian gas to fill this production gap, which is growing*' [Independent analyst on the Caspian, interview by author 16 May 2008].

The second purpose was to make profit from resource rent. Up until 2008, Gazprom could buy gas at prices that were much lower than those in the market. It could buy 1,000 cubic of natural gas for about \$50 and re-export it to Europe for \$250. The construction or threat of construction



of other alternative routes, like the Nabucco corridor, bypassing Russia, were used as leverage by Central Asian countries in order to increase the selling price of their natural gas to Russia; a strategy that was relatively successful. This is an example of the new approach that Russia is taking in regards to foreign energy policy in the Caspian. There seems to be a realisation that the monopoly of Russian export routes has come to an end - an inevitability since the Central Asian states gained their independence. Russia needed to adjust to the new reality and also take specific steps in order to assure that at least it keeps its economic hegemony in the area. This is done through the infiltration of Gazprom into the economies of the gas producing Central Asian countries in both the gas sector and other industries.

Finally, achieving economic hegemony in Central Asia, maintaining control over the pipeline network and utilising Central Asian gas are linked to the broader idea of the Russian state aiming to become an energy superpower in the sphere of oil and gas. The following quote was taken from the official magazine of the Russian Gas Society, which, as described in chapter 4, is a lobbyist for Gazprom, and thus echoes both the importance of Central Asia for Russia's global energy plans, but also the compliance of Gazprom in materialising them; 'Having regained control over energy policy, the Kremlin commenced devising strategies of further power projection. Russia is home to 27% of the known global gas reserves, Turkmenistan and Uzbekistan own 10% each [...] Russia can realise its ambition of becoming an energy superpower only in concert with Kazakhstan and Turkmenistan, the other two post-Soviet states that are strongly abundant in raw materials' (Rahr 2009:18-19).

### **5.3. Gazprom's part in Russia's policy in the Caspian**

Russian monopoly in the gas sector in the Caspian is translated into Gazprom's monopoly on exports from all the littoral states to the European markets. The situation might though be temporary as Russia is in a position to control the exports at the moment, but that does not mean that it will continue to do so for ever. The littoral states of the Caspian are independent states, which means that they can in theory pursue their own energy policies and choose whether or not they want to cooperate with Russia, whether or not they would like to attract foreign investment and whether or not they would like to build their own pipelines. The realisation of this fact brought a shift in Russia's foreign gas policy in the Caspian. In the past, Russia was trying to use the dependence of the mostly landlocked Central Asian countries on the Soviet export system in order to intimidate them into not joining mainly European Union (EU) and USA initiatives for alternative route projects, which would bypass Russian territory, namely the trans-Caspian pipeline (known also as the Nabucco project), but also to try to pre-empt these plans with the launch of new and expensive projects like the South Gas corridor. In the second term of the Putin administration, and within the Energy Policy framework economic priorities (as discussed in section 3.2.2.), Russian foreign gas policy in the Caspian started focusing on infiltrating regional gas markets through the commercial activities of Gazprom. As is analysed below, through the legal and illegal monopolies of Gazprom the Russian state manages to deter the threat of Nabucco, at least for the time being, infiltrate the Central Asian gas sectors and thus strengthen its grip on the region.

### **5.3.1 The legal monopoly of Gazprom**

The means by which the littoral Caspian states are subjected to the Russian state at the moment are various. First of all, there is the issue of the pipeline network. One of the particularities that go with the transportation of natural gas is that it needs to be done through pipelines. The liquefied version of natural gas (LNG) can be transferred by other means like any other liquid, but at the moment the littoral states lack the money and the technology to process their natural gas in order to get LNG. The network was built during the Soviet era and it connected the Central Asian countries with Russia and from there to Europe. Today the Central Asia Gas Centre is the main pipeline by which gas can actually be transferred into the European markets. The pipeline network used to be controlled by the Soviet Ministry for Gas but after the dissolution of the USSR and the emergence of the independent states in the area, the main export pipeline is controlled by Gazprom as it is the heir to the Soviet Ministry for Gas and is the only company that has enough capital to maintain the network. Peripheral pipelines of smaller capacity and connected to the main pipeline network were controlled by the other littoral states, at least until the second half of the Putin administration, when some states sold their operational rights to Gazprom (as discussed in section 5.3.2.).



**Map 5.1 Central Asia Gas Centre pipeline**

Source: Gazprom

The so-called ‘transit weapon’ has been used by Russia throughout the 1990s and is still in use today, though reinforced by contractual monopolies, which Gazprom holds throughout Central Asia. The use of Gazprom as an effective foreign policy tool in the economic sphere has proved effective in the realisation of Russia’s commercial and security goals in Central Asia; to keep control of the transit routes to Europe of the Central Asian resources by pre-empting any new routes bypassing its territory being built (Nygren 2007).

Gazprom’s legal monopoly in the Caspian is translated into a monopoly on export pipelines to the West. All the Caspian littoral states are dependent for exports, for the time being, on the old

soviet pipeline system, which runs to the north through Russia and from there to the west into Europe. The main Soviet era Caspian gas export route is called the Central Asia Centre pipeline, which goes from Turkmenistan through Uzbekistan into Kazakhstan and on to Russia. This is the only export route for gas to the European markets for the above mentioned countries. Inside Russia, Gazprom owns and operates the Unified Gas Supply System which is a 15.000 km integrated network of pipelines and branches commencing from western Siberia and stretching to the western borders of Russia. The 2006 law 'On Export of Gas' gives Gazprom the unique right to control all gas exports from Russian soil to the European markets [Yasev, interview by author 25 September 2008].

Kazakhstan has always been a close ally of Russia despite the fact that it has welcomed foreign direct investment in its energy sector since the mid-1990s, mostly in relation to oil. Kazakhstan tried to use its wealth of resources in order to both strengthen its position internationally and regionally. Unfortunately for Kazakhstan, its continuous dependence on Russian transit routes for reaching European markets meant that it could not compete with Russia when it came to regional hegemony. Kazakhstan's gas comes almost exclusively from associated gas in oil production. Much of its gas is re-injected in order to enhance oil output (IEA 2008:11). As a result, according to the Energy Information Administration, Kazakhstan produces as much gas as it consumes (<http://www.eia.doe.gov/emeu/cabs/Kazakhstan/NaturalGas.htm>). The fact that during the Soviet era Kazakhstan, which lacked its own economically viable gas resources, was viewed by Moscow as merely a transit route for Uzbek and Turkmen gas, meant that the gas pipelines were built accordingly from the west Kazakh oil fields to Russia and from there to Europe. As a collateral result the domestic gas distribution network was underdeveloped too,

especially in the south of Kazakhstan, where people depended on Uzbek gas supplies (Yenikeyeff 2008:3). In this respect, Kazakhstan lacks infrastructure both domestically and externally and is therefore dependent on Russia.



**Map 5.2 Kazakhstan's gas pipeline routes**

Source: Kazakhstan Ministry of Energy (cited in EIA)

The case of Turkmenistan proved to be the most important as it is the country with the most promising gas reserves in the area, and thus the key country for Russia to control. According to an independent analyst, the only other export route from Turkmenistan that has been built during the 1990s, supplies gas to Northern Iran, but that pipeline has 'no political significance' as for access to the lucrative European market Turkmenistan is bound to the Central Asia Centre pipeline [Independent analyst on the Caspian, interview by author 16 May 2008]. Turkmenistan has kept a neutral relationship with Russia. In general, it had remained closed to foreign direct investment opening up until the death of President Niyazov in 2006 due to political and

economic issues. Nonetheless as Turkmenistan is landlocked and thus dependent on the Russian transit routes for its natural gas exports inevitably a relationship with Russia was maintained. In 1999, Turkmenistan signed an agreement to supply significant amounts of gas via Russia.

Finally, Uzbekistan never really opened up to foreign investment due to its autocratic regime and its economic backwardness. Uzbekistan's relations with Russia during the 1990s were turbulent, but since the installation of the Putin administration there has been reconciliation between the two sides. In 2002, there were discussions on Russian investments in Uzbek oil and gas deposits resulting in a ten-year supply contract of Uzbek gas to Russia.

Nonetheless, there were attempts mainly by the EU and the US to diversify gas exports to Europe through channels which would not go through Russia. The trans-Caspian pipeline (Nabucco) was the most threatening project to Russian monopoly, and the Central Asian countries, especially Turkmenistan, showed a keen interest in it mainly because they wanted to have a lever against Russia in order to achieve higher gas prices and better deals, as was proven later. Attempts by Russia to react to this project by building the South Stream were only partially successful. Russia finally regained control over Central Asian gas in the later years of the Putin administration through Gazprom's contracts with the gas producing states.

### **5.3.2. The Contractual Monopolies of Gazprom and Monopsony**

The Russian state through Gazprom managed to tighten its grip on the Central Asian economies in three ways: Gazprom acquiring rights and assets in the Central Asian countries' gas sectors;

making deals to buy almost all of the gas output for export that these countries produce annually, i.e. production sharing agreements and gas export pipeline control; and finally and most importantly through the signing of a trilateral agreement among all the gas producing states to update the Central Asian Gas Centre and use it exclusively for gas exports, as well as to build a new Trans-Caspian pipeline. In this way Central Asian gas was guaranteed to transit the Russian pipeline network.

#### **5.3.2.1. Acquiring assets in the gas sector**

In 2000 and 2001, Gazprom was invited by Kazakhstan to take charge of the Kazakh distribution network and be part of the joint venture in gas exploitation and transportation and in 2006, Gazprom further agreed to develop the Kyrmangazy and the Kvalinsky three oil and gas fields on a 50/50 basis (Nygren 2007:11). KazTransGaz, a wholly owned KazMunaiGaz subsidiary, which makes a substantial part of its income from the transit fees of gas from Turkmenistan to Russia has to negotiate these revenues annually principally with Gazprom, which controls the gas from the time of purchase at the Turkmen boarder (Olcott 2007:15). In addition, Gazprom is the main partner to Intergas Central Asia responsible for 88% of the revenues from the Kazakh gas transportation company. Part of the deal other than the transition of Turkmen and Uzbek gas via the Central Asia Centre and the Bukhara-Urals gas pipelines, is to supply the north-western part of Kazakhstan with Russian gas (Yenikeyeff 2008:38). In table 6.1 we can see the volume of gas imports to Russia by Central Asian countries. Gas exports from Turkmenistan and Uzbekistan to Russia go through Kazakhstan to the Central Asia Centre pipeline.



**Table 5.1 Turkmen and Uzbek gas exports to Russia through Kazakhstan**

	<b>Year</b>	2005	2006	2007	2008	2009
<b>Exports to Russia by country in billion cubic metres per year</b>	Turkmenistan	3.8 bcm/y	41.0 bcm/y	42.6 bcm/y	42.3 bcm/y	11.8 bcm/y
	Uzbekistan	8.2 bcm/y	9.3 bcm/y	9.6 bcm/y	14.2 bcm/y	15.4 bcm/y

Source: Gazprom

In 2001, Turkmenistan suspended its gas supplies to Russia due to a failure to agree on a better gas price. In 2003, after Putin made some major concessions regarding visa issues between Russia and Turkmenistan, Gazprom signed a strategic agreement according to which Turkmenistan would supply Russia with gas for the next 25 years (Nygren 2007:12). Following massive disruptions in the Uzbek-Turkmen gas export route, in 2003 and 2004 Uzbekistan signed a 15-year production sharing agreement with Gazprom on gas extraction in the Shakhpakhty gas field and a 35-year agreement with LUKoil to develop the Kandym gas field. Gazprom later announced future investment of 1 billion US dollars in the Uzbek gas sector (Nygren 2007:12). On September 26 2005, President Karimov held talks with Gazprom's Alexei Miller over Gazprom's interest in 'privatising' the export pipelines in Uzbekistan including the Uzbek pipelines branches connecting to the Central Asia Centre pipeline (Socor 2005).

Table 5.2 shows the assets that Gazprom has acquired in other Central Asian gas sectors.

**Table 5.2 Gazprom assets in Central Asian gas producing countries in the gas sector (2007)**

<b>Country Activity</b>	<b>Company Agreements</b>	<b>JV/PSA</b>	<b>Transits/Supply</b>
Kazakhstan	KazMunaiGaz	Founding of ZAO KazRosGaz a 50/50 joint venture to market Kazakh gas internationally.	Medium-term transportation contracts for Russian and Central Asian natural gas through Kazakhstan from 2006-2010.
Turkmenistan	Turkmenneftegaz	Upstream joint ventures or PSA agreements on geological assessment.	A 25 year gas supply agreement from 2004 to 2028.
Uzbekistan	Uzbekneftegaz	In 2004, a 15 million US dollar PSA agreement was signed delivering 5 bcm of Uzbek gas annually to Russia.  Under a different PSA agreement, Gazprom is rehabilitating gas production.  In December 2006, the two parties agreed to do a feasibility study and production sharing agreement on fields in the Ustyurt region.	2003 Agreement to long-term purchases of Uzbek gas from 2003 to 2012.  September 2005 Agreement with Uztransgaz to transport gas through Uzbekistan from 2006 to 2010 via CAC and Bukara-Ural gas pipelines.

Source: (IEA 2008:17)

### **5.3.2.2. Contractual monopsony**

In Gazprom's 2007 annual report it is stated that Russia imported 8.5 billion cubic metres from Kazakhstan and exported 10 billion cubic metres, i.e. Russia is a net exporter to Kazakhstan. Uzbekistan produced in 2007 65.3 billion cubic metres of gas of which it consumed internally 50.6 billion cubic metres. Of the 14.7 bcm that remained for export, 10.5 bcm went to Russia (IEA 2008:10).

