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**Hydrocarbons and Russian foreign policy in the post-communist era (1991-2008): a case study.**

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A minor dissertation submitted in partial fulfillment of the requirements for the award of the degree of Master of Philosophy in Politics, Philosophy and Economic

Faculty of the Humanities

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## **Abstract**

This thesis aims to analyse the effect of hydrocarbons on Russian foreign policy in the post-communist period. In doing so it employs a constructivist meta-theory (actor-structure framework) and Susan Strange's approach to international political economy (IPE). The role of hydrocarbons in both the international political economy and Russia's domestic political economy is analysed. Thereafter a historical narrative outlining the affect of hydrocarbons on foreign policy from 1991-2008 is offered. There is also a brief focus on the role of Gazprom in Russian foreign policy.

It is found that hydrocarbons affected Russian foreign policy through the impact they had on the state's ability to control the domestic political economy (which was diminished in the 1991-1999 period, but strengthened as international oil prices rose thereafter). Hydrocarbons, though a source of power, are also found to tie the Russian state to the interdependent international political economy of the globalised era.

The analysis finds that the case supports the constructivist emphasis on the importance of understanding domestic issues when addressing the foreign policies of states. It also finds that the approaches used, Wendt's constructivism and Strange's IPE theory, work well in conjunction to illuminate foreign policy issues. A criticism of Strange's approach, however, is highlighted. She fails to give adequate attention to matters of geography in her model. This, it is argued, would be a fruitful endeavour for future IPE analysis, especially if addressed through the case of hydrocarbons in the IPE.

Word count: 32,990.

Keywords: Russia, hydrocarbons, foreign policy, constructivism, international political economy, political economy, Putin, Yeltsin, Gazprom, nationalisation.

## **Contents:**

Introduction.....	6
Part 1: Theory and Methodology .....	9
Chapter 1: Philosophy of Science - the science in social sciences .....	10
Chapter 2: Meta-theory - the actor-structure problem .....	15
Chapter 3: Theory - international political economy and foreign policy.....	21
Chapter 4: Case studies - n = 1 .....	30
Part 2: Hydrocarbons and Russian Foreign Policy .....	33
Chapter 5: Generative Mechanisms .....	35
International structure and hydrocarbons.....	35
Hydrocarbons - blessing and curse .....	42
Chapter 6: Russia's foreign policy in historical perspective .....	55
Background.....	57
Chapter 7: The Yeltsin years - the rise of the market .....	65
The liberal internationalist period (1991-1996).....	66
The pragmatic, patriotic period (1996-1999).....	76
Chapter 8: The Putin period - the return of the state.....	85
(I) Tax system: .....	90
(II) War on the oligarchs:.....	91
(III) Controlling the hydrocarbons industry:.....	93
1999-2003 Domestic consolidation: .....	98
2004-2006 Regional focus: .....	99
2007- Global ambitions: .....	103
Chapter 9: Focus on Gazprom .....	106
Gazprom in the domestic political economy .....	107
Gazprom – a source of power and cause of interdependence .....	109
LNG – changing the rules of the game .....	114
Part 3: A Picture of Points .....	117
Conclusion .....	121
Bibliography: .....	125

## **List of table and graphs**

Table 1: Approaches to foreign policy and IPE.....	18
Table 2: Natural resource abundance and rule of law.....	48
Graph 1: Russian oil and gas rents (1970-2005).....	50
Graph 2: Oil price and international political developments .....	62
Table 3: Survey of attitudes to political and economic reforms .....	79
Graph 3: Real GDP (1997-2009).....	88
Graph 4: Real GDP growth rate and oil price (1997-2009).....	88
Table 4: European reliance on Russian gas .....	110

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## **Introduction**

This thesis presents a case study on the affect the possession of vast reserves of oil and natural gas has had on Russia's post-communist foreign policy. In order to discern the affect, the post-communist era has been divided into two periods of roughly equal length (1991-2000 and 2000-2008). The first period saw Boris Yeltsin at the helm of a new state emerging from centuries as a multinational empire and decades of communist rule. It was also a state with an economy heavily dependent on hydrocarbons during a period of generally low international oil prices, and domestic upheaval due to harsh neoliberal economic reforms. This thesis posits that the low international oil price and the Russian economy's dependence on hydrocarbons significantly constrained Yeltsin's ability to act both locally and in the international arena. In the second period oil prices began their steady rise to historic levels (in 2008). This period, under Vladimir Putin, sees the state reasserting its power over the market by confronting the oligarchs, nationalising the hydrocarbons industry, enforcing taxation, and centralising power in the executive. This period also sees Russia reasserting itself on the international stage, with a focus on portraying itself as a great power and an emphasis on its sovereignty in an emergent multipolar international system.

In assessing the role played by hydrocarbons in this era, this thesis will employ Susan Strange's approach to international political economy (IPE) in conjunction with a constructivist meta-theory drawing on the writings of Alexander Wendt. These approaches stress the relationship between the domestic and international factors that determine a country's foreign policy. This relationship is framed in the actor-structure problem, which has become a cornerstone of debates within international relations

theory. In short, Wendt's constructivist theory states that actor and structure are codetermined and that this requires that analysts "theorise the state" – thus, in accordance with this theory, the thesis will investigate the domestic political-economy of Russia to an extent that is still rare in traditional foreign policy analysis. The first chapter is dedicated to outlining the theory and methodology that inform the approach taken in this case study. It is important to note the relationship between theory and case, as Odell, whose classification of case studies presented at the end of this chapter, does. Cases and theories have a dialectical relationship, a theory can illuminate aspects of a case, while a case is able to strengthen or weaken the viability of a theory. Both interact so that at the end of the process both have changed.

Chapter two begins with an examination of the role played by hydrocarbons in both the international political economy (structure) and Russia's domestic political economy (actor). Then, a brief background is given to the Russian case, which identifies some key factors that have affected Russian foreign policy in the past and also briefly examines the role hydrocarbons played in the fall of the Soviet Union. The two periods that form the main body of this case study are then analysed. Thereafter, there is a section highlighting the importance of the state-owned gas company Gazprom in analyses of Russian foreign policy.

The final section aims to gain perspective on the issues touched on throughout the analysis, and will perform many of the functions of a traditional conclusion. The goal here is to give the reader a clearer picture of the thesis' argument without delving into particular details.

Please note that extensive use of footnotes, definitions of terms can usually be found in the footnotes if they are not in the main body.

