Russia is awash in oil, and these days it is awash in oil money. There is no doubt that the Russian economic recovery of the past several years has been driven by hydrocarbons, especially petroleum. But what does it mean for Russia? The resource curse literature rightly calls attention to several negative outcomes that can accompany rapid natural-resource exploitation, from retarding growth in other sectors to undermining state institutions and impeding democratization (Karl 1997; Ross 1999, 2001). In the Russian case specifically, the state takeover of the country’s leading private oil company, Yukos, has soured many observers on the future of Russian political and economic development. Perhaps oil truly is a curse.

Of course, as Red Sox fans know—although Cubs fans may not be convinced—curses can be overcome. Can Russia avoid the negative consequences of oil wealth? This preliminary paper takes a step toward answering that question by examining what role oil plays—and does not play—in the Russian political economy and why. In complementary ways, Steven Fish (2005), Pauline Jones Luong and Erika Weinthal (2001), and Andrew Schrank (2004) have all suggested that oil’s effect on a political economy depends on the context in which it is developed, and in this paper I begin to explore that context in the Russian case. In the first section, I show in more detail how important oil is to the Russian economy and acknowledge that the Russian state seems sorely tempted to repeat historical mistakes of mis-management of the petroleum sector (and others). In the rest of the paper, however, I argue that all is not lost. The economy itself is more
complicated than simple dependence on oil, and the state’s management of oil revenues has been far from disastrous. Even the Yukos case does not represent an end to private business in Russia, but rather a change in state-business relations driven both by Putin’s worldview and by the fact that his government must compete with several other actors for control over the country’s resources. By describing some of the most important characteristics of the environment in which Russia’s oil boom is taking place, this paper begins to provide an empirical foundation on which to build theory in the tradition of those who have gone beyond the framework of the resource curse.

First the bad news: oil dependence and interventionist temptations

Russian economic growth since the end of 1990s has been highly dependent on one commodity—oil. Falling real costs for domestic inputs and rising international prices for outputs (although the two were not causally linked to each other) led to rapid increases in oil production. For example, TNK’s output was 42% higher in 2001 than 2000, and Yukos’s was 17% higher (Hill & Fee 2002, 466). Russian oil output in 1998 stood at about 6 million barrels per day (bpd), but by 2001, it was up to 7 million bpd, and by 2004, it was at 9 million bpd (Hill 2004, 12). Overall, oil accounted for about half of industrial growth in 2000-2003, and industry accounted for about half of overall economic growth in 2000-2003—thus, oil accounted directly for about 25% of GDP growth from 2000 to 2003 (Tompson 2004, 12). Even with the decline of output from Yukos, as long as prices remain well over their historical average, there is no way for petroleum not to play a leading role in the Russian economy.

In addition, the sector has probably contributed significantly in indirect ways, through domestic purchases of equipment and through the wages it paid its employees (Tompson 2004, 12; Hill 2004, 36). Furthermore, the continued high values of oil exports have allowed an
expansion of imports to meet rising domestic demand without returning to a reliance on foreign borrowing, which has probably made the recovery more stable than it otherwise would have been (Tompson 2004, 13). Similarly, increased state revenues from oil sales (and from the recovery more generally) allowed the Putin government to stop borrowing from the IMF and others and indeed to repay outstanding loans on time or ahead of schedule (Hill 2004, 15). While analysts disagree on how much the Russian economy would suffer if the price of oil fell significantly, everyone agrees that oil has been a fundamental driver of the recovery.

Putin himself has long argued that oil should be an important source of growth, so there is little reason to expect the state to do much to dampen its influence. In a 1999 article based on a 1997 kandidatskaia dissertation, he wrote that Russia’s natural resource endowment would have underpin the country’s economic expansion. Indeed, he expected hydrocarbons to be the driving force of the economy for at least 50 years (Balzer 2005).

But how should those resources be exploited, and by whom? The Yukos affair and related events have suggested that the state will be unable to refrain from heavy-handed involvement in business, with potentially deleterious results for the economy. Conventional wisdom was not always so grim. Although Mikhail Khodorkovskii is hardly a hero, given the way he acquired and built Yukos in the 1990s, most observers in 2003 believed those actions represented water under the bridge, interpreting Putin’s repeated assurances he would not reconsider old privatizations to mean he would not challenge the oligarchs. In addition, they pointed out that Yukos had recently become the poster child for improved corporate governance in Russia. Khodorkovskii had released his company’s accounting records for investor scrutiny, and Yukos seemed poised to attract the kind of foreign investment Putin claimed to want. More generally, a new, more productive, set of relations between the state and big business seemed to have developed. Opportunities for businesses, foreign and domestic, were growing; the economy was

1 Those figures are based on adjusted measures of sectoral contributions to growth. In official statistics, the “services” sector is over-represented because growth is sometimes attributed to trading companies, rather
expanding rapidly; poverty was declining. The news out of Russia seemed more consistently positive than at any time since the initial post-Soviet euphoria. Perhaps Putin was the strong leader Russia needed to complete its arduous journey toward capitalist democracy.