Even in the difficult case of Turkmenistan where the government does not disclose the exact amount of gas, Gazprom still managed to capture its gas sector. 'While Turkmenistan's offshore gas reserves are entirely unexplored those onshore are incompletely explored and the actual size of the explored and still recoverable is a matter of debate' (Socor 2005:24). Turkmenistan produced for the year 2007 72.3 bcm of gas of which it consumed internally 18.0 bcm of the 54.3 bcm of gas for export, 48.1 bcm went to Russia (EIA 2008:10). But even if Turkmenistan starts producing more or less gas, Gazprom is still certain to acquire all of its gas. According to Socor (2005:24) in the long term supply agreement signed between Gazprom and Turkmenistan, Gazprom deliberately used the term 'maximalist' volumes of gas. 'This procedure appears designed to pre-empt all of Turkmenistan's available gas export volumes for Russia. Even without holding Ashgabat legally viable to deliver those 'maximalist' volumes, it could prevent Turkmenistan from selling its gas to other countries unless and only until it fully meets its commitments to Russia'.

In essence, the bulk of all gas from the Central Asian gas exporting countries goes exclusively to Russia. Table 2 shows how much gas Central Asian countries export and how much is bought by Gazprom.

**Table 5.3 Gazprom’s contractual near-monopsony (2008)**

<b>Country</b>	<b>Production in billion of cubic metres annually</b>	<b>Domestic Consumption</b>	<b>Export to Russia</b>
Kazakhstan	12.9 bcm/y	10.6 bcm/y	8.5 bcm/y
Turkmenistan	72.3 bcm/y	18.0 bcm/y	48.1 bcm/y
Uzbekistan	65.3 bcm/y	50.6 bcm/y	10.5 bcm/y

Source: (IEA 2008:17)

### **5.3.3. The case of Azerbaijan**

Azerbaijan is looked into separately as it has been the only country in the Caspian that did not have import/export deals in the gas sector with Russia up until very recently. Azerbaijan produced 11 billion cubic metres of gas in 2007, thus becoming a net exporter of gas for the first time. Its gas fields are situated on the offshore fields operated by SOCAR, the national energy company. Nonetheless, according to official statistics, Azerbaijan is still a relatively small natural gas producer as its domestic consumption is 9.3 billion cubic meters, leaving only 1.7 billion cubic meters for export (IEA, 2008:10). The fact that Azerbaijan could not repeat its resource energy boom of the 1990s due to disappointing geological surveys and the problems caused by the unresolved Caspian legal status dispute have prevented any serious foreign direct

investment and expansion of its fields. BP has been its first and is still the only dominant investor in Azerbaijan operating all the major post-soviet projects (Damjan and Stone, 2010:49).

In 2008, Gazprom offered to buy all of Azerbaijan's gas at European prices. In June 2009, Gazprom and SOCAR signed a deal giving priority to Gazprom for Azeri gas, which was previously reserved for the Nabucco pipeline. As a matter of fact, the second phase of exploitation of Azerbaijan's Shah Deniz field was key to the operation of the Nabucco pipeline. Under the deal, Gazprom will buy 500 million cubic metres of gas from SOCAR in 2010. After the signing, Alexei Miler commented that 'all things being equal among potential buyers, priority will be given to Gazprom [...] other buyers would have to offer conditions that are more financially attractive' (Antonova 2009).

#### **5.3.4. Trilateral agreement on the use of the Central Asian Gas Centre and the construction of a Trans-Caspian pipeline**

On May 12, the Presidents of Russia, Kazakhstan and Turkmenistan signed a trilateral agreement, which was previously signed by the Uzbek President, on the 'reconstruction of the Caspian pipeline so that the pipeline will be able to pump no less than 10.5 billion cubic metres of gas and agreed on constructing a new pipeline system that will coexist with the trans-Caspian pipeline system'. Part of the agreement was also the expansion of the Central Asia Gas Centre towards Uzbekistan (<http://www.Kremlin.ru>). The pre-Caspian gas pipeline is 'targeted at transporting natural gas from fields in the Caspian Sea and other locations in Turkmenistan and the Republic of Kazakhstan to the Russian Federation' ([www.gazprom.com](http://www.gazprom.com)). The expansion of

the Central Asia Gas Centre to Uzbekistan serves to connect the gas flows of the country through Turkmenistan, Kazakhstan and on to Russia.

The significance of the signing of this agreement in practice is twofold; firstly the interdependence among the Central Asian countries in gas exports will increase, as well as, the control of Gazprom over them through a now unified system, where Gazprom holds the bulk of control through the contractual monopolies gaining both commercially and security wise. Secondly, Russia makes sure that foreign 'unwanted' interference is not only prevented, as the Central Asian countries are bound by contract to fulfil their obligations first and foremost to Russia and then to anyone else, but eliminated as well, as with the case of Nabucco.

When President Berdymukhammedov was asked about whether or not the Nabucco project was still on the agenda at the press conference following the trilateral meeting of the Presidents of Russia, Kazakhstan and Turkmenistan, where the agreement was signed he said that, 'it is not removed from the agenda' (<http://www.kremlin.ru>). Nonetheless some weeks after the agreement in June 02, 2007 the president of Kazakhstan stated that, 'There have been no concrete statements regarding the Trans-Caspian project so far [...]. In keeping with that declaration, the construction of a Caspian gas pipeline is in question now, and Kazakhstan is a transit country in this agreement [...]. This is purely a pragmatic approach. All arrangements with Russia have reached a level that is beneficial for us to move in this direction' (ITAR-TASS Daily 2007). After the signing of the trilateral deal, the launching of the Nabucco gas pipeline has been postponed until 2012-2013 (ITAR-TASS Daily 2008).

#### **5.4. Benefits for the Central Asian States**

The harsh reality for Central Asian states is that they cannot themselves control the exploitation of their own resources. This is due to many reasons including the fact that they are geographically landlocked, that lack of financial resources to fund exploitation projects would mean a dependency on a richer more powerful country, be it Russia, China, the US or a European country, and that the transportation of natural gas requires the physical presence of a pipeline network and that requires heavy investment. In any case there are some strong arguments as to why Central Asian countries prefer, even when they are given limited choices, to side with Russia. The first and most practical is that it is still cheaper to export through the Russian system than to build a completely new infrastructure (Fredholm 2005:15).

The second reason is linked to the elites ruling the Central Asian countries. Domjan and Stone (2010:36) comparing resource nationalism in Russia and Kazakhstan remarked that one of the differences between Russia and Kazakhstan, and it could very well be true about even harsher regimes than the Kazakh one in Central Asia, was how economic growth from energy resources was used by the political elites in the two countries; 'While both countries have employed state-centric models for economic development in their natural resource sectors during the period 2004-2008, the Russian variant tends to focus on power and prestige by way of economic growth, whereas the Kazakh variant focuses on economic growth and development as a basis for strengthening the political legitimacy of the ruling elite'.

Central Asian countries' elites seem to equate security with stability and stability with the survival of their regimes. The fact that it is taken for granted that no country will interfere in the domestic affairs of another and thus respect its 'sovereignty' gives a strong incentive to these countries to choose Russia as their partner, especially after their main problem with the gas prices has been solved. 'The ill-defined concept of 'sovereign democracy' has taken firm root in Central Asia. The region's authoritarian leaders appreciate the way Russia rebuffs Western criticism over democratic credentials and take it as an example not to give in to Western pressure' (Boonstra 2008:71).

And last, but not least, and connected to the previous point, is that they get the chance to participate in potentially powerful collective organisations like a Central Asian gas cartel. One of Putin's early strategies was the attempt to establish a gas cartel in Central Asia including Kazakhstan, Uzbekistan and Turkmenistan with the main purpose being the exclusive use of the Central Asian Centre for the transportation of gas to the European markets (Nygren 2007:9). Despite the fact that this has been achieved through the trilateral agreement on a common gas transit route among the states, the idea has not been abandoned and there is some evidence that the Medvedev administration will resume the attempts to create one. Regarding the Central Asian states, being a member of an organisation that could potentially influence gas prices would give them credibility domestically and will enhance their position in their respective countries.



## 5.5. Conclusions

As discussed in section 3.2.2., Russian foreign energy policy priorities in the Caspian include infiltration in the regional energy markets through the use of its oil and gas companies. In the gas sphere Gazprom through a web of legal and contractual monopolies assists the Russian state in maintaining its economic hegemony in the Caspian region and Central Asia.

In the USSR, foreign policy was heavily military and security oriented. In this policy making environment the gas sector in the Caspian was used in order to sustain the Soviet regime, with subsidised gas flows to the USSR and the Soviet bloc. During that period there was identification between the state and the gas sector as it was officially part of the Soviet government operated by the Soviet Ministry for the Gas Industry.

Under Yeltsin, Russian foreign energy policy in the Caspian became more commercial but it was still conducted through the security framework and as part of a foreign policy which was still heavily military based. The focus though this time was different. Maintaining control over the 'near abroad' through subsidised gas prices and a monopoly on export routes to Europe served both the priorities of the state in maintaining its sphere of influence but also the use of the revenues from selling gas to Europe in order to restructure the economy. The chaos in both domestic and external politics and the competition between the elites under the Yeltsin administration were reflected in the poor management of Gazprom both inside and outside

Russia, which left the company weak financially by the end of the 1990s. Unlike the oil sector, which at that time was full of private companies that had assumed enough power to control the state, Gazprom being a state company with all the additional financial burdens of having to subsidise gas consumption inside Russia, sustain the state budget and contribute towards the development of other sectors of the economy, was more under the power of the state than actually commanding policy.

Under Putin, priorities in Russian foreign policy making changed drastically as energy became a driver of foreign policy conduct in the Caspian. As discussed in Chapter 3, within the Energy Framework main goal of becoming an energy superpower, Russia's economic priorities in the region include: maintenance of the Russian monopoly on export routes to Europe and control over the resources of Central Asian countries. Gazprom is an integral part of Russian foreign energy policy in the Caspian in this respect as it manages to capture the Central Asian gas sector through legal and contractual monopolies.

After initial attempts to force Central Asian countries to both sell their gas to Gazprom at low prices and continue to use the Russian pipeline system, the Russian state realised that its monopoly in the area was seriously threatened. Different alternative routes and foreign direct investment offered to the newly independent states worked as a lever against the demands of Moscow. Gazprom has been appropriately used as a foreign policy tool, infiltrating the Central Asian gas markets with the backing of the Russian state and creating contractual monopolies in order to reinforce the legal monopoly it has on the export of gas to European markets. Gazprom, by taking part in the development and transportation in the gas sectors of the Central Asian

countries and by buying all of the gas produced there, secures the flow of Central Asian gas through the Russian pipeline system and ensures, to a great extent, the failure of any other party that would wish to buy gas from Central Asia. Likewise, the Russian state with the trilateral agreement on gas transits of Central Asian gas flows, made sure that competing projects like the Nabucco pipeline were made redundant.

The inability of the Central Asian states to control or own means of transportation for their natural gas puts them in the very peculiar position of both being dependent on Russia physically for the transportation of gas but also of the fact that they cannot become a regional energy power shaping policy despite the fact that they have abundant resources. This realisation on the part of the Central Asian states, plus the concessions on the Russian side to pay for gas at market prices and the fact that energy security and economic growth are closely linked to state security, which reinforces and preserves their regimes, have pushed them into siding with Russia instead of opting for a western partner.

In conclusion, Gazprom is a very useful foreign policy tool in the hands of the Russian state in the Caspian region. The Russian state gains geopolitical influence in Central Asia and economic gains from the revenues through taxation, plus it gets to maintain its economic hegemony in the region. This way it achieves its foreign energy policy goal of being an influential player in the gas market. This Chapter presented the case of the gas sector. Chapter 6 will demonstrate how Russia uses its oil companies in achieving its foreign energy goals in the Caspian oil sector.

## **CHAPTER 6: Russian foreign oil policy in the Caspian**

### **6.1. Introduction**

Russia's foreign energy policy goals within the Energy Framework, as explained in Chapter 3, in the Caspian oil sector are two-fold; to protect Transneft's monopoly and ensure Novorossiysk continues to function as the main export facility for Caspian Sea oil, or at least to benefit from any pipeline project which bypasses Russian territory; and to take part in the exploitation and production of oil in the rich oil fields mainly of Kazakhstan and to a lesser degree of Azerbaijan, in essence to retain its economic hegemony in the region through controlling or dominating the resources and transportation of the oil coming from the Caspian littoral states. (For the major oil pipeline export routes and export ports to Europe see map 3.1 on page 97)

Controlling oil transportation in the Caspian brings three main benefits for Russia; the first is the advantage of choosing the market where the oil is going to be sold. This is important for two reasons. Firstly, it enables them to choose the best customer for Russian oil in relation to prices, guarantee of payments etc. Secondly, they are able to use oil transportation as political leverage in relation to that market. This is a practice that Russia follows in the gas sector more than in the oil sector, but nonetheless when the two are combined Russia's leverage becomes stronger.

The second benefit is revenues from transportation tariffs. This is a double economic privilege for the Russian state as profits from both the Caspian littoral states for renting its pipeline system

for the transportation of their oil and from gains through heavy taxation on Transneft's exports to Europe, where oil is sold at a high price.

The third benefit is maintaining the near monopsony on oil in the Caspian region. In this way, the Russian state is able on the one hand to block any attempts by the other Caspian oil producing states to acquire any political advantage or leverage of their own over the European states, and on the other to maintain its own leverage over its European customers.