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## **Part 1: Theory and Methodology**

Brglez states that there are four levels of thinking and researching in international relations and that a better understanding of this differentiation would aid analysis (Brglez, 2001: 342). These levels can be applied to any social scientific enquiry, they are:

- 1) the philosophy of (social) sciences;
- 2) (general) social theory or meta-theory proper;
- 3) the theory of the specific field (international relations, economics IPE, etc);
- 4) empirical analysis of events in the field.

This ordering is from the most abstract to the most “concrete” and, according to Brglez, “from a simpler to a more complex understanding of international relations” (Brglez, 2001: 342). Furthermore, these levels interrelate (are “dialectically co-constitutive” in Brglez’s terms) in such a way that assumptions made at the more abstract levels (say, the philosophy of science) “enable and constrain” analysis at the more concrete levels (say, theory of international political economy) (Brglez, 2001: 342). Concurrently, analysis at less abstract levels may reaffirm/change/challenge the very assumptions under which it was initiated<sup>1</sup> (Brglez, 2001: 342).

The first section of this chapter will outline the position of this analysis with regard to the philosophy of science. It draws on the philosophy of Roy Bhaskar and his defence of naturalism. Alexander Wendt is one of the most prominent advocates of this philosophy within international relations theory and this section functions as an introduction to his constructivist theory which is addressed in the second section of the chapter. The third

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<sup>1</sup> In Bhaskar’s words: “Knowledge of deeper levels may correct, as well as explain, knowledge of more superficial ones” (Bhaskar, 1979: 16).

section looks at the international political economic (IPE) theory of Susan Strange, which is outlined and critiqued. Finally, the last section of this chapter will deal with the method of case studies. It will enumerate the types of case studies available to the analyst and will outline the type employed in this thesis.

## **Chapter 1: Philosophy of Science - the science in social sciences**

Wendt's constructivist theory has its philosophical roots in the work of Roy Bhaskar, who attempted a defence of the scientific method in the social sciences in his book *The Possibility of Naturalism* (1979). Naturalism is defined as "the thesis that there is (or can be) an essential unity of method between the natural and social sciences" (Bhaskar, 1979: 3). Bhaskar states that there are three types of naturalism (1) *reductionism*: "which asserts that there is an actual identity of subject matter as well"; (2) *scientism*: "which denies that there are any significant differences in the methods appropriate to studying social and natural objects, whether or not they are actually (as in reductionism) identified"; *scientific realism*: his view, which can accommodate the "more or less specific methods of both the natural and social sciences", but does not deny that there are fundamental differences between the two due to "real differences in their subject matters and in the relationships in which their sciences stand to them" (Bhaskar, 1979: 3).

Alexander Wendt argues that the adoption of scientific realism as a philosophical basis aids in tackling ontological<sup>2</sup> and epistemological<sup>3</sup> issues with regard to the actor-structure

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<sup>2</sup> **Ontology** : "Any way of understanding the world, or some part of it, must make assumptions (which may be implicit or explicit) about what kinds of things do or can exist in that domain, and what might be their conditions of existence, relations of dependency, and so on. Such an inventory of kinds of being and their relations is an ontology" (Scott and Marshall, 2005: *Oxford Reference Online*).

<sup>3</sup> **Epistemology**: "Literally "the study of knowledge," epistemology is the inquiry into the conditions, paradigms, and limits of knowledge, including the nature of truth claims and the historical contexts that have shaped human inquiry" (Calhoun ed., 2002: *Oxford Reference Online*).

problem in the social sciences<sup>4</sup>. Scientific realism is contrasted with empiricism in the debate on the philosophy of science. Wendt states that: “In contrast to empiricism, scientific realism can, in principle, call an ontology ‘scientific’ even if it includes unobservable generative structures<sup>5</sup>” (Wendt 1987: 350). What is at issue here is basically whether or not we can state that something is real (ontology) without the ability to experience it directly through our senses<sup>6</sup> and, furthermore, whether we can use this knowledge as a basis for making causal statements and scientific explanations (epistemology). The major schism between the two schools of thought is thus whether ontology is primitive or epistemology – scientific realists give a qualified argument for the former and empiricists an argument for the latter (for example Humean radical scepticism<sup>7</sup>). To simplify the scientific-realist position, Bhaskar states that “it is because sticks and stones are solid that they can be picked up and thrown, not because they can be picked up and thrown that they are solid (though that they can be handled in this sort of way may be a contingently necessary condition for our *knowledge* of their solidity)” (Bhaskar, 1979: 31).

While empiricists remain agnostic as to the existence of unobservable entities and instead focus on the theoretical proofs that act as evidence of them, scientific realists employ

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<sup>4</sup> Apart from inspiring Wendt’s constructivist theory in international relations, Bhaskar’s philosophy has become the basis for heterodox economics, a growing school of thought that challenges the neoclassical orthodoxy (see the writings of Tony Lawson).

<sup>5</sup> “Structures that are irreducible to and generate their elements” (Wendt, 1987: 155). This will be expanded upon later in the discussion on structuration theory.

<sup>6</sup> The ability to experience what is ‘real’ through one’s senses is the basis for empiricism (Scott and Marshall, 2005: *Oxford Reference Online*). Philosophers like Hume, Locke and Berkeley argued for this position against the rationalists represented by the philosophies of Descartes, Leibniz and Spinoza.

<sup>7</sup> Sokal and Brilmont highlight the fact that Humean radical scepticism (paraphrased as “Of course there exists an external world, but it is impossible for me to obtain any reliable knowledge of that world”) suffers from its universality. Nobody is genuinely sceptical about the reality they live in. They don’t question whether the coffee cup that stands in front of them exists or whether they would die if they jumped off the top of a sky-scraper. In the end, “the best way to account for the coherence of our experience is to suppose that the outside world corresponds, at least approximately, to the image of it provided by our senses” (1997: 55).

abductive inference<sup>8</sup> to build theories that can possibly be tested, and thus be subject to Popper's law of falsifiability. Wendt gives a couple of real world examples in order to illustrate his claims, such as the fact that the internal structure of atoms are unobservable, yet we can use our theories of them in order to build atomic weapons that can level cities (Wendt, 1987: 152). This sounds all well and good when referring to atoms and quarks and electricity, but the common social scientific refrain that humans cannot be equated with such basic entities still seems to stand unscathed. In Susan Strange's words "Social science can never confidently predict because the irrational factors involved in human relations are too numerous, and the permutations and combinations of them are even more numerous" (Strange, 1988:11).