In July 2003, however, that optimism quickly unraveled after police arrested Menatep’s CEO Platon Lebedev from his hospital bed and put him in jail to await trial on charges of failing to pay about $300 million for shares of the fertilizer plant Apatit in 1994 (Dow Jones 7/3/03). At about the same time, another Menatep executive, security chief Aleksei Pichugin, was arrested and charged with two murders (Glasser 7/4/03). While observers were shocked that even Menatep and Yukos were not immune from such investigations, many investors, including Exxon-Mobil and Chevron-Texaco, nevertheless decided the flap would probably blow over (Ostrovsky 9/29/03). Putin could not afford to damage a flagship company, the argument ran, and at worst he probably wanted to remind leading business figures to stay out of politics in the run-up to elections in late 2003 and 2004. In reality, however, the initial arrests were only the beginning. After putting Lebedev and Pichugin in jail, authorities questioned Khodorkovskii and other company executives, raided Yukos’ headquarters, and expanded their investigation (Glasser 7/5/03; Tavernise 7/12/03; Lipman 7/10/03; Ostrovsky 7/19/03). In October 25, prosecutors arrested Khodorkovskii himself and held him without bail on several counts of embezzlement, tax fraud, and other economic violations (Glasser & Baker 10/26/03).² Soon thereafter, with Moscow’s encouragement and assistance, Roman Abramovich’s Sibneft oil company backed out of a merger with Yukos (Glasser & Baker 11/29/03).³

The saga dragged on into 2005 and included multiple tax charges against Yukos, asset freezes that prevented repayment, legal action in Houston, a badly rigged auction of Yukos’s main

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² Although most observers remained uncertain as to the endgame in the Yukos conflict, the arrest of Khodorkovskii was enough to convince both Exxon-Mobil and Chevron-Texaco to suspend talks on acquiring a large stake in the company (Jack, Ostrovsky, & Saigol 10/27/03).
production asset, and cameo roles for the Chinese and Indian governments (Zhdannikov 12/29/04). In the meantime, the trial of Khodorkovskii himself ground on (Faulconbridge 2/18/05). The spectacle finally concluded in May 2005 with a twelve-day reading of the verdict by multiple judges. Khodorkovskii and his partner Lebedev received nine-year sentences for fraud and tax evasion (Lowe and Zhdannikov 2005). Despite promises to appeal, one of the most powerful early winners in the struggle for property seemed to have met his match in Putin.

Perhaps even more distressing than the Yukos case itself for those watching Russia’s development under Putin was that the incident seemed to be part of a larger pattern of capricious state intervention in private business activities. In addition to the incessant attempts to force Yukos to sell Yugansk, the state also appeared to reassess the status of several other important economic groups at the time. While Yukos was the largest and most famous company to face renewed tax investigations in 2003 and 2004, it was hardly the only one. In July 2003, for example, soon after arresting Lebedev, prosecutors reopened an investigation into Oleg Deripaska’s acquisition of several properties, including Avtobank and the Nosta steel plant (Bloomberg 7/16/03). They had closed the investigation in June for lack of evidence, but it was re-opened because, in the words of a spokesperson, the original investigation had been conducted in a “non-objective way” (Ostrovsky 7/16/03). Similarly, the government launched a tax investigation into Sibneft in November 2003, and in March of the following year it announced the company owed $1 billion in back taxes (Munter 11/19/03; Baker 3/4/04). In yet another example, a tiny customer of telecommunications giant Vympel’com sued the company in late 2003, arguing that he did not have to pay his $800 phone bill because Vympel’com did not actually hold the license for the cellular frequencies it used. Lending credence to charges that the customer was a front for a rival company founded by Putin’s telecommunications minister, the government agreed with the customer in January 2004, essentially ruling that Vympel’com could

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3 The merger had Yukos paying about $3 billion for a 92% stake in Sibneft, leaving Abramovich with a little more than 25% of the new entity—Yukos-Sibneft, or Yuksi (Belton 9/10/03). The share exchange
not bill its subscribers (S. Ostrovsky 2/6/04; Fraser 3/10/04). Later in the year, it also denied Vympel’com an expected increase in the number of phone numbers available for new customers (Bloomberg 7/13/04). Each of those conflicts developed along different paths, and they each produced a wide range of speculation about causes and implications, but they clearly demonstrated that pieces of the federal government were reasserting themselves as major and aggressive arbiters in disputes over property.

Even more ominous for those who concerned about an increasing state role in property redistribution, the Russian Audit Chamber issued a report on privatization 1993-2003 in late 2004, claiming that the process was significantly flawed (Yurova 12/2/04). Broadly speaking, the report stated that early legislation and enforcement mechanisms had been so poorly designed and monitored that privatization had frequently been carried out incorrectly. In a preliminary report, the Chamber found that some kind of violation had occurred in 56 of the first 140 cases examined (Goldman 2004, 323). The final version pointed to problems in several specific cases, including insurance company Rosgosstrakh; oil majors Sidanko, TNK, and Surgutneftegaz; Vnukovo Airlines; the Rybinsk motor plant; and the Baltic shipyards (Yurova 12/2/04).

Foreigners were not exempt from criticism, either. In January 2004, for example, the government decided to invalidate Exxon-Mobil and Chevron-Texaco’s 1993 victory in an auction for rights to develop the oil fields at Sakhalin-3 and put those rights up for re-auction (Hill 2004, 31; White 2/11/05). In early 2005, an Audit Chamber report claimed Royal Dutch/Shell (and its partners, including Japan’s Mitsui and Mitsubishi) had deprived the Russian state of up to $2.5 billion by buying inputs from expensive suppliers (Reuters 2/10/05). The next day, the Russian Ministry of Natural Resources announced that majority foreign-owned companies would not be allowed to bid for the rights to develop a number of large oil fields (or some gold and copper

actually took place in October, but Sibneft was able to break the deal in November.
deposits) expected to be auctioned off in 2005 (White 2/11/05). The rules of ownership were being rewritten once again.