Russia has been able to use Gazprom as a foreign policy tool in order to conduct its energy foreign policy for a very long time, as analysed in Chapter 5, but the equivalent in the oil sector was missing. This is down to two factors. Firstly, the oil sector was fully privatised during the 1990s and thus segmented among different owners, both private and state, while the gas sector always remained as a single unit and under the control of the state.

Secondly, the only companies which remained under the direct control of the state in the oil sector were Rosneft and Transneft. This created an insufficiency of state control over the sector. Rosneft up until its merger with Yukos was almost inactive in the oil sector [Sourzhenko, interview by author 29 April 2008]. Rosneft was established as a state enterprise in 1993 from the assets previously held by Rosneftegaz, the successor to the USSR Ministry of Oil and Gas. It became an open joint stock company in 1995 by a Russian government decree. In the period between 1995 and 1998, as a result of the lack of stable management and probably of the inability of the state to take control of the oil sector due to the wild privatisation of the 1990s, Rosneft's oil production fell and its oil refining collapsed to just one third of production capacity ([www.rosneft.com](http://www.rosneft.com)). Transneft only controls the transportation of oil, which without being an oil

producing and export company or without being able to favour state oil company by giving priority to or better tariffs for its oil transportation, like for example Rosneft, is not a very powerful tool for controlling the oil sector. As the Vice President of Transneft highlighted, *'we execute the Ministry's program of access to the pipelines. We are merely a vehicle of oil transportation'* [Barkov, interview by author 8 October 2008].

As explained in Chapter 3, the situation changed under Putin when in a move related to the high oil prices of the time energy became a driver in Russian foreign policy. The consolidation of the oil sector (analysed in Chapter 4), in line with the Energy Framework priorities (outlined in section 3.2.2.) of the state intervention in the oil and gas sector and the rise of Russian state oil and gas companies, both domestically and internationally had two consequences: the rise of Rosneft as the dominant company in the oil sector and the capture of the private oil companies by either the state or Rosneft. *'The big task of the past few years has been to create a counter weight in oil to what Gazprom is in gas. Russian foreign policy in gas was conducted through Gazprom but there was no counterpart in the oil sphere. That oil company is Rosneft'* [Elder, interview by author 21 April 2008].

The consolidation of the oil sector allowed the Russian state to assert its control over oil companies, both state and private, and use them in the formation of foreign policy as a muscle of the state in its foreign policy. This chapter will examine the case of the Russian foreign oil policy in the Caspian and explain how the commercial activities of the Russian oil companies in the region assist Russia in achieving its foreign energy goals in the Caspian.

## **6.2. Russian Oil Policy in the Caspian**

### **6.2.1. Oil and foreign policy in the USSR**

Oil has always been pivotal in both the domestic and foreign policy conduct of the USSR. The sheer size of its industry alone made it a very useful tool for any kind of policy making. At its peak level of production the USSR was the largest oil producer in the world well ahead of the USA and Saudi Arabia. Most of its oil reserves were located in Russia, which made up almost 95% of its oil output (CEE 2007:2). Official figures for oil production in the USSR between 1970 and 1991 show a steady increase from 353.0 million tons in 1970 to 624.3 million tons in 1988, the highest recorded oil production for the USSR. The largest growth in oil output was recorded in 1980 when Soviet oil production jumped from 490.8 million tons in 1975 to 603.2 million tons in 1980. This was connected to the discovery of vast oil resources in West Siberia. West Siberia went on to form the resource basis for all Russian oil companies up to the present day. The only disturbance in the output of oil is recorded in 1985 when production fell to 595.3 million tons instead of the 613.0 million tons produced in the previous year. From 1989 to 1991, there is a steady decrease in oil production from 607.3 million tons in 1989 to 515.0 million tons in 1991. It must be said at this point that the decline in oil production was more a result of the general upheaval in the whole of the USSR than connected to a decline in Russian oil production. On the contrary, figures show that Russian oil production, which formed the bulk of the Soviet oil production, was more or less steady from 1980 to 1989, with a sharp decrease only in 1991 from 516.2 million tons produced in 1990 to 461.1 million tons produced in 1991 in a total production for the USSR of 515.0 million tons for the same year (Watson 1996:430).

Oil was used for different purposes in the USSR than in post-soviet Russia, mainly due to the country's different economic and political regime, as well as its different foreign policy priorities. In the domestic sphere oil was used for two reasons; to subsidize all the Soviet republics with very low cost oil, which would be used both for domestic and industrial consumption, and also as a key financial source which would support other sectors of the economy. It is not a coincidence that serious attention was given to the energy sector at the same time as rapid industrialization programs were adopted. In this respect Stalin's economic policies had a major effect on the oil sector. The 1928 first five year plan channelled money into the energy sector, kick started its growth and defined its use in both Soviet domestic and foreign policy.

Due to the nature of the oil industry being different and more complex than the gas industry, in the USSR there was no single unit controlling the oil sector. This is linked to the fact that oil is not necessarily dependant on a physical pipeline network for its transportation as it can be transferred by other means such as railway, tankers etc, but it is rather linked to local factories and refineries. As a consequence, the oil industry was divided geographically, linked mainly to refineries in each region, for the purposes of better management. As s discussed in the next section, this fact determined the 'geography' of the newly emerged private oil companies in the privatization period under Yeltsin. This meant that there was some power given to the regions over oil production, which needed to be controlled centrally as well as locally. The numerous bodies and ministries assigned the task of regulating the oil sector included Minnefteprom in charge of extraction, Minneftekhimprom in charge of refinement, Gossnab in charge of distribution, and Soyuzneft in charge of exports. They were separately managed but the state



maintained central control through the Ministry of Oil and Industry. This same Ministry together with Gosplan, the State Planning Committee, set production quotas, established delivery plans and drew up plans for investment and innovation (CEE 2007:2).

When looking at Soviet foreign oil policy it is obvious that oil was used as a foreign policy tool, but the geopolitical objectives were not the same as under Yeltsin or Putin. While oil was used under Yeltsin for mainly commercial benefits and under Putin as a geopolitical instrument of controlling and profiting from Central Asian oil resources, in the Soviet Union it was used to subsidize oil sales to its Eastern European satellite states and thus use their energy dependence in exchange for their political loyalty. After the 1974-75 energy crisis oil was also used to profit from sales to the West. Nonetheless, when looking at Soviet foreign policy, it is important to remember that the main priorities of the USSR abroad were linked to its army superiority and its military industry, rather than using economic power to achieve political goals.

Lavigne (1983:135) writing on the pattern of relations between the USSR and its Comecon partners following the energy crisis of 1973-74 notes that the USSR used the fact that it had the monopoly on energy and raw materials supply to Eastern Europe in order to get both more and better quality products as well as political benefits. In this sense the oil sector served more to bring in the USSR's political influence rather than commercial gains: 'In contrast with the 1949-60 period, there is wide agreement among experts that during the whole period of 1960-74 the Soviet Union 'lost' on the economic side from its trade with Eastern Europe, this loss being compensated with political benefits. Thus the new situation created by the world crisis would

have restored an expected pattern of economic benefits accruing to the USSR, along with political domination’.

This further aided political and economic integration between the Soviet Union and its satellite states mainly through programs signed after 1975 such as an agreed plan for multilateral integration measures, which was adopted by the Comecon Council's session in 1975 for the period 1976-80 and the long-term special purpose programmes for co-operation which were agreed upon, in 1978 and 1979, for the next 10-15 year period. The purpose of these schemes was to eliminate the bottlenecks in Soviet energy and raw materials production achieved by means of joint investment projects, but also through a specialization scheme, according to which, East European countries were supposed to increase the production of equipment and goods needed for the development of Soviet natural resource capacities, as well as to adapt their production structure so as to ensure the most efficient use of these resources (Lavigne 1983:143).

The Caspian region formed an integral part of the USSR, excluding the Iranian portion. Therefore, when it came to oil production it was more affected by the domestic goals of the Soviet Union than its foreign policy ones. The Caspian region, as any other Soviet region, was to Moscow a subdivision of the larger Soviet oil industry and many times fell victim to the inefficiency of the centrally planned economy. Quite often there was disconnection and inconsistency between the centre and the periphery when it came to production needs. In Soviet foreign policy making, the Caspian region acted as a provider of, mostly, Central Asian oil to Eastern Europe through the Soviet oil transportation system. So in this respect it served Soviet foreign policy goals with regards to its satellite states. With the collapse of the Soviet Union,

Moscow lost control over the oil reserves of the most oil rich countries, such as Azerbaijan and Kazakhstan, which were and still are the major oil producers in the Caspian region.

### **6.2.2. Oil and foreign policy under Yeltsin**

With the dissolution of the USSR and the start of Yeltsin's presidency, Russia entered a period of many rapid changes in both its political and economic regime. The Soviet policy of meeting production quota instead of maximizing profits, together with an absence of market competition and lack of investment in the oil sector in favour of other sectors, such as the military complex, the controlled heavily subsidized prices and the phenomenon of non-payments, as well as lack of technological innovation and of a sound legal and regulatory system was a major drawback in the oil industry which was only visible after the collapse of the Soviet Union (CEE 2007:3-4; Allen 2001:868&877).

James Watson (1996) writing on the foreign investment climate in the Russian oil sector paints a grim picture of the politico-economic situation in the country. From 1991 to 1995, Russian oil output declined steadily from 461.1 million tons in 1991 to 312.0 million tons in 1995. Watson (1996) states that there are several reasons for the decline in oil output including the removal of state financing, which had revitalized the industry from the late 1970s to the 1980s, and the continued exhaustion of the main Western Siberian fields forcing the industry to move to smaller and geologically more complex fields. In 1992, the Russian Ministry of Fuel and Energy recognizing the problem adopted its 'Program to stabilize operations in the oil and gas industry in 1992-95 and until 2000,' which envisaged stable growth in the production of oil. At this point

it was more than obvious to most people that there was a great need to attract FDI into the Russian oil sector as the newly formed private vertically integrated Russian oil companies were unable to do so due to government price controls which kept domestic prices to one third of the world prices up until 1995 (1996:431).

Part of the changes that took place was the privatisation of the oil sector, known as ‘voucher privatisation’. As it was discussed in Chapter 4 in detail, the capture of the state by business in the oil sector started with the acquisition of state property and continued with increasing wealth and political influence of the so called ‘oligarchs’, who could exert political pressure at all levels of government until the fourth Duma.

As discussed in Chapters 3 and 4, the weakness of the state to take control of the oil sector and/or the owners of the private oil companies, the different elites clashing with each other, the adoption of Soviet priorities in foreign policy, i.e. mainly based on military strength, and the actual lack of an energy policy meant that there was no official role for oil in Russian foreign policy formation under Yeltsin. As mentioned in section 5.2.2., in the Russian Energy Strategy up to 2010, the main role for both the gas and oil sectors was to assist in restructuring the domestic economy of the state and secure the country’s energy independence.

Apart from the ‘introvert’ role given to the oil sector in rebuilding the Russian economy, there was another factor which complicated Russian foreign oil policy in the Caspian at that time and that was the fact that the previously Soviet space of Central Asia transformed into an area of independent and sovereign states, which viewed their energy resources as their ticket for

sustaining their independence and improving their economies. By choosing to open up their economies to foreign direct investment from Western companies, they automatically made a choice to go against the monopoly of transportation imposed by the structure of the old Soviet transportation system, which Russia inherited. That meant that the Yeltsin administration was losing ground in control of the oil sector in the Caspian, as the main strength of Russia in the area was not in its own resources, but in the resources of mainly Kazakhstan and Azerbaijan.

One of the factors that added to the inability of the state to form its foreign policy based on the oil sector was that it had no control over Russian oil companies. As analysed in sections 4.3.1., and 4.3.2., the 1990s was actually the decade when we witnessed a decline in state companies and the rise of private oil companies.

As early as September 1991, a voluntary association of Russian oil enterprises called Rosneftgas Corporation was formed to replace the U.S.S.R. Ministry of the Oil Industry. It was headed by Lev Tchurilov, the last U.S.S.R. Oil Minister, and he was soon replaced by Alexander Putilov, formerly general director of Ukraineftegas, a subsidiary of Lukoil. Within two years Rosneft was forced to give up its assets as the new vertically integrated companies began to emerge (Poussenkova 2007:12). The 'pie' of the Soviet oil industry was divided among 'red directors' like Vagit Alekperov of Lukoil and western-style 'oligarchs' like Mikhail Khodorkovskii of Yukos and Roman Abramovich of Sibneft [Subbotin, interview by author 29 April 2008].

From these acquisitions a rough geographical map of a kind of unofficial regional monopolies arose; Lukoil took over the Caspian region, in the opinion of many because of Alekperov's roots in Baku, Yukos took over Samara and other South Russian refineries and Sibneft operated in Omsk in south-western Siberia. The state company Rosneft got the leftovers from the division *'after the main oil companies got their pieces from the pie of the Soviet economy lots of crumbs were left on the plate such as research institutes, some oil deposits without pipelines, pipelines without good oil deposits, factories etc and all these crumbs made up Rosneft'* [Subbotin, interview by author 29 April 2008]. All the companies have western Siberia as their basis as it was the first oil rich region discovered in the Soviet Union, *'West Siberia was the first region where oil was first discovered and all the oil companies fared there. All the oil producing companies that existed in the Soviet times and they were bought by the present companies they operated there. This is why all the oil companies work in West Siberia, while for example East Siberia is more of a Rosneft territory. Lukoil for instance does not work there'* [Sourzhenko, interview by author 29 April 2008].