Indeed, it would be foolish to treat humans as one would atoms in theorising on social scientific issues, but this is not what Wendt and Bhaskar are attempting to do. They are outlining a methodology for evaluating and reforming social scientific theories that is based on the precept that generative structures, which produce our social scientific facts, can be studied in much the same way as scientific structures. Their theory is scientific in its approach and in its philosophical basis, but not in its assumptions about the nature of the units it studies (for instance it wouldn't impose conditions stating that events must be replicable under controlled circumstances as this is impossible in the social sciences<sup>9</sup> which deal with open systems). In this sense their approach is akin to Strange's when she states that "theory should be scientific only in the sense that the theorist respects the

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<sup>8</sup> **Abductive inference:** "an inference that theoretical terms refer to *real* but unobservable entities and processes" (Wendt, 1987: 352)

<sup>9</sup> In technical terms, the social sciences operate in an open system and are thus "denied, in principle, decisive test situations for their theories" (Bhaskar, 1979: 58). Bhaskar states that this means that the "criteria for the rational development and replacement of theories in social science must be *explanatory and non-predictive*" (1979: 58). This is in line with Strange's ideas and her critique of economic theory (especially international financial theories).

scientific virtues of rationality and impartiality and aspires to the systematic formulation of explanatory propositions” (Strange, 1988: 12)<sup>10</sup>.

The scientific method can be thought of in terms of a three-phase schema: (1) a phenomenon, or range of phenomena, is identified; (2) explanations for the phenomenon are constructed and empirically tested; (3) a generative mechanism is identified and itself becomes subject of explanation and testing (Bhaskar, 1979: 15). Thus the process begins again and continues in a dialectic manner.

At the heart of Wendt’s constructivist theory, which will be elaborated upon below, is the proposition that “unobservable and irreducible social structures can be scientifically legitimate... As long as they have observable effects or are manipulable by human agents, we can, in principle, speak meaningfully about the “reality” of unobservable social structures” (Wendt, 1987: 152). The philosopher John Searle espouses a similar view when he states that social reality is constructed. Even though social conventions are constructed, if they are held widely and strongly enough, they create “certain facts [that] are objectively true just because people act as if they are true” (Pinker, 2002: 64-65; Ruggie, 1998: 856)<sup>11</sup>.

An important distinction must be borne between facts that construct our social reality and socially constructed facts. History constructs our social reality but is not a social construction. There are many socially constructed *interpretations* of history (Marxist,

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<sup>10</sup> Bhaskar argues that “though, because social objects are irreducible to (and really emergent from) natural objects, and so possess qualitatively different features from them, they cannot be studied in the same way as them, they can still be studied ‘scientifically’” (Bhaskar, 1979: 26).

<sup>11</sup> Examples of social facts include “money, property rights, sovereignty, marriage, football, and Valentine’s Day, in contrast to such brute observational facts as rivers, mountains, population size, bombs, bullets, and gravity, which exist whether or not there is agreement that they do” (Ruggie, 1998: 856).

nationalist, sociobiological etc) but only one actual history (a series of causally related events). This historical determinism is central to the natural sciences: “the laws of nature and all their applications – the entire body of natural science – rest upon the notion of an eternal order which the sciences investigate” (Berlin, 2002: 18)<sup>12</sup>.

Using the same logic in the social sciences can lead to meaningful, falsifiable, claims. We can observe the effects of *generative structures* and draw plausible causal propositions from those observations. However, it is important to note that we cannot necessarily test them quantitatively and that we only test them to judge their explanatory power (Bhaskar, 1979: 62). Furthermore, the conclusions drawn, unlike in the natural sciences, are historically contingent (simply meaning that they are valid for specific past events and are not universal rules) and cannot be used to accurately predict future events<sup>13</sup>. Rather, they expose tendencies that may manifest themselves under particular conditions (Bhaskar, 1979: 68). This qualified epistemic relativity distinguishes the social from the natural sciences (with its universal laws) but in no way discounts a scientific approach to the social sciences.

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<sup>12</sup> In the social sciences, this idea of historical determinism is often rejected, as it is by Isaiah Berlin, as it seemingly nullifies ideas of free will (choice/agency). It will become obvious later that I don't reject agency and don't feel that such a rejection is required by holding a belief in the causal nature of history. For example: if stubbing her toe causes Mary to yell and curse we can record this event without stating that it could not be otherwise, thus denying free will. History records “how” events transpired, historical interpretation states “why” events transpired. It is my belief that the two can remain separate and thus that historical determinism does not impinge on free will. Historicism, on the other hand, “in the sense of deductively-justified predictability” is not tenable because social systems are open (Bhaskar, 1979: 61). We may discover causal links in past actions, but this cannot aid us in prediction. The common adage ‘you never step into the same river twice’ seems an apt illustration of this view.

<sup>13</sup> A quote from one of the key figures in the development of statistics, Pierre-Simon de Laplace, represents the antithesis of this assertion: “If an intelligence, at a given instant, knew all the forces that animate nature and the position of each constituent being; if, moreover, this intelligence were sufficiently great to submit these data to analysis...to this intelligence nothing would be uncertain, and the future, as the past, would be present to its eyes.”(Laplace 1814 in Mlodinow, 2009: 192). Simply, there are too many factors involved in human relations for this positivist dream to ever be a reality, even with the gifts Laplace gives his hypothetical individual.

## Chapter 2: Meta-theory - the actor-structure problem

The actor-structure<sup>14</sup> problem has refocused theoretical attention in the social sciences and made epistemological and ontological debates, like the one above, cogent once more. Hill states that it has put issues like freedom, determinism, and causation back on the table (Hill, 2003: 26)

An **actor** refers simply to “those that are capable of action” (Hill, 2003: 26). In the conception of IPE employed by this thesis, actor will refer mostly to states<sup>15</sup> (this state-centric approach will be explained in more detail later). **Structures** “are the sets of factors which make up the multiple environments in which [actors] operate, and they shape the nature of choices, by setting limits to the possible but also, more profoundly, by determining the nature of the problems which occur there, by shaping our very life-worlds” (Hill, 2003: 26). There is no need to choose between actor and structure in terms of primacy, what is sought is more nuanced than this. One aims to flesh out the relationship between the two in order to better understand the case. The strength of constructivism is that it allows us to theorise both actor and structure (neither are taken as given).

To better understand the actor-structure problem, Wendt states that it has its origins in two truisms that underlie all analyses in the social sciences: 1) humans and the organisations they form “are purposeful actors whose actions help reproduce or transform

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<sup>14</sup> Hill states that it is more accurate to refer to the actor-structure problem due to the common usage of the word agent to refer to a subordinate entity (an ‘agent of X or Y’). He reserves the word agent for state bureaucracies and bureaucrats (Hill, 2003: 27). I will adopt this terminology, but the debate remains essentially the same whether one speaks of actor-structure or agent-structure.