All of these moves by the government seemed to cow many in the Russian business world. For example, with Khodorkovskii being excoriated for his lobbying against oil tax increases and his “aggressive minimization” of Yukos’s tax liabilities, LUKoil spokesperson Dmitrii Dolgov, for example, said, “We understand that we have obligations to shareholders. But they are no more important than our obligations to society,” and several companies began to publicize how much they were paying in taxes (Raff 9/21/04). LUKoil broadcast that its tax payments rose 24%, while Sibneft said its effective tax rate in 2004 would be 20%, up from 15% (and even 12% in earlier years). The Novolipetsk Iron & Steel Works claimed it had paid more in taxes in the first 8 months of 2004 than it had paid for all of 2003, and Andrei Braginsky of Mobile TeleSystems noted that MTS’s effective tax rate in 2003 was 29% (Raff 9/21/04). Those statements were not complaints about high tax rates, as one might expect, but advertisements of companies’ commitment to the state and society. It is not hard to argue that the Russian state under Putin has been tempted by oil wealth to re-insert itself into the ownership and operation of key industries and that high petroleum prices are masking the long-term dangers of that approach.

All is not lost: The importance of context

Nevertheless, despite the importance of oil in the Russian political economy and the undeniable dangers it presents for future development, it is not clear that Russia is simply succumbing to a resource cure. Steven Fish (2005) has argued that the Russian situation is not typical of a resource-cure country, in that there seem to be no “rentier,” “repression,” or “modernization” effects at work (Ross 2001). Oil wealth is not being used to fund a large welfare state—instead, public spending and social service provided have dropped significantly since the

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4 The official justification was that Western companies might be content just to hold the assets as reserves, while the Russian government was interested in seeing the fields actually developed, which it argued
fall of the USSR. The repressive apparatus of the Russian state is significant and has
strengthened in recent years, but its growth seems unconnected to developments in the oil sector.
And despite the role of oil in both Soviet and Russian development, the broader economy and
society developed in very complex ways. In none of those ways is Russia like, say, Saudi Arabia.

Fish does not argue that Russia’s reliance on petroleum creates no problems for Russia.
Instead, he thinks it has hindered democratization in two ways. First, it fosters corruption, which
undermines accountability and public faith in elected institutions and may prompt calls for
 crackdowns on corruption without strong concern for due process, civil rights, or other mainstays
of democratic society. Second, it mitigates against deepening economic liberalization in a way
that would foster independent political activity.

This paper does not directly consider the question of democratization and is therefore not
concerned with Fish’s specific claims. They are important here because they remind us that oil
can have negative effects beyond those identified in the resource-curse literature. Two other
recent works have probed deeper into the problems of oil and have argued—in different ways—
that the context in which oil is discovered or exploited shapes the sector’s effect on political and
economic development. In the first, Pauline Jones Luong and Erika Weinthal (2001) find
evidence that the nature of privatization of the oil sector can shape its influence on a country. In
most cases, the petroleum sector remains state-owned, which often leads to problems like those
discussed in the resource-curse literature—“rent-seeking, excessive borrowing, wasteful
spending, and unbalanced growth” (215). When the sector is privatized, however, Jones Luong
and Weinthal find that those problems can be mitigated. Furthermore, foreign ownership tends to
undermine state building more significantly than domestic ownership.

A second work (Schrank 2004) also finds that the context in which oil is developed matters
for a country, although it focuses not on the ownership of the petroleum (or other natural-
resource) sector but on the broader sociological milieu in which the sector is embedded. Thus,

Russian companies would be more likely to do (White 2/11/05).
Schrank asks not why natural resources inhibit growth, but why some resource-rich countries grow and consume their resources while others remain poor and export them (2). He argues that countries with capitalist property relations tend toward intensive development and thus consumption of natural resources, while those with pre-capitalist relations tend toward extensive development and therefore export of natural resources (3).

For this paper, the most important finding in all three works just discussed is that the context in which oil is developed may play an important role in determining how that sector influences development in the country. The rest of the paper considers several aspects of that context in Russia and how they may shape oil’s role in the Russian political economy. It begins by noting that the Russian economy, although significantly dependent on oil, is considerably more complex than a simple oil economy. It then explores ideological and, more importantly, structural constraints on the Russian state’s relationship with petroleum. Those constraints consist of the country’s international position, its still-uncertain property system, and its federal structure.

*The economy is more than oil*

Petroleum has fueled recent growth in Russia, as demonstrated above, but a number of other sectors expanded as well. Labor productivity has risen in much of the economy, allowing Russian producers to continue to compete with imports in the face of ruble appreciation (OECD 2004, 29, 123, 125). Real wages rose 82% from 1999 to 2003 and were 28% higher than pre-crisis levels in early 2004. Indeed, another major force for growth has been increased domestic consumption, which has continued to spur growth in such areas as agriculture and food processing (Ahrend 2004, 13-14).