The downfall of the state company Rosneft seemed almost unavoidable. Despite the fact that in 1993 it accounted for over 60% of domestic oil production, caught between the demise of the old economic regime and the inefficiency of the state to manage it started shrinking. In April 1995, Rosneft was transformed into an open JSC by presidential decree no.327, but could not compete with the private oil companies, continuing to lose more and more assets ([www.rosneft.com](http://www.rosneft.com)). Attempts by Rosneft to bid for the 'loan-for-shares' auctions, where it was not even accepted to participate, or to take up key functions as a national oil company were normally outdone by one of the major private oil companies, most often than not by Sibneft. Poussenkova (2007:33) states

‘Rair Simonyan [Rosneft’s] former First VP, said in 1996: “Rosneft is currently like a collection of different companies which up to now have been developing independently, without proper coordination. We must simply create an organism that is viable, normal and integrated”’.

Just prior to 1998 there was a first attempt to merge Rosneft with other oil companies under Primakov, but it failed. Then, after the August crisis of the same year in 1998 there was a second attempt at merging Rosneft with Slavneft and ONAKO, the only other corporations with controlling interest still held by the state. Had this move been successful, Rosneft would have been strengthened considerably, but the move seems to have been blocked by rival companies, which were against the idea of a strong state company in the oil sector. Nonetheless, as Poussenkova (2007:17) puts it, ‘it can be claimed that during the 1998 default, the government saw that the only way out of the chaos would be to strengthen the state role in economy. Essentially, the creation of the mighty national company was in line with this policy’.

The only segment of the oil industry which remained under the control of the state was the main oil pipeline network operated by Transneft, which was the company created directly from the Soviet Ministry of Oil Transportation ([www.transneft.ru](http://www.transneft.ru)). Transneft, even today, has the monopoly on oil exports from the Russian Federation. The fact that the whole oil sector was fully privatised, apart from the oil export transportation system, meant that it was very difficult for the state to control it.

The only private company which was friendly and allied to the state during the Yeltsin administration was Lukoil and that gave the Russian state an opportunity to reap commercial

benefits from the resources of Kazakhstan and Azerbaijan, which it lost after the collapse of the Soviet Union. The connection between Lukoil and the state is determined by two factors. The first is the fact that it started as a state company in the Soviet Union, so effectively it could be seen as the successful counterpart to Rosneft, and the second factor is that its founder and director, Vagit Alekperov, belongs to the generation of the red directors with very close contacts with political elites as he served at the Ministry of Oil and Industry in the Soviet Union (Hanson 2005).

As Gorst (2007:9) puts it in her analysis of Lukoil ‘at its inception, Lukoil was Russia’s first bold experiment with private oil ownership and with decentralised oil industry decision making. But the company, sometimes pioneering oil policy, sometimes following orders, has always acted in close coordination with the government, often presenting itself as a faithful servant of state’. Lukoil was the first oil company to emerge out of the Soviet Ministry of Oil in 1991. Lukoil broke away in 1992 as a voluntary merger of the three West Siberian producers, Langepas, Urai and Kogalym and two refineries at Volgograd and Perm. In 1993, it was transformed by government decree into Russia’s first joint stock company (Gorst 2007:15). During the 1990s with the rise of the western-style ‘oligarchs’, Lukoil was supported strongly by Chernomyrdin, the founder of Gazprom and prime minister from 1992 to 1998. It has been claimed that Chernomyrdin was a strong Lukoil supporter and possibly even an early shareholder and a champion of the idea that Russia should have the equivalent of Gazprom in the oil sector (Gorst 2007:15).



Lukoil made the unlikely move to focus on the Caspian region at a time when other oil majors like Yukos and Sibneft were concerned with the vast resources in Siberia. The most common explanation for this is Alekperov's roots in Baku and thus a justified interest in his birth place. Another explanation could be the fact that Lukoil, though one of the biggest Russian oil companies at the time, was not as powerful as Sibneft or Yukos and thus had to settle for the second best option after Siberia and the south of Russia. Lastly, another explanation could be that Lukoil always tried to balance its commercial interests with the interests of the state and thus made a concession by focusing on a much poorer resource-wise area than Siberia and being an ambassador for the Russian state there. 'There is a marked geopolitical dimension to Lukoil's activities in the international arena where the company was for a long time regarded as Russia's foreign oil ambassador. Boris Yeltsin appointed Lukoil as coordinator of all Russian projects in the Caspian Sea in the mid 1990s. It was a job for a trusted insider' (Gorst 2007:20).

So despite the fact that the Caspian resources were undeveloped and the area was very hard to exploit due to geological perils, the presence of Lukoil there and its involvement in other littoral states' resources gave a footing for Russia into the region. 'The company's Caspian portfolio now includes projects off Azerbaijan, Russia and Kazakhstan. Opportunities are being pursued offshore in Turkmenistan and Iran. No other oil company has established such a comprehensive presence in the Caspian Sea. In return, Lukoil played a stabilising role during the complex Caspian boundary negotiations between Russia, Kazakhstan and Azerbaijan'. Demarcation agreements inked in the early part of this decade packaged certain offshore fields for joint ownership by different republics with each government nominating its representative for projects that could eventually yield billions of dollars of revenue' (Gorst 2007:30).

The map below illustrates the proposed demarcation of the Caspian basin.



**Map 6.1 Caspian proposed demarcation**

Source: EIA

### 6.2.3. Oil and foreign policy under Putin

Under Putin both the domestic environment of the oil industry and Russian foreign oil policy changed profoundly. The incorporation of energy as a driver of Russian foreign policy brought about three changes in line with the Energy Framework priorities outlined in section 3.2.2.: the first was the reassertion of state control over the oil sector, the second was the rise Rosneft as the

dominant player in the oil sector and the third is the use of oil companies as foreign policy tools in Russian foreign energy policy conduct in the Caspian.

As analysed in Chapter 4, the internal situation in the oil sector where the private oil companies had captured the state continued for at least the first half of the Putin administration. Yukos was becoming by 2003 'a source of social and political influence independent of the Kremlin; it was perhaps also heading towards at least partial acquisition by a Western major. Both developments were unacceptable to traditionalist believers in an all-powerful Russian state' (Hanson 2006:2). As discussed in chapter 4, the influence that the 'oligarchs' had on decision making started to wane by the fourth Duma. For Putin 'it was necessary to deal with the new business elite, the so called oligarchs, as an independent source of power' (Clark 2006:2).

The Khodorkovskii case that took place during the second half of the first Putin administration was a strong warning against the oligarchs and it led to a 'consolidation' between business and the state, which in reality was a subordination of business to the state's will. Through grabbing assets from independent companies and relocating them to the state companies, the state created energy giants, in which it holds majority stakes. These giants are Gazprom, controlling the gas sector, and Rosneft, which has emerged in the last couple of years and is expected to control the oil sector in a similar way. *'Rosneft grabbed the assets of Yukos with the help of bankruptcy of the company and became the largest company in Russia by means of resources while before it was 8<sup>th</sup> in Russia. Now it is the largest company. So the state began to use more such instruments like courts, the prosecutor's office or tax evasion schemes to intimidate and force people to be loyal. Russian business was created with such tricks during the 1990s, like tricks where the*

*producing company sold its oil to some offshore company and then the offshore company was bought by the founding company. The state understood that it could use the law to intimidate and control them and thus increased the power of state companies and became less dependent on private business'* [Sourzhenko, interview by author 29 April 2008].

At the same time as the capture of business by the state was under way another event took place; state companies started rising to power. In the gas sector, this translated into Gazprom having increasingly more power in shaping gas policy with exclusive rights over the gas sector. In the oil sector, the only surviving state company Rosneft together with an increase in its influence also acquired the private oil companies, which were in decline. In this respect we see the rise of a new breed of 'oligarchs' taking over the place of the western-style 'oligarchs' like Khodorkovskii and Abramovich, as opposed to a 'consolidation' of business with the state. These 'oligarchs' were either tycoons which followed the state line, like Lukoil's Alekperov or people from Putin's presidential administration, like Rosneft's Igor Sechin. 'In 2004-05, as the Yukos affair was unfolding, a doctrine about 'strategic' resources began to emerge-chiefly but not only from Vladislav Surkov, a deputy head of Putin's presidential administration. Strategic natural resource deposits and strategic enterprises had to be under national control. This did not have to mean state ownership. One could infer from much of what Surkov had to say that 'trusted' Russian tycoons would suffice' (Hanson 2006:2).

Putin's coming to power signified a new era for Rosneft. Bogdanchikov, the company's new president since 1998, 'was quick to side with him and follow the same line of increasing the power of the state over private companies and reinforcing state companies in order to counter the

oligarchs in the domestic market as well as to use them in the formation of foreign energy policy' (Poussenkova 2007:30). In 2002, the Board of Directors of Rosneft approved the new strategy of development, which included the transformation of the corporation into a transnational energy company dealing with hydrocarbons, coal mining and power generation. After the acquisition of Yukos, Rosneft was transformed overnight from a very modest player by Russian standards (21 mt of oil production in 2004) into the third biggest Russian oil company (75 mt of oil production in 2006) with proven oil reserves of 2.05 billion tons and gas reserves of 691 bcm as of December 31, 2005 (Poussenkova, 2007:9).

With the installation of the power vertical in Russian politics, Russian foreign policy became genuinely presidential. The power vertical works in such a way that it renders every decision-making body beneath the presidential administration irrelevant. The decisions were taken at the top and were put in practice directly at the bottom. Especially with matters such as energy and security, which are central to the preservation of the current system and for the materialisation of the elite's goals. As a result, the role of the government in decision making had been reduced to the minimum [Elder, interview by author 21 April 2008]. Consequently, Russian foreign energy policy under Putin had been conducted directly by the Kremlin. The situation slightly changed after Putin became the prime minister in 2008 under the Medvedev administration. As analysed in section 4.5.3.1., the oil companies are now directly under the Energy Ministry lead by the head of Rosneft and former member of the Putin Security Council, Igor Sechin. The shift is more consequential of the move of the Putin administration from the Kremlin to the White House than of any significant change in the way the sector is controlled. It is Putin's power vertical that still controls the oil sector through Igor Sechin, Rosneft and the Ministry of Energy rather the

Ministry of Energy itself as a governmental body. *'We work in a very close contact with companies, so we know their opinions and positions and we take them into account in our everyday work, so when we work on the strategy we naturally keep in mind their interests'* [Pleshin, interview by author 23 October 2008].

As discussed in Chapter 3, in official Russian state discourse the actual production of oil and gas in the Caspian is not presented as being important for the country's energy security in relation to the volume of its resources, as much as Western and Eastern Siberia are. The Caspian in the case of oil is important to Russia for two main reasons: the first is access to other littoral states' resources, mainly those of Kazakhstan, and the second is control over oil exports from the area. *'The Caspian region is important and there are no doubts about that at all. In general the main Russian oil provinces are in other areas. This is not about the Russian [Caspian] resources. But from the point of view of cooperation with our partners, the Caspian is, no doubt, important to us. It is very important for Russia in terms of cooperation with the littoral states, which are on the one hand our allies and on the other hand our competitors, as we work on the same markets'* [Pleshin, interview by author 23 October 2008].

The existing Caspian pipeline system used to be part of the unified Soviet system which transported both oil and gas to the north into Russia and from there to the European markets. For Russia it is important to maintain this specific route for two reasons. The first one is that in this way all oil goes through the internal Russian pipeline system, which is to a large extent owned by the state-run monopoly Transneft. The profits that Transneft makes from tariffs go directly to the State Fund and state budget through heavy taxation. The second reason is that Transneft has

the monopoly on export pipelines. So the state will gain again from both taxation on the companies and from high prices for energy to the European markets.

As analysed in Chapter 3, the economic foreign energy policy priority of the Russian state in the Caspian within the Energy Framework is infiltration in the oil markets of the Central Asian states. This is done through the use of its oil companies. The state controls part of the process of the oil production and transportation in the Caspian region either through shares that the Russian oil companies have in projects on the other littoral states' territories, or through joint ventures, or through the control of the oil pipelines.

### **6.3. Transneft, Rosneft and Lukoil's role in Russian foreign energy policy in the Caspian region**

The manner in which the Russian state tries to assert itself financially in the Caspian in the oil sector is different to its approach to the gas sector, due to two factors. Firstly, the oil sector is much more flexible than the gas sector due to the fact that the littoral states' gas sectors are physically attached to the Unified Gas System controlled by Gazprom while when it comes to oil transportation they are other alternatives, such as tankers and railways.

The second factor is that the Russian oil sector itself had been privatised internally in the 1990s and thus divided among different companies, and as a consequence the state's influence over it was weakened. As it is going to be explained below, even at the present time after the recapture

of the sector by the state and the emergence of the national oil company Rosneft, legal restrictions force Russia to favour Lukoil over Rosneft for geopolitical purposes. In this respect there is not one single company through which state goals can be achieved, as in the case of Gazprom, but three and in order for us to understand the effectiveness of Russian foreign energy policy in the Caspian, we have to explore the actions of all three companies, Transneft, Rosneft and Lukoil, together.

### **6.3.1. Rosneft's legal restrictions and Lukoil's instrumental role in Russian foreign policy in the Caspian region**

When looking at the role of Lukoil in Russian foreign policy in general, but also in the Caspian more specifically, as the Caspian has been Lukoil's main offshore territory since the 1990s, one has to take several factors into consideration that make it important to the Russian state. First of all, Lukoil is one of the leading Russian oil companies both domestically and internationally. Therefore its sheer size and oil resources alone make it important enough to be used by Russia in its foreign policy. The second factor is that Lukoil has been working in the Caspian and Central Asia territories since the 1990s. This signifies that the company has already established itself as a reliable partner for the main oil producing Central Asian states, mainly Kazakhstan, and has already been participating in many joint ventures and PSAs in the area. In this respect the company already has a foot in Central Asia and this could be a major advantage for the Russian state in exerting and increasing its influence over the region.