<sup>15</sup> Later, the role of Gazprom in developments will be looked into in detail – however, the fact that the state and Gazprom are so intimately entwined means that it need not detract from the state-centred approach taken.

the society in which they live” (free will and agency are intact), and 2) society is basically a number of relationships which themselves structure the interactions between these purposeful actors (Wendt 1987: 337-338). The actor-structure problem gives us three options<sup>16</sup>:

- 1) We make the structure/society ontologically primitive, as world system theorists (like Immanuel Wallerstein) and other structuralists do in IPE.
- 2) We make the actor/individual (state), ontologically primitive, as Weberian sociologists, rational choice theorists and neorealists (like Waltz), with their emphasis on capabilities and grounding in microeconomic theory<sup>17</sup>, do in IPE.
- 3) We give actor and structure equal and irreducible ontological status as constructivist/structuration<sup>18</sup> theorists (like Wendt, Hill, and Ruggie etc) do in IPE.

Thus, we can deduce the typical dichotomies that have exercised theorists for ages: actor-structure, individual-collective, voluntarism-determinism, epistemology-ontology, and objective (rational)-subjective (interpretive). What constructivist theory attempts to do is bridge these divides without compromise or contradiction. By making ontology primitive we are able to approach social issues scientifically through theorising on the observable effects of generative structures. By giving actors and structures irreducible ontological status we can show that structures and actors are co-constitutive and can gain a more realistic insight into IPE. As Wendt states on the advantages of such an approach, “This

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<sup>16</sup> Please see Appendix 1 for Bhaskar’s schema with regards to sociology and his **Transformational model of social activity**.

<sup>17</sup> Ruggie states that “Neorealism and neoliberal institutionalism are drawn directly from microeconomics” (Ruggie, 1998: 862). This allows them to employ rational actor models in their analysis of social phenomena, an approach that has become more nuanced over the years but is still open to criticisms of over-simplification.

<sup>18</sup> Structuration theory was first propounded by Giddens who talked about “the “duality” of structure: at once constraining human action but also being (re)created by it” (Ruggie, 1998: 875). In Wendt’s 1987 paper he uses the term structuration theory. Since then, however his approach has been shown to differ in important ways from that of Giddens. A constructivist approach is taken here, but the two are quite similar.

conceptualisation forces us to rethink the fundamental properties of (state) agents and system structures. In turn, it permits us to use agents and structures to explain some key properties of each as effects of the other, to see agents and structures as “codetermined” or “mutually constituted” entities” (1987: 339).

Ruggie has identified three schools of constructivism in the international relations literature:

- (1) **Neo-classical constructivism**: which remains close to more mainstream theories, is based on pragmatist philosophies while emphasising the intersubjectivity of meaning (Ruggie, 1998: 881). Theorists in this school include: Ruggie, Katzenstein, Ernst and Peter Haas.
- (2) **Postmodernist constructivism**: which is affiliated with the philosophies of Foucault, Derrida, and Nietzsche. As would be expected, these theorists take a linguistic approach and focus on the discourse that constitutes the ontological primitives (e.g. the state, international institutions, etc) (Ruggie, 1998: 881). Prominent theorists in this school include Richard Ashley, Campbell, and many feminist theorists (Ruggie, 1998: 881).
- (3) **Naturalistic constructivism**: which can be thought of as lying between the two above, it draws its inspiration from the scientific realist philosophy of Bhaskar and includes theorists like Wendt and Dessler (Ruggie, 1998: 881).

The implications of adopting naturalistic constructivism (henceforth referred to simply as constructivism) are numerous. Firstly, one must reject both **methodological**

**individualism**<sup>19</sup>, which is central to rational choice theory and neoclassical economics, and **methodological holism** which underpins collectivist theories (Marx and Durkheim) (Carlsnaes, 1992: 249). One must also balance rationalist and interpretive methodology, in order to avoid what Archer has referred to as the upward or downward conflation that characterise theories that adopt these approaches (Carlsnaes, 1992: 249).

The following schema illustrates the tendencies prevalent in foreign policy analysis and IPE, it summarises Carlsnaes' distinctions whilst adding those made by Wendt and others.

**Table 1: Approaches to foreign policy and IPE**

	<b>Objective/Rationalist</b>	<b>Subjective/Interpretive</b>
<b>Individualist</b>	Rational Choice Theory, Neorealism, Neoliberal institutionalism, Hobbesian realism.	Decision-making approach, psychological approaches.
<b>Collectivist</b>	World-systems Theory, Marxism.	Bureaucratic/Organisational approaches (Durkheimian), Nationalism, Post-modernism

<sup>19</sup> Bhaskar defines **methodological individualism** as “the doctrine that facts about societies, and social phenomena generally, are to be explained solely in terms of facts about individuals” (Bhaskar, 1979: 34). A view held by Popper: “all social phenomena, and especially the functioning of social institutions, should be understood as resulting from the decisions etc. of human individuals.... We should never be satisfied by explanations in terms of so-called ‘collectives’” (Popper quoted in Bhaskar, 1979: 34).

All of these approaches become problematic in light of the constructivist conception of the actor-structure relationship. Now that we have a broad idea of constructivist theory and its implications we must turn to two related issues:

The first being that constructivism requires us to develop a theory of the state<sup>20</sup>. According to Wendt, such theorising must be empirically grounded and offer an explanation of the “causally significant properties (such as powers, interests, practices)” of the state as an actor (Wendt, 1987: 365). Neorealism takes states as given unitary actors and focuses on the system level of analysis, thus ignoring/dismissing the need to theorise the state. Constructivism, on the other hand, compels us to look at both the internal (domestic) and external (international) structures that enable and constrain action by the state. Wendt states that “international and domestic structures generate the “rules of the game” (broadly defined to include state agents themselves) within which states interact” (Wendt 1987: 360).

The second being that we need to view the international structure as a social structure, and theorise how this structure is transformed through the agency of actors. In this sense Wendt’s theory is not new, it is similar to the English School of international relations (represented by the likes of E.H. Carr and Headley Bull). Buzan states that the English School represents a tradition of thought that is “distinct from both realism and liberalism and able to combine both and put them in historical perspective” (Buzan, 1993: 328). The international structure is not static and is not reified (as it is in theories like world-

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<sup>20</sup> A workable definition of the state is important, but due to space constraints a proper conceptual analysis of the term is impossible here. Weber’s definition will suffice as it is broad enough to satisfy contending theories as to the state’s role in the IPE. He defined the state as: “a human community that (successfully) claims the monopoly of the legitimate use of physical force in a given territory” (Weber in Held Ed, 1983).

systems analysis and structuralism). Actors are shaped and constrained by this structure, but they can change it too.