One source of this growth was the dramatic devaluation of the ruble in 1998. With the collapse of their currency’s value, Russians very quickly began to substitute domestically produced goods for imported ones (Tompson 2004, 9). Domestic producers (with access to dollars) were also aided by the fact that input prices, including for energy, did not rise as fast as
the ruble devalued, so their real prices dropped, at least through 2000 (Ahrend 2004, 9). Indeed, the devaluation was so large, that domestic producers of goods that could be substituted for imported items could actually raise their prices and still compete favorably with imports (Tompson 2004, 9). That, of course, meant inflation for consumers, but it also meant expansion for producers.

The devaluation even helped resuscitate the Russian agricultural sector. Indeed, agriculture was the first sector in which the import-substitution effect took hold, as citizens switched from hopelessly expensive imported foods to acceptable Russian substitutes. The shift significantly increased the number of profitable farms in the country, and the output of Russian agriculture as a whole rose every year from 1999 to 2001.\(^5\) Small private farms also benefited from the new environment, although their contribution to overall production remained relatively tiny. Likewise, with the growth of output from large farms, the proportion of Russian food grown on tiny personal plots finally declined marginally, although it still far outweighed the percentage of farmland in those plots.

And, of course, the devaluation helped Russian exporters. Any good with a ruble price became cheaper on international markets. More important, however, since Russia’s main exports were commodities priced internationally in dollars, was the initial drop in real wages and the price of other inputs in the production of those commodities (Tompson 2004, 9).

Devaluation and its after-effects, however, have not been the whole story of Russian economic development since the crash. Growth since 1998 has been considerably higher and lasted much longer than expected, repeatedly surprising analysts (see Table 1).

<table>
<thead>
<tr>
<th>Year</th>
<th>OECD Economic Outlook predictions</th>
<th>Actual</th>
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</thead>
<tbody>
<tr>
<td>1999</td>
<td>6.3</td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>1.0</td>
<td>10.0</td>
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In addition to the direct and indirect effects of oil discussed earlier, several factors have supported this sustained development in the economy. On the budgetary side of things, federal budget revenues rose from 9.1% of GDP in 1998 to 20% in 2002, in part because devaluation allowed for remonetization of the system (Aslund 2004, 400; Woodruff 2004 (APSA)). At the same time, while the Primakov government proposed spending increases, it was unable to raise expenditures as fast as revenues increased (Tompson 2004, 9). For instance, the government did not index pensions to inflation, which allowed their real value to fall “by about half between the summer of 1998 and early 1999” (Aslund 2004, 400). This can (and did) have a devastating effect on much of the population, as real social expenditures dropped rapidly, but it moved Russia into fiscal balance (and even surplus), which positively affected the economy for years after the initial effects of devaluation wore off (Tompson 2004, 12).

Also, the state has so far managed its oil revenues relatively well. It created a “stabilization fund” by significantly taxing petroleum companies for profits generated by abnormally high oil prices. So far, the fund has avoided the kinds of scandals that surrounded large pots of money—such as IMF loans—in the 1990s. Some observers fear the government will succumb to populist pressures for inflationary spending of the fund, while others argue the money should be invested instead of saved, but right now it provides a safety net for the economy as a whole, presumably increasing confidence and underpinning growth.

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<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>CAGD</th>
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<tr>
<td>2001</td>
<td>4.0</td>
<td>5.1</td>
</tr>
<tr>
<td>2002</td>
<td>5.0</td>
<td>4.7</td>
</tr>
<tr>
<td>2003</td>
<td>4.5</td>
<td>7.3</td>
</tr>
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*Source: Tompson 2004, 10; Ahrend 2004, 4.*

State-business relations beyond Yukos

Just the importance of petroleum in the Russian economy can be overstated, so also can too much be made of the Yukos affair and other apparent examples of state encroachment. Focusing on them ignores instances of state action in the opposite direction. That is, one of the greatest difficulties in arguing that the attack on Yukos and other actors represented the end of state support for private property lies in the fact that even as Putin’s government launched those attacks, it was privatizing other major assets. For example, Putin oversaw the privatization of the oil company Slavneft’ in late 2002 and allowed a private consortium (TNK and Sibneft’) to win. Indeed, the state-owned company Rosneft’ was excluded from the auction by a court decision two days before the sale. In addition, he allowed an unprecedented merger between TNK and British Petroleum in 2003. After years of antagonistic relations followed by a series of complicated negotiations, including direct meetings with Putin, TNK and BP agreed in June 2003 to pool their Russian oil assets into a 50-50 joint venture called TNK-BP (“BP Seals Historic TNK Tie-Up” 2003; Fridman, Jack & Ostrovsky 2003). Finally, Putin’s government sold its remaining stake in the oil giant LUKoil (about 7.6%) to ConocoPhillips for about $2 billion in September 2004, and the foreign company then expanded its holding to approximately 10% through stock-market purchases (Cameron, Ostrovsky, & Wagstyl 9/30/04; Bloomberg 12/24/04).