The third factor explains the paradox of favouring Lukoil over the national oil company Rosneft in the sense that it has been assigned duties and responsibilities of strategic importance to the Russian state, when Rosneft has already strengthened its position inside Russia becoming the number one oil producing Russian company domestically. Rosneft as a company carries too many legal risks connected to the acquisition of Yukos, which are still unresolved, a fact that makes any business venture outside the territory of Russia too fragile and dangerous for all sides included in the partnership or venture, be it Rosneft itself, the partner company or state, or even the Russian state.

Rosneft is currently the respondent in a number of lawsuits filed against it from western companies and shareholders connected to the Yukos affair. 'Rosneft faces several risks arising out of its acquisition in late December 2004 of Baikalfinancegroup, which had won an auction for the sale of 76.79% of the shares in Yukanskneftegaz, controlled by OJSC NK Yukos' (OAO Rosneft Prospectus: 34). The litigation and arbitration against Rosneft includes claims that the auction was not valid and that 'Rosneft engaged in a conspiracy, with several other parties, including the Russian government, Gazprom and Rosneftegaz, to renationalise the assets of Yukos'. If the litigators win their case against Rosneft then that could 'adversely affect Rosneft's operating results and financial condition and could have a material adverse effect on Rosneft and the value of the securities [...] in addition there is the theoretical risk that there will be attempts to hold Rosneft liable for certain judgements or arbitral awards that might possibly be obtained against the Russian Federation' (OAO Rosneft Prospectus: 35).

The fact that there has been no conclusive decision on any of the allegations against Rosneft constitutes a high risk for the company and renders it unreliable to be used on its own in foreign policy conduct. It seems that the Russian state would prefer to use a more stable private company like Lukoil in its investment in the Caspian than its national oil company, which would be too precarious in case it would be found guilty of the allegations against it. In such a case the loss for the Russian state would have been enormous as it would probably be forced to abandon any project or PSA it would be involved in and thus lose all its investment money. In this respect, Lukoil is at the moment its safest option in foreign energy policy in the Caspian. As Elder put it, *'Lukoil is the acceptable private business face of Russia abroad'* [Elder, interview by author 21 April 2008]

The inability of the company to invest abroad safely is also reflected in the strategic goals set by Rosneft, *'at the moment we are not interested in investing abroad. Our main goal is to expand the assets of the company domestically'* [O'Brien, interview by author 30 September 2008]. For Rosneft, Southern Russia including the Russian sector of the Caspian has always been used in order to diversify the resource base that comprises the majority of it. 'The South of Russia accounted for 25% of oil and 30% of Rosneft's gas production during the 1990s. It is one of the oldest oil and gas producing provinces in the country where the average daily output of wells is about 0.6 tons, while lifting costs are one of the highest in Russia. However, its strategic advantage is the proximity to export ports located on the Black Sea and well developed production and social infrastructure. Thus, Rosneft's resource base was sufficiently diversified, and the company was protected against the inevitable decline of production in West Siberia' (Poussenkova 2007:27). Nonetheless it must be noted here that Rosneft takes part in oil projects

in the Caspian, though to a much lesser degree than Lukoil, and that its presence in the region is growing.

### **6.3.2. Transneft's legal monopoly**

Russia's quasi monopoly on oil transportation in the Caspian is realised through Transneft, which controls the old Soviet oil transportation system, one of the two main outlets of oil from the littoral states to Europe. Transneft's monopoly is translated into controlling 95% of the domestic oil transportation and 100% of Russian oil exports to Europe. It is the successor to the Soviet oil transport monopoly and after the collapse of the Soviet Union it remained wholly state-controlled. Apart from controlling the Russian oil transport pipelines it takes part in major joint ventures in the Caspian, particularly in Kazakhstan and Azerbaijan. During the Soviet era, oil from the Caspian region was exclusively transported through the unified transportation system. The pipeline network has a total length of about 62 000 km, making it the largest integrated system in the world. It interconnects with 17 countries, including Russia, Ukraine, Kazakhstan, Belarus, Lithuania, Latvia, Uzbekistan, Turkmenistan and Azerbaijan, Germany, Poland, the Czech Republic, Slovakia, Hungary, Slovenia, Croatia and Serbia. The system also provides access to other international markets via large marine terminals on the Black Sea (Novorossiysk, Tuapse, and Odessa) and on the Baltic Sea (Ventspils, Butinge, and Gdansk) (IEA 2008).

After the collapse of the USSR, there were some disruptions to the flow of oil from these countries, or even destruction of some pipelines, due to the new economic or security situation

that these countries were facing. As the responsibility for the maintenance of the network fell to every newly independent country there were instances when there was no proper management of resources to cover the costs. In order to find a solution to the problem two declarations were signed between Russia and the other Caspian states, one on the construction of the Caspian Pipeline and another on the reconstruction of the central pipeline network. This is of course in favour of Russia as it was guaranteed that the network would go through its territory. As the head of the Central Asian Division of the Ministry of Energy put it *'if we compare the maps of the old pipelines and those under current construction we will see that they coincide completely. It is clear that construction or reconstruction of pipelines across the main routes where all you have to do is just to re-animate the old project is much cheaper than to construct something completely new'* [Pleshin, Interview by author 23 October 2008].

In this respect it is logical to assume that the interests of the Caspian oil producers to opt for the economic solution of using an already existing pipeline network, would coincide with the Russian ones. This is firstly because they do not need to construct a new pipeline and secondly because in any case they can have better prices or better deals with the Russian government on export tariffs, like exchanging part of the payment for oil or gas or some other 'goods'. In turn, when Russia gets to control pipeline routes and have them pass through Russian territory it gives special privileges to its state companies. Also by controlling the pipeline routes, it has political leverage against countries that are oil consumers, such as Europe for example. By deciding to diversify its oil routes, Russia can exercise political pressure to resolve issues between Europe and Russia, as it could potentially threaten Europe's energy security. This is also linked to the notion of security of a supplier country. Diversification of routes is a very important part of this.

*'Russia controls all the pipelines on the territory of Russia, which give it the opportunity to first monopolise all the tariffs, all the oil routes and to distribute privilege routes to Rosneft and Gazprom'* [Sourzhenko, interview by author 29 April 2008].

Transneft itself ranks the Caspian region very high in its agenda, *'Russia is a littoral state so of course, the Caspian area is important for us. Under current conditions, the Caspian region is less reliable than Russian territory. The Caspian region has its link with Europe first of all through Russia and secondly, through the Caucasus while all the other directions are closed. The Russian corridor of oil transportation from the Caspian region to Europe is the most perspective and the most interesting with regard to its reliability and economic benefits'* [Barkov, interview by author 8 October 2008].

Despite the fact that oil can be transferred through other means, in general it happens that transportation through pipelines is the preferred choice for oil output from the Caspian. *'Only small amounts of crude move in other ways, mostly by rail to supply refineries in the Far East not on the main pipeline system. An increasing amount of crude oil does move to various export points by rail to get around both physical bottlenecks in the pipeline system and government-imposed administrative restrictions'* (IEA 2008:14). Nonetheless competition from other alternative routes is attempted to be restrained by Transneft with future foreign projects, *'Burgas-Alexandroupolis is a new pipeline, which will go around the straits of the Bosphorus and Dardanelles and this pipeline will become a real competitor for tankers used in this area. This pipeline – if something happens in the straits – will provide energy security for our Western*

*partners too. I mean energy security of European countries'* [Barkov, interview by author 8 October 2008].

## **6.4. Independent pipelines**

### **6.4.1. The Baku-Tbilisi-Ceycan (BTC) Line**

The BTC is a US-led project that transports Caspian oil to the Black Sea via Georgia bypassing the Russian oil pipeline system. Construction of the pipeline has been perceived as a direct threat to Russia's national interests and an attempt on the part of the US to infiltrate the Caspian and protect the interests of American companies there. When Kazakhstan decided to join in the project it found that it was restricted by the bilateral relations with Russia to use any alternative routes for oil export to the West. *'For Kazakhstan it is necessary to diversify its export routes. This is something that has been discussed for a long time, because it would be beneficial to Kazakhstan to sell oil and gas directly to Europe and get paid properly. Nonetheless, Kazakhstan has made foreign agreements with Russia and is obliged to fulfil them. These agreements hinder the diversification process'* [Grozin, interview by author 16 May 2008]. By managing to prevent Kazakhstan, the country with the most promising oil resources, from using the pipeline, Russia managed to make the BTC line redundant. The pipeline mainly works with Azeri oil exporting the bulk of Azerbaijan's oil production at 28.5 million tons per year. So despite the fact that the pipeline is working and it monopolises Azeri oil, the main political purpose of its construction was not met. No Russian oil company is involved in the BTC line.

#### **6.4.2. The Caspian Pipeline Consortium (CPC) Line: Russian hegemony through its oil companies**

The CPC is the only privately owned oil export pipeline system going off the territory of Russia. That automatically means that despite the fact that all the export oil pipelines going through Russia are controlled by Transneft, in this particular case they are not, so Russia loses the monopoly on the control of the exports and the regulation of tariffs. *'The CPC is a sore question for Russia. Russia controls all the pipelines on its territory, which give it the opportunity to first monopolise all the tariffs, all the routes of oil and to distribute privilege routes to Rosneft, Gazprom and other Russian companies, which are wholly or partly controlled by the state'* [Sourzhenko, interview by author 29 April 2008]. The CPC is an international consortium involving both states and companies. The pipeline runs from the Tengiz oil field in Kazakhstan to the port of Novorossiysk in Russia.

The agreement on CPC was signed in 1997 and until 2006 the Russian state's share was held by the Ministry of Property. Since August 2007, the state share has been transferred to Transneft, giving it a total of a 45% stake in the consortium and making it the majority shareholder in the consortium. CPC has its own tariffs, which the Russian state believes to be too low. For the time being voting on major issues is done through unanimity and Russia is pushing for this to change to a majority vote. If that becomes the case in the future, then the Russian state through Transneft and the joint venture of LUKoil and BP will have much more than half of the stakes and subsequently control of CPC ([www.cpc.ru](http://www.cpc.ru)).

The initial agreement on CPC among the investors was that the pipeline was going to be expanded. Because of the financial problems that it has at the moment - the consortium has considerable debts of about \$5 billion - Russia is blocking its expansion and pushing for higher tariffs. On the one hand it is Russia and Transneft against the foreign investors and Kazakhstan is in the middle. Chevron, being the biggest foreign investor in both CPC and the joint venture Tengiz-Chevroil between Chevron and various Kazakh companies, has stated that if the pipeline is not expanded then it will look for alternative routes, in an attempt to protect its interests [Sourzhenko, interview by author 29 April 2008].

## **6.5. Legal and Contractual Monopolies in the Caspian**

### **6.5.1. The case of Kazakhstan**

Russia's main target country in the Caspian in relation to its oil reserves is Kazakhstan. The country is the second largest oil producer among the Caspian littoral states after Russia. Its proven oil reserves were estimated in 2009 at 30 billion barrels with probable reserves being much higher. The country's main oil reserves are located in the west, where three major onshore oil fields, Tengiz, Uzen, and Karachaganak, are located. In addition, Kazakhstan's sector of the Caspian Sea is believed to contain even greater undiscovered oil reserves than the estimated 9-13 billion barrels at its offshore Kashagan field (<http://www.eia.doe.gov>). The most important feature of Kazakhstani oil exports is that the country is in a position to export the bulk of its oil production as domestic consumption is relatively low. Kazakhstan produces about 70.0 million tons per year of which 50.5 million tons go through the Caspian export routes and the Russian



system. Kazakhstan was the largest exporter of Caspian oil in 2007 with around 52 million tons per year, followed by Azerbaijan and Russia. Russian oil exports from the Caspian region account for only 3% of the country's total oil exports (IEA 2008:6).



**Map 6.2 Kazakhstan oil pipelines**

Source: EIA

For Russia it is very important to have access to Kazakh oil both in the country's fields and Caspian offshore, as well as with regards to their transportation. This is both due to the vast oil reserves that the country has, but also because Azerbaijan, the other major oil producer in the region, with proven crude oil reserves estimated at 7 billion barrels is very reluctant to go into any partnership with Russia regarding its oil reserves, though it does to a much lesser degree than Kazakhstan *'Our main oil producer partner in the Caspian is definitely Kazakhstan'* [Pleshin, interview by author 23 October 2008].

### **6.5.1.1. Lukoil's and Rosneft's involvement in Kazakhstani oil projects**

Kazakhstan's oil industry grew during the Soviet era. After the collapse of the Soviet Union, the newly independent state looked to the West, mainly BP, for foreign direct investment which assisted in the boom of its oil industry. Russian oil companies were not represented at first in any of the major oil fields, namely Tengiz and Karachaganak. Lukoil was the first Russian oil company to invest in the Kazakh fields. 'In October 2005, Lukoil invested \$2 billion in the acquisition of Nelson Resources, a Canadian listed independent with interests in four joint ventures in western Kazakhstan. Nelson Resources also has an option on two offshore blocks in the Caspian' (Gorst 2007:29).