Constructivism is a meta-theory and cannot fill in the blanks it identifies in the theories it analyzes. In this sense it does not directly compete with theories like neorealism, neoliberal institutionalism, or world-systems theory<sup>21</sup>.

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<sup>21</sup> Some, like Ted Hopf (1998), a proponent of postmodern constructivism, have tried to place constructivism in competition with international relations theories. However, although its arguments may delegitimise the claims of these theories, it does not compete as a substitute for them – at least not in the form in which Wendt originally presented it, which is the form adopted here.

### **Chapter 3: Theory - international political economy and foreign policy**

Prior to the 20<sup>th</sup>, and in the first decades thereof, the social sciences were a lot less rigidly separated than they have now become. Social scientists like Max Weber, Adam Smith, Karl Marx, Karl Polanyi, J.S Mill, etc, dealt with all aspects of social life (ethics, economics, politics, sociology, international relations). This changed in the 20<sup>th</sup> century as the different schools of thought became evermore specialised and exclusive in both their approach and their assumptions. This has led to great specialisation within the various schools, but this specialisation has come at the cost of explanatory power. In the spectrum between scope and detail, the social sciences have become imbalanced towards detail.

International political economy, in the guise in which Susan Strange presents it, is an attempt to bridge the artificial divides that separate these schools. Strange's approach to IPE is able to fit with the meta-theory presented above (she recognises the interplay of actors and structures) and her approach will be the theoretical basis of the case study. What follows is a brief sketch of her approach and a critique.

Strange's definition of the study of IPE is that "it concerns the social, political and economic arrangements affecting the global system of production, exchange and distribution, and the mix of values reflected therein" (Strange, 1988: 18). Thus, it is obvious that she disregards the artificial boundaries between international relations, economics, sociology, and politics. For her, politics is about the provision of public

goods<sup>22</sup> and public order, whilst economics “is about the use of scarce resources for unlimited wants” (Strange, 1988: 14).

The values she identified were: wealth, security, freedom, and justice (Strange, 1988: 17). The hierarchical ordering of these values according to the priorities of particular societies gives them their outlook, and this outlook determines their actions. The major schools of thought in international relations (IR) and IPE can be categorised according to how they order these values in their analysis. Thus, a Marxist would place justice at the top of their list, whilst a neorealist gives priority to security, a liberal would give priority to freedom and a mercantilist to wealth. All societies have all these values, it is the difference in combinations that sets them apart (Strange, 1988: 17). For Strange, it is power that determines the nature of the combination (1988: 23).

Strange distinguishes between two types of power – relational and structural. Relational power is the traditional conception of power, and can be thought of as the ability of actor A to get actor B to do something they wouldn't ordinarily do (1988: 24). Structural power “is the ability to shape and determine the structures of the global political economy within which other states, their political institutions, their economic enterprises and their scientists and other professional people have to operate” (Strange, 1988: 24-25). In her approach power is distinct from authority and authority does not lie solely with the state.

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<sup>22</sup> A **public good** is one that is non-rival (the use of the good by one individual or group in no way diminishes the ability of another to use it) and one where exclusion may be impossible (“a good is excludable if the owner of the good can exclude other persons [or groups] from using it (if they do not pay for it)”) (Kindleberger, 1981: 243, Sorensen & Whitta-Jacobsen, 2005: 281, Russett, 1985: 224). Russett explains that “Few goods ever fit these criteria perfectly; one can usually find some possibilities of rivalness and exclusion, but judgements of less and more are perfectly feasible” (Russett, 1985: 224). Public goods can be contrasted to private goods which are both rival and excludable (Cerny, 1995: 600).

One should note that for Strange structural power is the more important of the two powers. It “confers the power to decide how things shall be done, the power to shape frameworks within which states relate to each other, relate to people, or relate to corporate enterprises” (1988: 25). The relative power of actors is dependent on how able they are to shape the structures that determine the relationship (Strange, 1988: 25). Furthermore, “it is impossible to have political power without the power to purchase, to command production, to mobilise capital. And it is impossible to have economic power without the sanction of political authority, without the legal and physical security that can only be supplied by political authority” (1988: 25). It is not a case of one or the other, but rather one enabled and constrained by the other.

This idea has much in common with Douglas North’s institutionalist political economy. North states that in order for markets to function transaction costs (the uncertainty attached to any exchange due to asymmetrical or incomplete information) need to be kept below a certain threshold (North, 1992: 2). Institutions are mechanisms that reduce the cost of transactions (conventions, norms, and practices make exchanges more certain/routine) and are thus a fundamental part of the market. States have the power and authority to ensure these costs are below the threshold and markets can function.

It is important to note that her approach is not limited to analyses of events at the global level, it can be equally useful in explaining events at the domestic level or small group level (family, village etc) and the dynamic interaction between all these levels (Strange, 1988: 26).

Four structures exist in Strange's model:

- (1) **The security structure:** "The framework of power created by the provision of security by some human beings for others. The protectors – those who provide the security – acquire a certain kind of power which lets them determine, and perhaps limit, the range of choices, or options available to others" (Strange, 1988: 45).
- (2) **The production structure:** "The sum of all the arrangements determining what is produced, by whom and for whom, by what method and on what terms" (Strange, 1988:62).
- (3) **The financial structure:** "The power to create credit implies the power to allow or deny other people the possibility of spending today and paying back tomorrow, the power to let them exercise purchasing power and thus influence power for production, and also the power to manage or mismanage the currency in which credit is denominated, thus affecting rates of exchange with credit denominated in other currencies" (Strange, 1988: 88).
- (4) **The knowledge structure:** This one is a bit more difficult to define as "it comprehends what is believed (and the moral conclusions and principles derived from those beliefs); what is known and perceived as understood; and the channels by which beliefs, ideas and knowledge are communicated – including some people and excluding others" (Strange, 1988: 115).