None of those decisions may win Putin great praise from supporters of private property in light of the Yukos affair, but they do need to be explained. One frequent approach is to argue that anti-market forces (usually in the form of the “siloviki”—men from the former KGB and other power ministries) have not yet entirely captured the Russian state and therefore have had to make concessions to economic liberals. Alternatively, perhaps the temptations of oil wealth haven’t fully manifested themselves yet. Kremlinology, however, has a spotty history at best, and explaining Russia’s present in terms of some expected future is a questionable approach. It may be more useful, therefore, to examine more closely the context in which oil is being developed in Russia.
In Putin’s Russia, where the president has focused much of his efforts on strengthening his office and administrative apparatus, one of the most important forces influencing the state’s relationship with oil is the president’s own worldview. Putin has consistently presented himself as a patriot, one who wants to re-develop the country domestically and internationally. More precisely, his understanding of the political and economic world seems based on the idea that the primary goal of policy is to develop the state as a whole, rather than any single part of society. In the international economic realm, this means Putin sees an arena where states, not firms, are the main competitors and in which relative gains are important. At home, while private economic activity is a powerful engine of growth, the state can and should foster economic development, especially when a country is far behind the economic leaders of the world. Those premises may turn out to be misguided, but they are not entirely without intellectual and political pedigree. Economic nationalism and state-led development have guided and assisted regimes throughout history and have met with some success in the past.\(^7\)

Whether those goals turn out to be realistic or not, they can help explain otherwise perplexing actions of his government. Khodorkovskii, for example, interfered with virtually every aspect of this vision of state-business relations. His lobbying against oil tax increases and his “aggressive minimization” of Yukos’s tax liabilities undermined the state’s ability to direct revenues where it thought they were needed, and his moves to build an oil pipeline to China outside the direction of the state hampered Putin’s ability to use energy as a foreign policy tool. Companies that did not so brazenly challenge this approach to state development have fared better.

Ideology, however, is a notoriously weak constraint on state action and therefore a weak explanator of government action. Even more important for understanding the Russian state’s relationship with its hydrocarbons is to remember the contexts of ownership and geography in

\(^7\) Economic nationalism has had its supporters in the United States at least since Alexander Hamilton, who wrote in 1791 that “Every nation ... ought to endeavor to possess within itself, all the essentials of national supply” (cited in Gilpin 1987, 180). Gerschenkron (1962) is a classic investigation of the virtues of state involvement in the economy in a country that needs to “catch up” with others.
which it operates. The federal government has re-inserted itself forcefully into the struggle over property in Russia, but that conflict has been underway since the late Soviet era. It extends well beyond the oil sector, and powerful competitors for assets can still limit state efforts to re-establish control. Furthermore, the sheer size and geographical scope of the oil industry affects Russia’s development as a federal state. As discussed in more detail below, this combination of ideas and institutions is shaping the Russian political economy in a number of ways that, while potentially problematic, are not anticipated in the resource-curse literature.

Oil and foreign policy

Unlike most oil-dependent countries in the world, Russia is a former great power. Since the fall of the Soviet Union, one of the animating questions in the Russian leadership has been what role the country would play in the world after the Cold War (Adomeit 1995; Light 2001). Whereas the Yeltsin administration vacillated in its answer over the years, the Putin government has consistently sought to return to a position of prominence in international relations.8

Given the decline in Russia’s military capacity since the early 1990s, as well as the role of hydrocarbons in today’s global economy, Russia’s natural resources may be its most effective lever for international influence. Certainly Putin sees them that way. He argued even before he became president that the Russian government should use the oil and gas sectors as tools to re-assert itself in the world (Balzer 2005). That vision seemed to drive his political choices when, in the same week that he stated Russian foreign policy should “serve the cause of the overall development and modernization of the country,” he appointed Energy Minister Viktor Khristenko as his envoy to the Commonwealth of Independent States (Hill 2004, 20).

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8 Note that such a return does not always imply combative relations with neighbors, rising powers, or the US, since cooperation can also lead to influence. However, the current Russian foreign policy sees Russian interests as independent of others’ and therefore does not rule out competition with other states, including the US.
The realities of Russia’s natural-resource endowment mean Putin’s goal is more than idle dreaming. For example, in 2001, about 16% the (pre-expansion) EU’s oil consumption came in the form of imports from Russia (Hill & Fee 2002, 467). Natural gas may actually be an even more important source of influence, since Russia sits upon 32% of the world’s proven gas reserves, which is far more than any other country (Iran has 15%, Saudi Arabia 4%, and the US 3%) (Hill & Fee 2002, 468). Furthermore, gas is becoming an increasingly important source of energy worldwide. It currently accounts for about 23% of total consumption (coal is about 24%), and some analysts expect it to have almost a 30% share by 2020 (Hill & Fee 2002, 268; Hill 2004, 32). Gas in 2001 represented 22% of EU energy consumption (with oil at 44%), and it was Europe’s fastest-growing source of energy (Hill & Fee 2002, 468). One-fifth of the natural gas consumed in the pre-expansion EU came from Russia (Hill & Fee 2002, 468).

Natural resource supplies could also strengthen Russia’s position vis-à-vis its Asian neighbors. China, of course, is a recurrent foreign-policy concern for Russia, both as a potential balance against the United States and as an opportunity and a threat in its own right. The potential for trade growth, for example, is enormous, as trade between the two states rose to all of $8 billion in 2000 (Hill & Fee 2002, 470-471). At the same time, Russia has long been concerned about the demographic imbalance in the area (Alexseev 2001; Hill & Fee 2002, 470-471). One way to strengthen the Russian hand in negotiations with China and other Asian states is through the energy sectors, although doing so will require significant increases in production and, especially, pipeline capacity (Hill & Fee 2002, 470-471, 477).