Largely due to terms of an offshore boundary accord between Russia and Kazakhstan, Lukoil has gained a strong position in the area. The accord, finalized in 2002, designated three offshore structures for joint exploration and development by the two republics. Lukoil was named Russia's representative at the Khvalinskoye and Tsentralniye projects which are being tackled in partnership with KazMunaigas, Kazakhstan's state oil company. Separately Lukoil won two exploration blocks in the Caspian at Tyub Karagan and Achinsky. In south central Kazakhstan, Lukoil is producing oil from the Kumkol field where it holds a 50% interest in the Turgai Petroleum joint venture. China National Petroleum Corp (CNPC) Lukoil's partner in Turgai Petroleum bought its stake in the project from the Canadian-listed independent PetroKazakhstan in September 2005. KazMunaigas later exercised its preemptive right to muscle into the deal (Gorst 2007:30).

Since July 2001, Rosneft has been involved in the development of the Adaisk zone with recoverable oil reserves estimated at 75,100 mln tons of crude in western Kazakhstan. Rosneft also takes part in the development of the Kurmangazy structure with total oil reserves of around 1.8 bln tons located in the northern part of the Caspian Sea together with KazMunaiGas. The subsidiary of Rosneft, RNKazakhstan, was authorized by the RF government in 2003 to participate in the Kurmangazy project and finance the Russian share of expenses. On 6<sup>th</sup> July 2005, a relevant PSA and Agreement on Joint Activities were signed in Astana in the presence of Russian and Kazakh Presidents (Poussenkova 2007:55).

#### **6.5.1.2. Kazakhstan's oil transportation routes: Russian hegemony and quasi-monopsony**

In the sphere of transportation Kazakhstan's main export routes at the moment include the Russian dominated CPC, the Russian controlled pipeline network through the Atyrau-Samara pipeline and the Baku-Novorossiysk pipeline, the BTC and the pipeline connecting it to China. The CPC pipeline going from the Tengiz fields in Kazakhstan through Novorossiysk in Russia exports 32.6 million tons of oil per year of which 25.6 million tons are coming from Kazakhstan and 7.0 million tons are coming from Russia. Kazakhstan also exports 16.0 million tons of Kazakhstani oil through the Atyrau-Samara pipeline, going from Kazakhstan to Russia and 4.4 million tons through the Baku-Novorossiysk Pipeline from Azerbaijan to Russia. The remaining oil is used to cover Kazakhstan's obligations in sending oil through the BTC and towards China (IEA 2008).

**Table 6.1 Estimated Kazakh oil volumes transiting Russian dominated and Russian controlled networks in 2007**

<b>Name of Pipeline</b>	<b>Oil export in million tons per year</b>
Tengiz-Novorossiysk (CPC Line)	25.6 mt/y
Atyrau-Samara Pipeline	16 mt/y
Baku-Novorossiysk Pipeline	4.4 mt/y

Source: (IEA 2008:6)

The hegemony and quasi-monopsony of Russia over Kazakhstan is obvious from the figures above. From the 52 millions of tons of oil exported every year from Kazakhstan, about half of them, 25.6 millions of tons, transit the Russia dominated CPC line, and another 20.4 millions of tons transit the Transneft network. In all, a total of 46 millions of tons of Kazakh oil go through Russian controlled pipelines. The contractual monopoly Russia imposes with Kazakhstan serves two purposes. The first is the continuous dependency of Kazakhstan on Russian oil export routes and thus Russia's profiting from Kazakhstani oil resources. The second is the prevention of any serious competition from mainly Western countries, such as the USA, trying to access Kazakhstani resources and diversify their export routes in order to avoid Russia.

### **6.5.2. Lukoil's involvement in Azerbaijan**

Azerbaijan is the second major oil producer in the Caspian after Kazakhstan with annual exports of 35.2 millions of tons (IEA 2008:8). Its largest hydrocarbon basins are located offshore in the Caspian Sea, particularly the Azeri Chirag Guneshli (ACG) fields, which accounted for over 80

percent of Azerbaijan's total oil output in 2008 and thus it would be very advantageous for Russia to have access to it, though the bulk of Azeri oil goes through the BTC line, as will be analysed later.

Lukoil is an investor in both of the two big foreign projects underway in the Caspian. Lukoil has a 10% stake in the BP-operated Azerbaijan International Operating Company (AIOC) developing oil reserves at the Azeri and Chirag fields plus deep water sections of the Guneshli deposit. Lukoil is also a partner at BP's Shah Deniz natural gas and condensate field. Shah Deniz came onstream in December 2006. On the west coast of the Caspian, Lukoil is exploring at the D222 block (formerly Yalama) in a partnership with Azerbaijan's state oil company Socar (Gorst 2007:31).

#### **6.5.2.1. Azerbaijan's oil transportation routes**

Azerbaijan's main export route is the BTC line, which it provides with 28.5 million tons of oil annually - about two thirds of its oil export capability (IEA 2008). Russia has no interests in the BTC line as the pipeline operates as a counterpart to Russian domination in the transportation field in the Caspian. In this respect Russia cannot gain revenues from the BTC. Another export option, which Azerbaijan has is the Baku-Batumi Azerbaijan-Georgia (by railway), where it exports about 4.4 million tons (IEA 2008). Russia is again not involved in the project. The only Russian controlled pipeline that Azerbaijan uses is the Baku-Novorossiysk pipeline where 2.3 million tons of Azeri oil is exported every year.

**Table 6.2 Azeri oil volumes transiting Caspian export routes in 2007**

<b>Name of pipeline</b>	<b>Oil in Millions of tons per year</b>
BTC Line (Azerbaijan-Georgia-Turkey)	28.5 mt/y
Baku-Batumi (Azerbaijan-Georgia by train)	4.4 mt/y
Baku-Novorossiysk Pipeline (Azerbaijan-Russia)	2.3 mt/y

Source: (IEA, 2008:6)

The figures from table 6.2 show the failure of the Russian state to assert its hegemony in the Azeri oil sector. It seems that most of the Azeri oil is transiting alternative routes with only a small proportion transiting the Russian oil transportation system.

## **6.6. Conclusions**

This Chapter analysed Russian foreign oil policy in the Caspian through the commercial activities of Russian oil companies in the region. The Russian foreign oil policy main priority in the Caspian in line with the Energy Framework, analysed in Chapter 3, is to retain its economic hegemony in the region through controlling or dominating the resources and transportation of the oil coming from the Caspian littoral states. Russia's main foreign oil policy goals in the region are: to protect Transneft's monopoly, benefit from any pipeline project which bypasses Russian territory and take part in the exploitation and production of oil in the rich oil fields mainly of Kazakhstan and to a lesser degree of Azerbaijan. The Russian state tries to control the region

through different channels using companies, such as contracts and bilateral agreements, which sustain Russia's economic hegemony through quasi monopolistic structures, contractual monopolies and monopsony.

In line with the Energy Framework the intervention of the state in the oil sector, analysed in Chapter 4, resulted into the capture of business by the state and prompted the rise of Rosneft in the oil sector with private oil companies being either absorbed by Rosneft or, when willing to follow the state policy like in the case of Lukoil, becoming partners to the state majors. The power of the state over the oil sector allows it to use both state and private companies as foreign policy tools in the formation of foreign oil policy making in the Caspian.

In order to see the effect of Russian oil foreign policy in the Caspian we should take into consideration the operations of all three Russian companies that work there, as the oil sector is not a single unit as the gas sector has been for a substantial period of time, thus it needs coordination among different companies and the state in order to be successful. The most evident case where this happens is the CPC line, which is seemingly an independent pipeline that bypasses Russia, but in reality is a project where Russia has a very strong voice in through the combined shares of Lukoil, Rosneft, Transneft and the Russian state itself.

The biggest Caspian oil producer is Kazakhstan, followed by Azerbaijan and Russia's goal is to join in the exploitation and transportation of their resources. In Kazakhstan, it has been so far successful as both Lukoil and Rosneft are working on Kazakh oil fields, both off and onshore, plus the majority of Kazakh oil is transported either through the CPC or through other Russian

controlled channels. Russia's acquiring large amounts of oil, almost the whole oil output of the country, from Kazakhstan is a commercial way to block energy policy decisions made against Russian interests, and protect its own energy security. In the case of Azerbaijan, Russia has not been altogether successful, managing only to have Lukoil participate in the two main Azeri fields in the Caspian and Transneft use a small amount of Azeri oil for the European markets. Nevertheless, it still manages to infiltrate the Azeri oil market, albeit to a small degree.

This Chapter demonstrated how the commercial activities of the Russian oil companies when seen within the energy policy framework reveal the degree of the influence that the Russian state has over the oil sector of the Central Asian countries. Furthermore, when we combine the influence that the Russian state exerts in both the oil and gas sectors of the Caspian states we can understand the degree of infiltration of Russia in their energy sectors through its companies. As a result we are able to observe how Russian foreign energy companies are used as foreign policy tools by Russia in order to achieve its foreign energy goal of becoming a major player in the global energy markets.



## CHAPTER 7: Conclusions

### 7.1. Introduction

This thesis has aimed to elucidate *why* and *how* Russian foreign energy policy is conducted in the Caspian region, paying particular attention to the Putin administration. The focus is justified on the basis that energy has become much more relevant and, for specific regions, central to Russian foreign policy making since Putin came to power. Furthermore, the case of the Caspian has been selected on the grounds that despite being central to Russian area studies in the past in respect of its oil and gas reserves, as the author has already argued, the analysis offered can be seen as incomplete. Studies have overlooked the use of companies as agents of policy making, especially as separate case studies. Moreover, in reference to the Russian oil and gas companies' operations in the area, there has been a failure to define the restraints on a company to act as an influential political agent abroad and to interpret the overall company strategy within the framework of Russian foreign energy policy. These omissions have limited our understanding of Russian foreign policy conduct in the Caspian.

## 7.2. Thesis contribution

### 7.2.1. State-business relations in the Russian oil and gas sector

The contribution of this thesis is mainly evident in three interrelated areas. The first contribution in the field of domestic politics (with regards to state-business relations in the Russian oil and gas sectors) offers a different perspective on the relationship between the state and companies through the *inclusion* and *exclusion* mechanisms of the oil and gas business actors by the state as influential players from the decision making centres and the decision making process as a whole. The relationship is investigated, predominantly by the ability to lobby state structures through either lobbyists or lobbying organisations, as a parallel and interwoven process to the political consolidation of the state. The argument made is that the capture of the oil and gas business sectors by the state became possible only after the installation of Putin's power vertical. This process involved gaining an absolute majority inside the Duma and thus eliminating any serious competition from non-conformists to the state line, having direct control over strategic resources, like oil and gas, as well as, over foreign policy making and thus having at its disposal the necessary tools to control the companies' activities. By looking at the lobbying process we can see two results as a causal effect of the power vertical in the political life of Russia: the first has been the exclusion of private companies from decision making; the second is the concentration of power in state companies both as influential actors in Russian politics and as agents of the state in the consolidation of the energy sector. The steady two-way process of the *inclusion* of state companies into and the *exclusion* of the private companies from decision making presents a more holistic picture of state-business relations in the Russian oil and gas sectors and better

explains both the state's hold on the sector and the undisrupted duration of the relationship, a fact that contributes to the ability of the state to use companies in foreign policy making. Through control of policy-making channels, the Russian state has managed to bring private companies under its control and promote state companies both domestically and abroad when possible. The power leveraged by the state over the oil and gas companies has made it possible for them to be used as agents of the state abroad.

### **7.2.2. Russian foreign policy analysis**

The second contribution in the field of foreign policy analysis, with regards to the study of Russian foreign energy policy in general, lies in the *analysis* of the continuities and change in Russian domestic and external politics and their *synthesis* in order to further our understanding of the actual processes of foreign energy policy making. The argument is that although there has been a lot of research done on Russian foreign policy conduct there are two main problematic *epistemological inadequacies*, which limit our understanding of Russian policy making. These inadequacies are at the *analysis* level and the *synthesis* level. One part of the problematic at the *analysis* level is that certain practices are either taken for granted, like the fact that Russian state companies act as foreign policy agents abroad, or their function is explained through other ill defined concepts, like Russian energy security, a notion that has been rarely defined clearly, or the link between Russian foreign and energy policy.

The second part of the problematic relates to the separation between politics and economics in the analysis of foreign policy, both among Russian area studies experts and foreign policy

experts in general<sup>21</sup>. The gap that this practice creates is that domestic actors are not taken into consideration when analysing Russian foreign policy. Furthermore, there is a notable absence of examining non-state actors in foreign policy making and specifically energy companies, which are commercial players. The logic behind this argument is that foreign policy making is conducted through both state and non-state actors. The state normally intervenes only when there are landmark decisions to be made or when there is a major crisis where the energy sector is involved. This has been already discussed at length in current Russian foreign policy analysis. What has not been covered to the same extent is the day to day policy making through the daily operation of the companies inside the Russian energy policy framework. By looking at the non-state actors in Russian foreign energy policy we can see *how* energy policy is applied in practice.

The problematic at the *synthesis* level, which is closely related to the problematic at the *analysis* level, is found in two frequent trends among Russian area studies analysts. The first of these is that despite the fact that there has been state-business analysis done regarding the Russian oil and gas sectors, it has always been treated as a domestic issue for the Putin administration overpowering the oligarchs. The argument of this thesis is that by looking at the relationship through the *inclusion* and *exclusion* framework of analysis, we can establish the real extent of the power that the state has over companies and comprehend better *how* and *why* the companies' interests are harmonised with those of the state in foreign policy. The second trend, which is connected to the first one, is the fact that exactly because there is a lack of *synthesis* in Russian foreign policy analysis, there are gaps which create inconsistencies in the study of Russian foreign energy policy. So for example when we are looking at Russian foreign energy policy in

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<sup>21</sup> A lot of studies of Russian foreign energy policy have been based on Political Economy which is a discipline on its own, but the author here refers to the lack of taking into consideration economic actors or the role of the economy in the analysis of Russian foreign energy policy.

the Caspian without looking at the commercial activities of the Russian oil and gas companies in the area within the framework of Russian foreign energy policy making, i.e. through the legal and contractual monopolies of the companies in the region, then we tend to either focus on only the political influence that the Russian state exerts at times of crisis or to assign political power to Russian state companies. By first *analysing* separately and then *synthesizing* all the different components of policy making we can acquire a systematic study of Russian foreign policy conduct.