We can approach our analysis of IPE issues by seeing where they fit into this structural schema and by asking the questions: 'who benefits from the structural arrangement?' – this will lead us to the actor with structural power (the power to shape the structure, and thus the range of options open to actors within it); once the actors are identified we can ask 'what are the bargains that have been reached in this arrangement?' – this is done in

order to identify the balance of interests and power and how decisions are reached. These bargains are not static but, rather, have to be renegotiated in order to deal with developments in a dynamic and open social system. For Strange, and for this thesis, “the basic bargain to look for is often the tacit one, that one between authority and the market” (Strange, 1988: 39).

In her writings, Strange has addressed the state-market interaction with a focus on the relationship between firms and states in the IPE. She states that: “Governments must now bargain not only with other governments, but also with firms or enterprises, while firms now bargain both with governments and with one another. As a corollary of this, the nature of the competition between states has changed, so that macroeconomic management and industrial policies may often be as or even more important for governments than conventional foreign policies as conventionally conceived”, thus, firms as actors become important players in the study of international relations and political economy (Strange, 2000: 60).

Hill defines foreign policy as “the sum of official external relations conducted by an independent actor (usually a state) in international relations” (Hill, 2003: 3). According to Strange, this policy must now be looked at as relating to market actors (multinationals in particular) and this relation occurs through macroeconomic and industrial policies as well as through official foreign policies with states and security matters in mind. She states that: “If wealth for the state, as for the firm, can be gained only by selling on the world markets – for the same reason that national markets are too small a source of profit for survival – then foreign policy should now begin to take second place to industrial policy; or perhaps, more broadly, to the successful management of society and the efficient

administration of the economy in such a way as to outbid other states as the preferred home to the transnational firms most likely to win and hold world market shares” (Strange, 2000: 64). This statement may be true in certain circumstances, especially with regard to developing countries, but in others it is obviously false.

As will be shown later in this case study, countries are very reluctant to allow Gazprom to enter or operate in their markets. This is due to it being state owned (50.01 percent shareholding) and concerned with energy, which is a strategic industry that is too important to be outsourced to another authority – especially, it seems, when that other authority is backed by a resurgent Russia. Strange’s assertion that foreign policy is waning in importance must thus be re-evaluated and qualified to pertain to only certain cases. States are still wary of the intentions of multinationals because the home country of multinationals (not just ones partly owned by the state) affects the way they operate (their values). This is a point made clear by Schrire when he states that “the idea of a non-state transnational corporation is a myth and a dangerous one at that. Corporations remain entities within national systems and share the cultural values of their home countries (2000, 63). This is the view adopted when analysing Gazprom’s role in Russian foreign policy later in the thesis.

Strange’s approach is useful because it takes a broad view of social life and events, but also offers a workable set of tools and views that allow us to make headway with a case study. Thus, it is a good bridge between the meta-theory provided above and the history of events we will encounter in the case. The only issue that needs to be expanded upon is the role of geography in this approach.

It is accepted that states are not the only actors in international political economy and their apparent decline in the era of globalisation has become an almost common-sense statement. With globalisation, we are told, borders are becoming less important (due to the freeing-up of trade) while physical space is being overcome through transport and communications technology. Time and space have become relative and both have shrunk due to globalisation. This, however, does not mean that geography can be ignored.

Although it can be argued that multinational corporations (with production and marketing strategies that span the globe and various sources of mobile capital) have to some extent circumscribed the power of states to regulate and control the international economy, it must also be accepted that states still possess the authority within their territories (and to some extent beyond) and significantly impact the international economy. One should also remain cognisant of the fact that the nature of states and the power they have changes over time. In the 1990s it seemed clear that their influence and authority were in decline. However, subsequent events (the War on Terror, the current financial crisis and bail-out schemes and the looming energy crisis) have brought the state back to the centre of analysis. States, as will be shown below, are territorially based units of authority - not many people argue otherwise. Thus, if one accepts that the state plays a role in IPE (whatever that role is and whatever significance one gives to it) and that territory is central to our conception of states, then one must conclude that geography still has something to tell us about the IPE.

Development economists have also noted the affect of geography on development. Whether a state is located in an arid, tropical or temperate climate all have significance as to the range of options open to the people in those states to develop viable and sustainable

markets (tropical climates mean more diseases, arid climates limit agriculture and food security, etc). Whether a country is landlocked or situated on the coast affects its ability to trade (if it is landlocked it needs to negotiate with neighbours to use their transport systems to the coast so they can export – or they have to rely on aeroplanes to transport their exports to market, which significantly affects the competitiveness of the price of their goods). Who their neighbours are, politically, also has an affect (being situated in the Middle East, for example, has obvious consequences for security and the ability to attract foreign direct investment due to the instability of the region).

With regards to hydrocarbons specifically, it cannot be ignored that these resources are situated in certain states and not others. The role of energy in IPE is not ignored by Strange, but still she fails to theorise on the affect of geography on the IPE structure. Even in her section on transnational transport systems she fails to give any significance to geography, an astounding feat of myopia. This lacuna in her approach needs to be dealt with.

Obviously, geopolitics and political geography can aid us in bridging the divide between Strange's approach and a more useful one. However, the works that are available at present, whether in the realist category of Halford Mackinder, the critical category of O'Tuathail or the world-systems approach of Immanuel Wallerstein, to name a few, all have their specific problems too. Wallerstein's approach, adopted by Taylor and others, reifies the system, while Mackinder's is too deterministic; O'Tuathail's approach is post-modernist and does not fit the constructivist meta-theory and philosophy of science approach surveyed above. There is a lacuna in Strange's approach but this doesn't warrant us forcibly connecting her approach with an established field of study such as

political geography or geopolitics. We can add geography to the model already offered, it would have little affect on her assumptions or methods. For this reason, an attempt to stick a square peg (political geography) into a round hole (Strange's IPE) is not done here.

Marrying Strange's IPE with geography is necessary to get a more realistic view of IPE. The territories of states are constructed facts of our current world society, just as money, sovereignty, and property rights (to give Pinker's examples) are social facts. Geography should be thought of as the fifth structure that needs to be added to the approach outlined above. It interacts with the security and production structures explicitly, but can also explain phenomena with regard to knowledge (think of such clusters as Silicone Valley in which innovation occurs in a particular space and is to a large degree the product of that space) – finance, however, is a more problematic structure to deal with. This thesis won't attempt to marry Strange's IPE with geography explicitly, but it can be viewed as a case study that takes geography into account, and thus perhaps as a first step in such a synthesis.