Oil and property

As already discussed, the Yukos affair shook some observers’ understanding of the Russian property regime to the core. What once seemed like a stabilizing system of private ownership

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9 Although there is still a long way to go to change infrastructures to run on gas rather than oil, plenty of gas (more than 25% of what is now consumed) is exported/imported (Hill 2004, 32).
appeared to collapse in a heap of capricious state intervention when the government took over Yukos. Putin’s antagonism toward private business is incomplete, however, and he has been willing to tolerate private economic actors, even in the oil sector, who share their wealth with the state and society. More important, the ongoing struggle for assets in Russia includes multiple competitors outside the state. The biggest economic groups in the country often seemed most rattled by the Yukos affair, and they scrambled to react to their new circumstances. Even among those groups, however, some took advantage of their rivals’ misfortune or faint-heartedness to expand. Second-tier groups, meanwhile, seemed in better position to benefit from the changed context, and some of them proved especially adept at using the new environment of center-regional relations to challenge their larger antagonists successfully.

Large-group reactions

For the leading conglomerates, the new approaches ranged from exit to new forms of aggression against rivals. Vladimir Potanin and Roman Abramovich seemed most eager to follow the path of simply quitting the game by converting property to cash, although Potanin’s efforts were not nearly as pronounced as Abramovich’s. Indeed, Potanin’s Agros holding continued to grow, acquiring the Ekstra-M and Pervaia peterburgskaiia makaronnaia factories to become the largest pasta producer in the country (“Konflikt vokrug” 2003). At the same time, Potanin moved out of the defense sector, where the state’s interests were likely to be more intense than in, say, food processing. For instance, he sold his 50% stake in Oboronitel’nye sistemy to a company affiliated with the state firm Rosoboroneksport (“Interros Sheds Last of Its Defense Assets” 2003).

Abramovich, for his part, made increasingly obvious moves toward the exit beginning in 2002. At the end of that year, oil giant Sibneft paid him a secret $1 billion dividend on profits and planned to pay him another $1 billion in late 2003, thus allowing him to pull cash out of the enterprise without having to sell it (Jack 8/9/03). In several other cases, Abramovich went even
further by parting with actual property. In the spring of 2003, he sold his 26% stake in Aeroflot to National Reserve Bank for about $135 million; in September his 50% of RusAl went to his partner Oleg Deripaska for $2.5 to $3 billion; and in November, he sold his 37.5% stake in Ruspromavto to Deripaska for an undisclosed amount (“Deripaska Buys Up Other Half of RusAl,” 2003; “Oligarch sells his last assets in Russia” 11/11/03). He also tried to sell out of Sibneft, as noted above, although he reconsidered in light of the political pressure surrounding the Yukos affair. In still further evidence of his plans to exit Russia, Abramovich purchased the Chelsea football (soccer) club in July 2003 for 150 million pounds and began to make his home in London (“Deripaska Buys Up Other Half of RusAl,” 2003; Jack 8/9/03; “Russian oil tycoon is UK’s richest man” 3/9/04).

Other actors, by contrast, took advantage of opportunities to expand, although they seemed more cognizant of the need to work with the Kremlin in doing so. At Gazprom, for example, where the state had restored firm control, management continued to bring wandering enterprises back into the fold and also sought out new pieces to add to its empire (Gazprom 2002). Much more aggressively, Oleg Deripaska’s group snapped up several of the assets Roman Abramovich sold off. In addition, Deripaska chased new prizes, especially in collaboration with Alisher Usmanov of Gazprominvest, who had avoided the wrath of Aleksei Miller during the house cleaning at Gazprom in 2001-2002. In 2003, for example, Usmanov and Deripaska founded Urals Steel, into which they poured their shares in the Nosta Iron and Steel Works (Helmer 5/22/04). Deripaska’s Base Element, along with Millhouse Capital and Nafta-Moskva, had sued Nosta for bankruptcy back in 2001-2002, forcing Andrei Andreev to sell out to them. Millhouse and Nafta-Moskva later sold their shares to Usmanov, allowing the creation of Urals Steel, which Deripaska soon sold to Usmanov. In another joint effort, Deripaska and Usmanov bought a 31% stake in the iron ore factory Olkon, which supplied steel giant Severstal’ (AKSnews.ru 2/17/03). Severstal’ yielded no ground in the face of litigation threats or rival shareholders’ meetings, but
Deripaska had clearly decided to remain aggressive in the new political and economic environment.