### **7.2.3. Russian foreign policy in the Caspian**

The Third contribution is in regard to the study of the Caspian region. This thesis adds to our comprehension of Russian foreign energy policy in the area by applying the thesis hypothesis to two separate case studies; one is the oil sector with the examples of Rosneft, Lukoil and Transneft and the other is the gas sector with the example of Gazprom (see chapters 5 and 6). The Caspian is an area where this new propensity in Russian foreign energy policy can be observed, as the region is especially important to Russia for its pipelines that give access to the European markets and its resources and the other Central Asian countries, rather than of the Russian Caspian sector's actual resources themselves. Russian foreign energy policy in the Caspian demonstrates the effects that the changes in the domestic environment have had on the foreign policy making environment. The installation of the vertical of power and the capture of business by state corporations internally had as a consequence the emergence of new actors in foreign policy making, which could deal with the demands of the new foreign policy tendencies; a combination of economic and political policies and interests. The originality of this

contribution is that despite the fact that there have been various studies of Russian companies and their role in foreign policy formation in relation or in reference to the Caspian region (mostly about Gazprom and two in-depth studies on LUKoil and Rosneft), they have never been approached through the lens of the *analysis* and *synthesis* framework in order to give the complete picture of Russian foreign energy policy in the area. This originality is at the core of the contribution this thesis makes to Russian area studies.

### **7.3. Research findings**

The main problematic in current Russian foreign policy analysis is that despite the fact that energy and specifically the oil and gas sectors are used as the basis for Russian foreign policy in specific areas like the Caspian region, there is no understanding of how this is done in practice. The most obvious answer to the question of how is Russian foreign energy policy conducted would be through the use of Russian oil and gas companies. But then other questions arise such as how is this done exactly? There are different types of oil and gas companies. Some are state controlled, others are private. Even if we accept the vague assumption that state companies can and are used as foreign policy tools, the question still remains of how can a private company be used as a foreign policy tool? How much control can the state have over a commercial entity in order to entrust it with the mandate of conducting foreign policy? Even in the case of state controlled companies, how can a company act as a political agent? What are the limitations of this? In sum, how can commercial interests be harmonised with state interests and then be applied in Russian foreign energy policy in the Caspian?

The logic of this thesis was based firstly on establishing the links between the state and oil and gas business and then on showing how companies are utilised in foreign policy making by using the Caspian as a case study. The conceptual framework of the analysis was built upon a two-level hypothesis; on the first (domestic) level, the hypothesis was that there is an relationship between the domestic process of the consolidation of both political actors and the energy sector under Putin's power vertical and the ascendancy of Russian oil and gas companies, both state and private, as foreign policy tools in the Caspian. On the second (external) level, the hypothesis was that in order to fully understand the use of Russian oil and gas companies in the conduct of foreign policy making in the Caspian there is a need to look at the commercial actions of the companies inside the framework of official Russian foreign energy making.

### **7.3.1. Analysis at the domestic level of the hypothesis**

#### **7.3.1.1. State-Business relations in the Russian oil and gas sectors: Means of Inclusion in and Exclusion from policy making**

The consolidation of the state has been a parallel and reinforcing process to the consolidation of the energy sector. By looking at the practices of *inclusion* and *exclusion* of the oil and gas companies by the Russian state from decision making, we can establish the link between the state and the energy sector as an ongoing process instead of a selection of different milestone events, such as the Yukos affair or the TNK-BP incident. These events have of course been pivotal in the formation of state-business relations but they do not explain fully how selected events have been influential enough to stop private companies from acquiring power or some kind of power again.

The answer is that they cannot because the channels leading to the decision making centres have been controlled by either the state or state controlled companies since the installation of Putin's power vertical. Thus private companies in the oil and gas sectors can only cooperate with the state or a state controlled company in order to assure its commercial survival.

Throughout the length of the relationship between the state and the oil and gas business sector from the Yeltsin to the Putin administration, there has been one steady indicator of the degree of the capture of any part by the other, the extent of the state's strength<sup>22</sup>. As it was discussed in Chapter 4, at periods when the state was weak there was a capture of it by business, as during the Yeltsin administration. On the contrary when the state was strong, as in the Putin administration, there was a capture of business by the state. A link between the power of the state and that of the companies is not implied here. The strength of the companies themselves is irrelevant to the weakening or strengthening of the state, meaning that the companies themselves are in a position to influence it, though the opposite can and has happened. In this respect the state is always the more influential part of the equation.

During the Yeltsin administration (1993-1999) the mechanisms of *inclusion* and *exclusion* to power were not in operation as the state was too weak to capture business. The openness of the political environment of the time allowed for a greater degree of access to decision making. There was a multiparty system where the party of power was a minority in the Duma. The legislature was independent from the executive and the key lobbying activities of the oil and gas companies took place inside the Duma, mainly with regards to privatization auctions. The

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<sup>22</sup> The terms 'strong' and/or 'weak' when in reference to the state relates to the degree of the centralization of power and the ability to exert influence over the political and economic actors.



multivocality of the Yeltsin period and the balance of power between the executive and the legislature made it possible for different companies to lobby for their own interests. The newly created economic elite, the so called oligarchs, rose to power and managed to capture the state through financing the government or various party activities or even by running for office themselves. The peak of their power during this period was the re-election of Yeltsin aided by the oligarchs in 1996. Lobbying at the Duma increased as more oil lobbying groups were created and more Duma deputies sided with the various companies. Unlike the present time, most companies had access to the Duma, both Russian private and state ones, as well as foreign companies. However, by the end of this period it was clear that foreign companies had a disadvantage vis-à-vis Russian companies. In sum it has been argued that the capture of the state by private business in the oil and gas sector during the Yeltsin administration was translated in practice into the *inclusion* of the mainly private oil people in the process of decision making, even resulting in the occasional *exclusion* of the state companies from decision making.

The Putin period has been widely marked by a shift in the balance of power in favour of the state. Nonetheless this has been a gradual process rather than an instant one. When Putin came to power in 1999 he inherited Yeltsin's 'environment', i.e. the elites that were already established during the 1990s, and added a new kind of elite from his inner circle. Putin's goal to assert the power of the state over every strategic sector of the economy and political life started to materialise through actions such as the founding of United Russia, the last (and strongest) incarnation of the party of power, which started to consolidate the state politically. Rising oil prices since 2001 geared an ever increasing interest in the oil and gas sectors. Nonetheless the Russian state was still too weak to exert any influence over private companies. During this time

the activities of the company people inside the Duma were colossal, as well as through different channels to decision making, like lobbyist organizations such as the RSPP or personal contacts with the Putin administration and Putin himself. Towards the end of 2003 the Yukos affair took place and the state started to reassert its power over the oil and gas sectors.

During Putin's second term (2003-2007) both the consolidation of the state politically and the consolidation of the oil and gas sector were completed and the mechanisms of *inclusion* and *exclusion* were in full motion. The power vertical was firmly put in place with United Russia receiving 37% of the seats in the Duma, practically controlling the opposition, and the president became very powerful as many strategic sectors came under his direct rule. The concentration of power at the top made any other channel for lobbying redundant. The gradual decline of access for private companies to the legislature took place in parallel with an increase in the power the state held over the political life of Russia and as has been argued, this has happened because of and not in spite of it.

#### **7.3.1.2. Results of the mechanisms of *inclusion* in and *exclusion* from policy making**

The mechanism of *inclusion* and *exclusion* had two results. The first result regarding the *exclusion* of private companies from decision making had two different outcomes. The most influential foreign companies operating in Russia were effectively eliminated, e.g. TNK BP. This elimination was either literal or through the threat of bankruptcy and the grabbing of their assets by the state through taxation raids and so on. As a result, the state ensured that there would not be any involvement of foreign interests in the energy policy line of the companies. Apart from

the obvious rationale behind this move which is the fact that foreign involvement in a strategic sector of a country's economy should be as minimal as possible, it also served the purpose of ensuring that there would be no foreign involvement serving possibly competing interests in the companies' foreign policy, such as for example Gazprom's gas pipelines' policy in the Caspian region and the opposing western interests of building alternative pipelines.

In relation to Russian private companies as a result of the mechanism of *exclusion* they began losing ground when it came to important decisions such as their participation in PSAs, passing favourable laws like tax reliefs in their favour and so on. As a result the Russian private companies which survived the selective elimination of other companies, like Yukos, or integration with a state company, like Sibneft with Gazprom becoming GazpromNeft, were forced to side with state companies and sometimes submit to them in order to assure their survival.

The second consequence regarding the mechanism of *inclusion* of state companies in decision making is that it resulted in the ascendancy of these companies first domestically and later internationally, as they were favoured by the new political situation in Russia. Domestically they managed to strengthen their presence in the internal market by increasing their market capital through the acquisitions of other companies, such as Yukos and Sibneft, as part of the consolidation of the energy sector, as well as through exclusive access to major projects inside Russia, e.g. Eastern Siberia. At the same time because of the mutually exclusive relationship between the *inclusion* and *exclusion* mechanisms, state companies acquired the privilege to have access to decision making centres as private companies lost theirs. As was argued in Chapter 4,

the institutionalisation of lobbying practices meant that private companies could only have access to power through the two blocks that were created, those of Gazprom and Rosneft.

On the international level, the takeover of the oil and gas sectors domestically gave rise to the Russian state and loyal-to-the-state companies as agents of Russian foreign policy abroad. The case of the Caspian region has been an example of this development. The importance of this event has been that although it is undeniable that the emphasis on energy in Russian policy making has been a product of many parameters, both domestic and external, like the rise in oil prices in 2001, without this internal shift of power in state business relations the conduct of Russian foreign policy wouldn't have been properly implemented in practice. These two parallel processes in the domestic sector made the shift in Russian foreign policy possible. Now Russian foreign policy could become Russian foreign energy policy.

### **7.3.2. Analysis at the foreign level of the hypothesis**

#### **7.3.2.1. The Link between Russian Foreign Policy and Energy in the Caspian**

The focal point in Russian foreign policy since Putin's first presidential term in has been energy and more specifically oil and gas. The economic growth of the country, tightly linked to its oil and gas sector, is central to Russia's foreign energy policy objective of becoming an influential world energy supplier and economic actor. The Caspian region is a key geographic area in this respect. This is for two reasons; firstly, despite the fact that Russia possesses much larger quantities of oil and gas in other parts of the country, like West and East Siberia, as it was argued

in Chapter 3 and applied in Chapters 5 and 6, in the Caspian Russia has both access to its own resources but also to the resources of the other littoral states. Secondly, the Caspian is critical due to the network of oil and gas pipelines that cross Russia and end up in the European markets. As has been argued in this thesis, Russia's foreign policy towards Central Asian states is becoming more and more commercial and Russian oil and gas companies are playing a central role in its implementation.

Russia's objectives in the oil and gas sphere in the Caspian are a mixture of economic and political issues within the security mindset of the foreign policy framework. They are principally two; control of oil and gas production and control of oil and gas transportation to the European markets. Attainment of these goals has two outcomes for Russian foreign policy; the first is that Russia maintains its economic hegemony in the region by continuing to obtain maximum profit from all forms of oil and gas sales and transportation by keeping to a minimum the competition for the European market from the other oil and gas producing countries in the region. The second goal is that it is able to use this power over Central Asian states as leverage and in this way to preserve and extend the already existent politico-economic influence that it has over these countries and consequently use it when desirable and possible in order to achieve its energy policy goals there. As was argued in Chapters 5 and 6, Russia through the commercial activities of its companies manages to control both the production and transportation of natural reserves of the other littoral states and thus secures maximum profits from the oil and gas volumes that transit both its pipeline system and those that pass through alternative routes.

## 7.4. Synthesis

### 7.4.1. Russian Foreign Energy Policy in the Caspian: Bringing the picture together

The reassertion of state power over the oil and gas companies under Putin gave his administration the potential to use the companies as agents of foreign policy making within the framework of Russian foreign energy policy. The case of the Caspian has been investigated in this thesis through looking at the daily functions of the four Russian companies which operate in the region, Gazprom for gas, Transneft, Rosneft and Lukoil for oil. The argument which has been demonstrated in Chapters 5 and 6 is that through an elaborated set of legal and contractual monopolies, the Russian oil and gas companies by acting exclusively as commercial entities materialise and preserve the goals of the Russian state in the Caspian, which is economic hegemony through the maintenance of both the *monopoly* status which Russia enjoys in Central Asia, as well as, the *legal monopolies* through the use of the Russian pipeline network.

The objective behind this tactic is that the original hegemony in the Caspian enjoyed by Russia for many years after the collapse of the Soviet Union due to the inability and lack of alternatives available to other oil and gas producing countries has begun to come to an end. As any other independent state, the Central Asian countries can decide whom to cooperate with and which pipeline route to choose depending on their own national/commercial interests. This of course would be contrary to Russia's interests as it seeks to both benefit from other countries resources and minimize competition in the European markets. This would give Russia both financial gains and leverage against both the Central Asian states and Europe as its main supplier. Through its

oil and gas companies, Russia manages to keep most of the Central Asian states dependent on its transportation system by reinforcing their commercial commitments towards it and to eliminate competition by acquiring rights to their oil and gas resources through exclusive buying deals.