#### **Chapter 4: Case studies - n = 1**

Odell defines a case simply as “a single instance of an event or phenomenon” (Odell, 2001: 162). The single phenomenon being investigated here is the affect the presence of hydrocarbons (specifically oil and natural gas) have on the foreign policy of the state in which they are found (in this case Russia). Being a case study the conclusions drawn from this analysis are of minor interest to political science theory. A case study is anecdotal rather than evidentiary in the grand debates of political theory. In order to better approach the level of scientific enquiry the political scientist must do a comparative study of at least two, but preferably more, cases (large-*n* statistical analysis).

A natural trade-off emerges between in-depth knowledge and understanding of a case (qualitative analysis) and general understanding of the whole (quantitative analysis). Both have their advantages and disadvantages.

Odell reminds us that “The single case study is actually a family of research designs” (Odell, 2001: 162). These designs are distinct but not necessarily mutually exclusive and one case study can embrace multiple aspects of these designs. Odell recognises the following types:

1. **The descriptive case study:** this type aims to describe an important case without engaging with other scholarship or generalising the case for the purposes of theory building. Other scholars, however, may employ this case study in wider debates on theory. It is doubtful whether a case study can indeed be purely descriptive, but that is a debate for another time.

2. **The preliminary illustration of theory:** as the name suggests, this is a case used to illustrate a theory. “It puts concrete flesh on the bare bones of an abstract idea in order to help readers see its meaning more clearly, and to convince them that the idea is relevant to at least one significant real-world instance” (Odell, 2001: 163). Importantly, this case study doesn’t engage contending theories in order to judge which is more relevant/useful/precise.
3. **The disciplined interpretive case study:** this case study seeks to interpret and explain by the application of a known theory to new terrain (Odell, 2001: 163). Although the single case cannot be used to test the theory, it is able to show that a known theory can account for the event. Such case studies become important bones of contention in the wider theoretical debates. There is the risk of constructing the case to suit the theory employed, which needs to be countered by offering alternative interpretations and arguing for the applicability of one’s theory over others. One should also offer counterfactual arguments in order to test one’s use of causality. This is done through speculating what the outcome would have been if one’s independent variable (in our case the presence of hydrocarbons) had no affect on the dependent variable (in this case Russian post-communist foreign policy)<sup>23</sup>. This, in turn, will make the interpretive case study more disciplined (Odell, 2001: 163).
4. **The hypothesis-generating case study:** any case study can become a hypothesis-generating one.
5. **The least-likely (theory-confirming) case study:** although a case study can neither wholly validate nor invalidate a theory, a least-likely case study can be strong evidence in favour of a theory. Such a case study aims to show that a case

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<sup>23</sup> This basically amounts to employing the null hypothesis to test the validity of one’s true hypothesis.

that is very unlikely to conform to the precepts of a theory actually does. The logic that follows is that most other, more suitable, cases will also conform.

6. **The most-likely (theory infirming) case study:** this is the logical antithesis of the least-likely case study. A case is chosen because it conforms with the conditions needed for the theory, then it is shown that even this case cannot confirm the theory.
7. **The deviant case study:** such a study aims to illuminate the limits of a theory by documenting a case that does not conform with it. Unlike the most-likely case study, however, this is not done with the purpose of gathering evidence against the theory, but rather in order to direct further enquiry and explanations. Such a case study can help in identifying “conditions that are necessary or favourable for [the theory’s] operation” (Odell, 2001: 166).

This is not an exhaustive list, but highlights most of the important types. The case study presented here is a mixture of a disciplined interpretive case study, as it will use known theories (Strange’s approach to IPE), a preliminary illustration of a theory, as it seeks to expand and critique the known theory by adding geography to the established schema offered by Strange, as well as a hypothesis-generating case study.

## **Part 2: Hydrocarbons and Russian Foreign Policy**

It would be foolish to claim that one factor determines a country's foreign policy in its entirety. Factors - like ideology, level of institutional and economic development, identity, security, geopolitical position, personalities of powerful politicians, history, and possession of valuable resources, among others- interact in a complex web of causal relations. The job of the analyst is to tease out these relations and offer a perspective that simplifies and explains what drives a country's foreign policy (in Strange's terminology, it is necessary to investigate the bargains that have been negotiated and see how they have resulted in actions and the nature of the structure). What follows is a narrative on how Russia's possession of vast amounts of hydrocarbon resources (oil and natural gas) has affected its foreign policy in the post-communist era.

The first part of this chapter is dedicated to the role of hydrocarbons in (1) the international political economy (the structure) and (2) Russia's political economy (the actor). According to the theory posited above, actor and structure interact, with the latter enabling and constraining the actions of the former. What results is the foreign policy of the actor.

The second part of this chapter is a historical account of how the interaction between the actor and the structure was played out in two periods – the first, under President Yeltsin when international oil prices were low; the second, under President Putin when oil prices steadily rose to historic levels. Through this comparison the thesis aims to discern the affect of hydrocarbons on Russia's foreign policy. This section is introduced with a brief

introduction to some drivers of Russian foreign policy and a brief description of the role hydrocarbons played in the fall of the Soviet Union.

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## **Chapter 5: Generative Mechanisms**

### **International structure and hydrocarbons**

*“Energy is the basis of industrial society. And of all energy sources, oil has loomed the largest and the most problematic because of its central role, its strategic character, its geographic distribution, the recurrent pattern of crisis in its supply – and in the inevitable and irresistible temptation to grasp for its rewards.” - Daniel Yergin 1991.*

As already discussed, Strange’s approach to IPE is deficient because it does not take into account geography as a structure in IPE. Nowhere is the presence of geography as a structure felt more than in the issue area of energy. Simply put, some states have hydrocarbon resources within the territories they have authority over and others do not, but all states in the modern capitalist system rely on hydrocarbons for the functioning of their economies. This fact gives those with hydrocarbons immense structural power, but also ties them into the globalised and interdependent international system

In his historical account of the role oil has played in modern history, *The Prize*, Daniel Yergin identifies three themes that arise by studying the history of oil:

- (1) “Oil is the world’s biggest and most pervasive business, the greatest of the great industries that arose in the last decade of the nineteenth century” (Yergin, 1991: 13). The great oil companies of the twentieth century, starting with Standard Oil and then Royal Dutch Shell and the ‘Seven Sisters’, changed the way business was done. They created enormous amounts of wealth for their owners and, sometimes, for the elites in the countries they operated in.
- (2) Oil is inextricably intertwined with the strategies of states in global politics to gain security (economic and political) and wealth - basically power (Yergin,

1991: 13). This was true in World War I, World War II, the Suez Crisis, Cold War, the first and second Iraq Wars, and remains a major factor.