In an expansion strategy that looked beyond Russian borders, oil company TNK and its owner Al’fa Group forged an unprecedented deal with British Petroleum in 2003, but not before making certain that Putin approved of the agreement. TNK had used the bankruptcy process to grab oil major Sidanko’s two most productive oil fields in 1998, not long after BP had bought 10% of Sidanko from Vladimir Potanin. British Petroleum, however, fought TNK in the courts and in the capitals of several countries, and TNK eventually returned the fields to Sidanko in 2001 and bought out all shareholders in Sidanko except BP, which retained its 10% stake (Whalen & Bahree 2003). In 2002, BP bought an additional 15% of Sidanko from TNK, demonstrating a continuing strong interest in Russian oil reserves (Whalen & Bahree 2003). After additional negotiations, including direct meetings with Putin, TNK and BP agreed in June 2003 to pool their Russian oil assets into a 50-50 joint venture called TNK-BP (“BP Seals Historic TNK Tie-Up” 2003; Fridman, Jack & Ostrovsky 2003). The deal would cost BP $2.4 billion in cash up front and $3.75 billion in BP stock transferred to TNK in three yearly payments from 2005 to 2007 (Hoyos, Jack, & Ostrovsky 2004). Al’fa Group thus aggressively pursued the financial resources of an international investor but also recognized the need for explicit permission from Putin in the new environment.10

Second-tier counterattacks

Despite the attention they receive in scholarly and journalistic accounts, national-level economic groups are not the only competitors for property in today’s Russia. At the sub-national level, several “second-tier” groups, often with ties to regional governments, also seek to defend or expand their holdings. As first-tier groups suffer political or economic setbacks, those at the next
level down may be in position to benefit. In the oil sector, the powerful Surgutneftegaz would once have been considered second-tier, and it still tries to remain out of the national political spotlight. Other regionally concentrated companies may also be able to survive and thrive in the changing ownership environment under Putin. Two examples from outside the oil sector illustrate how second-tier groups took advantage of changing circumstances to defend themselves against assaults from two previously dominant players, Oleg Deripaska and Vladimir Potanin.

Ilim Pulp Enterprise controlled three major firms in the Russian timber sector at the beginning of 2002: Kotlas Pulp & Paper Combine in Arkhangelsk oblast, Ust’-Ilim Timber Processing Combine (LPK) in Irkutsk oblast, and Bratsk LPK. After a few months, however, Oleg Deripaska’s Base Element once again tried to pry Kotlas and BLPK away from Ilim Pulp. In both cases, a micro-shareholder that most observers believed was connected to Deripaska filed suit against Ilim Pulp in Kemerovo oblast, which was not home to any of the plants in question. The shareholder did not sue any of the factories directly, but instead charged that Ilim Pulp had not lived up to its obligations to invest in either Kotlas or BLPK (Chazan 8/12/02; Clark 11/5/02). In the case of Kotlas, the Kemerovo court awarded 3 billion rubles in damages to the plaintiff, and a share registrar close to Deripaska determined that Ilim Pulp’s 61% stake in Kotlas should be turned over to the Russian State Property Fund to cover the award (Chazan 8/12/02; Smith 8/5/02). The Fund, in turn, sold the shares to St. Petersburg banker Vladimir Kogan, who was an ally of Deripaska, along with others (Clark 8/6/02; Clark 11/5/02). Similarly, the court transferred Ilim Pulp’s shares in Bratsk LPK to the Property Fund, which sold them to Continental Invest, at the time at least 30% owned by Deripaska (Clark 1/15/03).

In the Russia of 2000, that would have been the end of the story. By the middle of 2002, however, Ilim Pulp did not have to crawl away and lick its wounds. Instead, the company convinced Putin to send the Ministry of Economic Development and Trade, the Ministry of

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10 In a separate transaction that also suggested approval from the Kremlin, Leonard Blavatnik, founder of Access Industries and a shareholder in TNK-BP, bought George Soros’ 25% + 1 share of telecom giant
Justice, and the office of the Prosecutor General to investigate (Clark 8/6/02). In addition, when Deripaska and his team elected a new board of directors at Kotlas and tried to enter the grounds, they and their armed guards were turned back by gunmen supporting the original Kotlas leadership (Clark 8/12/02). Finally, in a clear change from earlier practice, the presidium of the Kemerovo court overturned the court’s original decision. It argued that the micro-shareholders had neither given Ilim Pulp enough warning to mount a legal defense nor shown injury to themselves, which would have been necessary for an award of damages (Clark 11/5/02). Over the next several months, which included another round of armed standoffs, Ilim Pulp eventually regained ownership of the plants it had held before the suits began and seemed to have chastened Deripaska, at least for the moment (http://berkon.com.ua/novosti_e.htm; accessed 7/14/04).

Whether the possibly temporary victory represented the triumph of law or the strength of Ilim Pulp’s political connections was for optimists and pessimists to discuss, but it certainly indicated that some of the rules of the struggle for property had changed.

A similar conflict occurred in 2003 between Vladimir Potanin’s Agros group and the Taganskii Meat Processing Plant (TAMP), which controlled about 7% of Moscow’s market for processed meat (Borisova 2003). In January 2003, through mechanisms never fully disclosed, Nikolai Kolosov acquired about 14% of TAMP-kholding, which owned TAMP (“Konflikt vokrug” 2003). Over the next several weeks, he launched a series of lawsuits designed to help take over the plant for Agros. The new arbitration code did not seem to constrain him at all, since his filings all took place outside of Moscow. In Volgograd oblast, he won a claim to freeze about 75% of TAMP’s stock, while a court in Khakasiia removed the other 16 managers of TAMP-kholding, arguing their failure to pay dividends at TAMP had undermined the holding’s financial position (“Konflikt vokrug” 2003). Kolosov then transferred a controlling stake in TAMP to a new company, and by February 11, 2003, Agros had bought almost 60% of TAMP from MDM-Sviazinvest in early 2004 (Jack, Ostrovsky, & Pretzlik 2004).
Bank, which claimed to have bought it from investors “who are not well known in Russia” ("Konflikt vokrug" 2003; Borisova 2003).