The realisation of Russian foreign energy policy objectives of economic hegemony, control over the pipeline network and utilising Central Asian gas in the Caspian is done through the legal and contractual monopolies of Gazprom. The main Caspian gas target-countries for Russia are Kazakhstan, Turkmenistan, Uzbekistan<sup>23</sup> and to a much lesser degree Azerbaijan. Gazprom holds a legal monopoly on exports to European markets from the Caspian and all the littoral states are dependent for exports, for the time being, on the old soviet pipeline system which runs to the north through Russia and from there to the west into Europe. In 2007, Russia imported 8.5 cubic metres from Kazakhstan and exported 10 billion cubic metres, i.e. Russia is both the main importer of Kazakh gas and a net exporter to Kazakhstan<sup>24</sup>. Of the 65.3 billion cubic meters of gas Uzbekistan produced in 2007, 50.6 billion cubic meters were consumed internally, 10.5 billion cubic meters went to Russia. From the 72.3 billion cubic meters of gas Turkmenistan produced for the year 2007, 18.0 billion cubic meters were consumed internally and 48.1 billion cubic meters went to Russia. In essence the bulk of all the gas from Central Asian countries is exported exclusively through Russia(IEA 2008).

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<sup>23</sup> Despite the fact that Uzbekistan is not a littoral Caspian state and thus this thesis is not primarily concerned with it, based on the fact that it is part of the wider Central Asian area and that it is a major gas producer makes this additional information relevant to the research as it enhances the main argument of Russia's economic hegemony in the Caspian.

<sup>24</sup> The reason why Kazakhstan needs to import gas from Russia is related to its inadequate infrastructure as explained in detail in Chapter 5

As it was discussed in length in Chapter 5, Gazprom's contractual monopolies of Gazprom which reinforce the company's legal monopoly as they prevent the other gas producing states from taking part or fulfilling their contractual obligations they have signed where they need to use an alternative to the Russian pipeline route, like the Nabucco pipeline, include; acquiring rights and assets in other Central Asian countries' gas sectors, as in the case of Kazakhstan; making deals to buy all the gas produced in these countries available for export, as in the case of Turkmenistan which signed a 25 year strategic agreement to supply Russia with the 'maximum' volume of production, or in the case of Uzbekistan which signed a 15 year supply agreement with Gazprom; and signing agreements obliging Central Asian states to use the Central Asian Gas Centre, such as the Agreement on the use of the Central Asian Gas Centre and the construction of a Trans-Caspian pipeline (all the agreements are outlined and explained in detail in Chapter 5).

The materialisation of Russian foreign energy goals in the oil sector of the Caspian differs from that in the gas sector. This is for two reasons; the first is the fact that oil supplies are not physically attached to the pipelines, thus they can also be transported by other means, such as tankers and railways, which the Russian state cannot control. This makes the continuation of the legal monopoly of Transneft in the area much more difficult than Gazprom's and less straightforward. The second reason is that due to the fact that the Russian oil sector had been divided among different companies during the privatisation period, there is not one company which can serve Russian foreign policy goals in the Caspian, as with Gazprom in the gas sector, but three companies, one of which is private, Lukoil. In this respect the *analysis* and *synthesis* framework of study is even more important for us to understand *how* a private company can be



an agent of the state abroad. This is especially significant in the case of Lukoil and Rosneft, as Rosneft cannot operate freely abroad due to the legal restrictions imposed on it because of the acquisition of the Yukos assets, as explained in detail in Chapter 6. It must be noted here that while the manner of foreign policy conduct in the Caspian is different from the gas sector, energy policy objectives remain the same.

In the field of oil transportation through pipelines, Transneft maintains a monopoly on the export of oil to European markets that transits the Russian pipeline system. There are another two major independent commercial pipelines, which do not travel through Russian territory; the Caspian Pipeline Consortium which nonetheless is dominated by Russia, as was explained in detail in Chapter 6, and the Baku Tbilisi Ceyhan pipeline, which is a US-led project that transports Caspian oil to the Black Sea via Georgia bypassing the Russian oil pipeline system. The BTC line is the most problematic pipeline network for Russia as it has no access to the oil carried through it, thus it is perceived to be a direct threat to Russia's transportation objectives in the Caspian. Russia's goal in this respect is to block major oil producers' access to the pipeline through contractual monopolies.

The main Caspian oil target- states for Russia are Kazakhstan, the biggest oil producer in the Caspian with annual exports of 52 million tons of oil, and Azerbaijan, the second biggest with annual exports of 35.2 million tons of oil. Lukoil and Rosneft take part in most major projects within Kazakhstan and Lukoil is a major partner in Azerbaijan's largest offshore hydrocarbon basin in the Caspian Sea, the Azeri Chirag Guneshli field, which accounted for over 80 percent of Azerbaijan's total oil output in 2008. Azerbaijan does not use the Transneft system, but

Kazakhstan does. From the 52 million tons of oil produced annually, 20.4 millions of tons go through the Transneft network and the rest through the Russia led CPC line. The contractual monopoly Russia imposes on Kazakhstan guarantees the continuous dependency of Kazakhstan on Russian oil export routes and the exclusion of its oil flowing through alternative export pipelines.

The last part of the *synthesis*, which will help us gain a deeper understanding of Russian foreign energy policy conduct in the Caspian through its oil and gas companies, refers to the combination of the commercial actions taken by the companies inside the framework of Russian foreign policy analysis. When we put all the *analysis* together we can make four main observations with regards to Russia's foreign energy policy goals in the Caspian of becoming an influential energy player for both Europe and Asia. The first observation is that through its companies Russia's goal to have access to Central Asian resources has been to a large extent obtained, especially in the gas sector. In the oil sector, while Russian companies have great access to Kazakhstan's reserves, Azerbaijan is much more reluctant to cooperate with Russia, although Lukoil is a major partner in its biggest project.

The second observation is that the objective of enforcing the legal monopolies of Gazprom and Transneft has also been met to a large extent. Again in the gas sector Gazprom seems to have a very strong hold on the main gas producing countries, not only restricting them from using other alternatives through the contractual monopolies, but also by reinforcing their interdependence through signing or renewing deals for the use of the Central Asian Centre pipeline. In the oil sector where there are alternative routes a monopoly has been much more difficult to achieve.

Kazakhstan sends half its oil through the Transneft system and half of it through the Russia dominated CPC line, so in essence through its companies Russia benefits both directly via Transneft and indirectly through dominating the alternative route pipeline, i.e. the CPC. Azerbaijan does not use the Transneft network preferring to send its oil mainly through the BTC line. The third observation is that as a consequence of the above Russia's economic hegemony in the region is reinforced through both the capture of the other producing countries' reserves and the elimination of competition regarding the European markets. The fourth and final observation is that through its companies Russia manages to preserve and enhance its politico-economic leverage in both Central Asian countries and Europe, which in turn can be used in the future in order to push for better energy deals and more power over the Caspian region.

## **7.5. Directions for Future Research**

This study creates a lot of possibilities for further research. There are three main directions that such future research could follow. The first one is in relation to additional area studies research, based on the analysis of official policy documents, elite interviews and quantitative data, on Russian state-business relations and how they reflect on Russian foreign policy making in the Caspian. The suggested conceptual framework informed by Neo-liberal ideas on non-state actors in foreign policy used in this thesis could be applied to other Russian business sectors which are active in the Caspian, like the Russian electricity sector. The results of this research could further our understanding of the use of Russian different energy companies in the formation of Russian foreign energy policy in the Caspian as a whole.

The second direction is in relation to the other Caspian littoral states. The same model of analysis could be used based on the *inclusion* of state companies in and the *exclusion* of private companies from decision making informed by the Neo-liberal ideas on the importance of non-state actors in international affairs. Specialisation on the politico-economic system of each country and language skills used in order to interpret official documents and conduct interviews will assist in the in-depth study of the subject. By comparing and eventually combining all the findings of this research we could gain deeper knowledge of how the various Caspian states' oil and gas companies act as agents of foreign energy policy in the Caspian as a whole, if they do at all.

The last direction is an area studies research, based on the conceptual framework suggested in this thesis, of the use of Russian oil and gas companies, or lack of it, in Russian foreign energy policy in other geographical areas, like East or Western Siberia. Analysis of primary sources on energy, security and foreign policy, and elite interviews with policy makers and business executives might reveal different energy security priorities in the given territories and thus a different role for the Russian oil and gas companies to play in the conduct of Russian foreign energy policy there. This study would be interesting as it could demonstrate how important or unimportant the specificities of each region and the already set relations among the states involved are for the companies to be able to operate as foreign policy agents. It would also offer us the knowledge of other case studies that could help us understand deeper Russian foreign energy policy in the oil and gas sector as a whole.

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## **Appendix**

### **Personal Interviews**

#### *State Elites*

Alferov, Zhores I. (2008) Duma Deputy, Communist Faction, Moscow 21 October

Gratsov, Ivan D. (2008) Duma Deputy, A Just Russia Faction, Member of the Committee on Energy, Moscow 16 October

Grizlov Alexey (2008) Former member of the Yeltsin Administration (worked under Gaidar)/Currently works on the Energy Strategy up to 2030, Moscow 19 May

Grozin, Andrei (2008) Former member of the Kazakh Presidential Administration, Vice Director Institute of CIS countries-Expert on Central Asia and Kazakhstan, Moscow 16 May

Igoshin, Igor (2008) Duma Deputy, United Russia Faction, Member of the Committee on Innovation, Technology and Science, Moscow 19 May

Klimov Andrey (2008) Duma Deputy Chair of the Committee on International Affairs United Russia Faction, Moscow 19 May

Novikov, Sergey (2008) Head of the Federal Service for Tariffs, Moscow 22 September

Peshkov Maxim (2008) Ministry of Foreign Affairs, Director of the Third CIS Department, Moscow 23 October

Pleshin, Leonid (2008) Ministry of Energy, Director of the Central Asian Division, Moscow 23 October

Satarov, Georgi A. (2008) former member of the Yeltsin Administration, Moscow 15 April

Subbotin, Mikhail (2008) Director of the Science and Consulting Company PSA-Expertise, former member of the Ministry of Energy under Yeltsin, Moscow 29 April

Yazev, Valery A. (2008) Deputy Spokesman of the Duma, United Russia Faction President of the Russian Gas Society, Member of the State Duma Energy Committee, Moscow 25 September

#### *Companies*

Barkov, Mikhail (2008) Vice President of Transneft, Moscow 8 October

O'Brien, Peter (2008) First Vice President of Rosneft, Moscow 30 September



[Anonymous] Gazprom Representative (2008) Gazprom, Moscow 19 May

[Anonymous] Member of the Managers Board of a Russian Gas Company #1 (2008) Moscow 21 October

[Anonymous] Member of the Managers Board of a Russian Gas Company #2 (2008) Moscow 21 October

### ***Lobbyists***

Korzun, Elena (2008) General Director of Assoneft, Moscow 29 October

Kotelevskaya, Irina V. (2008) Russian Union of Industrialists and Entrepreneurs, Head of the Department for Ties with the Authorities, Moscow 16 May

Krylova, Dina V. (2008) Chief Executive and Board Member, Director of the Centre of Expertise on Small Business problems, OPORA Russia, Moscow 28 October

[Anonymous] Member of the Board of Directors (2008) Association of Petroleum Refineries and Petrochemicals Moscow 18 September

### ***Academics***

Belyi Andrei (2008) Higher School of Economics, Head of Energy Institute, Moscow 27 March

Kryukov, Valery (2008) Head of Economic department, Higher School of Economics, Moscow 25 September

Milovidov, Konstantin, N. (2008) Head of Department International Oil and Gas Business, Moscow 13 October

Safaryan Armen V. (2008) Executive Director International Institute of Energy Policy and Diplomacy, Centre for Strategic Energy Research and Geopolitics, MGIMO University, Ministry of Foreign Affairs, Moscow 18 April

### ***Journalists/Experts***

Auzan, Alexander A. (2008) President of the National Project Institute, Moscow 6 October

Belova, Maria (2008) Institute for Energy and Finance, Head of the Oil Infrastructure Division Energy Department, Moscow 14 October

Elder, Mirriam (2008) The Moscow Times, Journalist/Expert on the Russian Energy Sector, Moscow 21 April

Gromov, Alexey (2008) Deputy General Director, Institute of Energy Strategy, Consultant for the Ministry of Energy Russian Federation Moscow 15 October

Kozertsyk, Ekaterina (2008) Vice Director of Neft u Kapital, Moscow 15 April

Mahortov, Evgheny (2008) Member of the Committee on the Problems of the Fuel and Energy Complex and the Reproduction of the Mineral Resources Base, Ministry of Energy/Senior Analyst, Centre for the problems in the relations between business and state, Moscow 29 October

Simonov, Konstantin (2008) General Director of the National Energy Fund, Moscow 13 October

Sourzhenko, Vera (2008) Energy reporter, Vedomosti, Moscow 29 April

Tolstikh, Pavel (2008) Senior Analyst, Centre for the problems in the relations between business and state, Moscow 29 October

Verezemskii, Sergey (2008) Head Director of Neft i Kapital, Moscow 15 April

Volkov, Alexey (2008) Institute for the Problems on anti-Monopoly, Moscow 7 October

Yakhuda Viktor (2008) Journalist for Russian Business Daily and Business Consultant, Moscow 17 April

[Anonymous] Independent analyst on the Caspian (2008) Moscow 16 May