As in the case of Ilim Pulp, however, the original management team at TAMP fought back and won. Although the Agros team took over TAMP by force in March 2003, the Moscow oblast arbitration court ruled on July 7 that Agros needed to return the factory to the old management. The court reversed itself two days later, but the TAMP team brought its own armed guards on July 10 and took the plant back (Borisova 2003). Agros appealed to the federal prosecutor’s office, but in September, the Moscow oblast court reiterated its demand that Agros return the shares in TAMP to TAMP-kholding ("Konflikt vokrug" 2003). Finally, in February 2004, Agros seemed to give up, hiring Halic Investment to sell off its stake in TAMP (Vyshii arbitrazhnyi sud 2004). The scuffle was hardly an unambiguous demonstration of the rule of law, but it again indicated that second-tier groups had found another weapon to add to their arsenals.

**Oil and federalism**

The experience of second-tier economic groups, regardless of their sector of concentration, reminds us of the importance of Russia’s federal structure its political and economic development. The evolution of Russia’s federal system has been problematic to say the least. Several researchers have examined the different resources available to both the central government and the dozens of regional governments that were all fighting for power, legitimacy, and economic development in post-Soviet Russia. Their studies have offered enlightening and provocative explanations for the center’s inability to enforce many of its decisions in the regions, the regions’ decisions to raise and then drop secessionist demands, and the peculiar development of center-regional relations in Russia.11

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We can build on the insights of those excellent studies, however, by recognizing that regional
governments serve as more than potential impediments to Moscow’s goals or demanders of
political independence. They are also independent actors in the redistribution of property in
Russia, and the incentives they face and resources they control will shape their behavior in
fundamental ways. This section begins to consider the incentives and resources created by the
structure of the oil industry.12

The physical scale of the oil industry is astonishing. Moving tons of dirty sludge from wells
in Siberia to consumers in Moscow or abroad is an extraordinary task. Not only does the
petroleum have to move thousands of miles from the drilling area to the retail outlet, but it has to
go through several stages of refining, separation, and transportation. In Russia, the infrastructure
of that system—including pipelines, pumping stations, and refineries—is spread across many
regions of the country in ways that pose important questions for the country’s continued political
development

Deposits are largely concentrated in Western Siberia, although a few lie elsewhere, and
further exploration may uncover others at some point. That concentration of natural wealth has
presented a political quandary since the creation of an independent Russia—how and whether to
redistribute that wealth throughout the country.13 Tiumen’ oblast is consistently the richest region
in the country and has always argued it contributes too much to the federal budget and receives
too little in return. Furthermore, even within the oblast, the two, large autonomous okrugs in the
north, where the oil and gas actually lie, consistently call for greater independence from the oblast
capital in the south. With world oil prices far above their historical average, the desire to control
or share in that wealth will only further complicate relations among the federal government, the
oil-rich regions, and other parts of the country.

13 Indeed, it was an issue in Soviet times, as well, but the institutions for dealing with it were markedly
different than they are now.
The most important deposits outside of Tiumen’ may be those in and around Sakhalin, an island near Japan. In addition to the equity issue just discussed, the Sakhalin reservoirs raise questions of control over foreign policy. International companies have played an especially large role in developing the Sakhalin fields, and the deposits’ proximity to East Asia makes them a logical source of exports to the region. Relations between Sakhalin and the center have been less contentious than those between Moscow and Tiumen’, but as Putin’s recent moves against the foreign companies suggests, control over Russia’s far-flung petroleum resources is still unresolved.

In addition to the hydrocarbon deposits themselves, the pipeline and refining system is also spread unevenly across Russian territory, which may affect Russia’s evolving federalism. Although the issues complicating relations between Moscow and such Caucasus republics as Chechnya and Dagestan go far beyond oil, the presence of a significant refinery in Grozny and a pipeline from the Caspian through Chechnya surely influenced Russian policy toward the region in the 1990s. A pipeline was subsequently built around Chechnya, but it now passes through Dagestan, meaning that oil still must figure into Moscow’s calculations about the region. Even outside the Caucasus, questions of pipelines and refinery control can affect center-regional relations, as different levels of government compete for tariff and tax revenue.

In place of a conclusion

It is now well established among scholars that oil wealth is at least as likely to be a curse as a blessing for political and economic development. As with any concept that gains popularity, however, the idea of the resource curse can become less and less precise and therefore give a false sense of explanation. Analysts may be tempted to blame all manner of pathologies on an abundance of oil, rather than examine a case like Russia to see whether it truly exhibits the characteristics of a rentier state anticipated in the literature. In other words, we stop thinking
about how Russia might overcome its resource curse or even how that curse has manifested itself in practice in Russia.

This is a preliminary paper that tries to lay out some of the ways oil can and does affect the Russian political economy. Petroleum is key to the economy, but it is not the only contributor, and in any case, the misuse of oil money is far from Russia’s biggest problem. Indeed, the role of hydrocarbons in Russia’s political economy is still evolving. Certainly the current government aims to harness that wealth for the purposes of foreign policy and domestic development, but it is unclear how and whether it will be able to do so. The international arena is still highly volatile, and control over domestic resources is still fragmented. The evolution of that control—rather than simply the amount of wealth generated by the sector—will eventually determine just how oil affects Russia’s development.
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