- (3) We are now Hydrocarbon Man. To quote Yergin “It’s oil that makes possible where we live, how we live, how we commute to work, how we travel ... It is the lifeblood of suburban communities. Oil (and natural gas) are the essential components in the fertiliser on which world agriculture depends; oil makes it possible to transport food to the totally non-self-sufficient megacities of the world. Oil also provides the plastics and the chemicals that are the bricks and mortar of contemporary civilisation, a civilisation that would collapse if the world’s oil wells suddenly went dry” (1991: 14-15). It is difficult to deny the pervasive influence of hydrocarbons on modern life, yet new impetus on alternative sources of fuel may in time change this situation. However, as we are aware, an alternative world economy based on cleaner fuels is still a while off.

It is possible to get an idea of the importance of hydrocarbons by seeing how they fit into Strange’s framework:

- (1) **Security structure:** As many histories of the twentieth century and of oil have shown, one of the most important strategic factors in both world wars was the ability of the victors to secure energy supplies and deprive their opponents of energy. Energy is a strategic factor in any war because modern armies and navies cannot operate without it. However, due to the presence of intercontinental missiles, energy is no longer as big a concern as it once was with regard to warfare and strategy. Instead, hydrocarbons are more a concern when it comes to economic security. Without access to hydrocarbons at a reasonable price, economies would falter and markets collapse. This point was made abundantly

clear during the two oil crises of the 1970s, which illustrated that even military and economic superpowers like the US could be brought to their knees by the actions of oil producing countries. Since then, US foreign policy has been, to a large extent, involved in gaining energy, and thus economic, security.

- (2) **Finance structure:** Oil transactions are mainly denominated in US dollars (although the Euro is being used more and more), this means that the US has been able to profit off the oil industry even though it is the world's most oil-dependent country. Petrodollars find their way back into the system through the US economy which allows the Americans to run a huge deficit. However, it is not just the American economy that is dependent on oil. The entire international financial system is dependent on continuous economic growth (Wakeford, 2007: 11). Wakeford explains this by saying that this is “because new money is created as debt, on which interest payments are required. The only way that interest can be repaid in future is if more new money is issued which itself increases the stock of debt. The collateral for this debt is continuous economic growth” (Wakeford, 2007: 11). Thus, any sudden increase in the oil price, which signals a worldwide decrease in economic growth (as the 1970s and 2008 showed), has a significant affect on international financial stability.
- (3) **Production structure:** every industrial age is dependent on a particular energy resource. Coal was the energy source for the first industrial revolution - oil and gas are the sources for our current industrial age. Hydrocarbons are required as an input in production (either indirectly through the use of electricity, or directly as with fertilisers and plastics), and as an input in the transportation of products (“the world's transport systems – including ships, trains, airplanes, and road transport – depend on oil for some 90 percent of their energy”) (Wakeford, 2007: 1).

(4) **Knowledge structure:** The affect of hydrocarbons on the knowledge structure is more difficult to ascertain. If the old adage ‘travel broadens the mind’ is accepted literally, and the affect of hydrocarbons on the international transport system is taken onto account, then it can be concluded that our knowledge of the world and the different peoples that populate it has been a function of the affect of hydrocarbons on world society. Less abstractly, we can argue for the role played by hydrocarbons in chemistry, pharmaceuticals, and agriculture. Furthermore, hydrocarbons, through their affect on the production structure (the mechanisation of industry), have meant that more people have been able to ‘get off the land’. The mechanisation of industry has allowed more people to devote more time to the higher pursuits of learning. Globalisation and its subsequent knowledge effects can also be seen as a function of our hydrocarbon-based international society.

With regards to the actual structure of the international hydrocarbons industry, the role of the oil cartel OPEC must be taken into account. The OPEC members together account for 75 percent of the world’s proven oil reserves (Strahan, 2007: 159). This gives them unequalled power in determining the international market price for oil. However, the usual group decision-making and free-rider problems plague the cartel as we would expect them to plague any large and important decision-making body. OPEC members frequently ‘cheat’ and sell more than their quotas. This can lead to the body being unable to effectively control the world’s price. Russia is not a member of OPEC but has benefited off its actions indirectly (as the events of the 1970s illustrate). It is also at the mercy of decisions made by the body and its members (as when Saudi Arabia flooded the oil market and drove the oil price down in the mid-1980s).

Gas prices are a function of oil prices, as the two are partial substitutes (Wakeford, 2007: 7). This means that when oil prices drop Russia gets hit by lower gas prices too. Attempts are being made to change the pricing mechanism of gas in order to decouple it from the oil price. This would be a major aid to Russia's aim for economic stability. There is, at present, no gas cartel in the mould of OPEC, although it appears that Russia will try to establish such a cartel in the future (with Algeria, Iran, and possibly Qatar). There has been no need for a cartel in the past due to the nature of the gas industry. Gas pipelines have had the same monopolistic effect as a cartel would, but with the development of Liquefied Natural Gas (LNG) technology the industry is set to change. LNG allows for gas to be carried across oceans, much like oil, in LNG carriers, thus freeing up trade significantly.

There is no need to convince even the most casual observer of international political economy of the importance of hydrocarbons in the IPE. Three developments are set to have the biggest affect on hydrocarbons, and thus on the IPE in general. The first is the continuing economic rise of China and India. Their development means that the demand for hydrocarbons will be strong well into the future. The second is global warming, which will incentivise a move away from the exploitation of fossil fuels and towards alternative sources of energy. This is a development that is hard to predict as it seems that it is at present impossible to convince countries to take the first steps in reducing their use of hydrocarbons (as the recent Copenhagen summit in 2009 illustrated). The third, and most significant development, is the phenomenon known as peak oil. The fact is that all hydrocarbons (oil, coal, and natural gas) are finite natural resources. Most indications (even by conservative estimates coming out of the US government) are that the world is

nearing the peak of international oil production. Once the peak is reached international reserves will go into terminal decline. The decline of oil will be far quicker than generally expected (the Hubbert-curve<sup>24</sup> is not necessarily perfectly symmetrical). When oil runs out alternatives will have to be sought. One such option is natural gas, which is a convenient substitute. However, gas reserves are finite too.

These three developments should be kept in mind when considering the affects of hydrocarbons on the IPE, as they will be fundamental considerations for decision makers going forward. The affects of these developments, however, will not be central to this analysis as it deals with past events. With regards to peak oil it should be noted that Russian reserves of oil have already peaked (by most estimates at some point in the early 1990s). It is estimated that at present exploitation rates Russian oil will last another 30 years. However, their natural gas reserves, the largest in the world, should last another 180 years (Stuermer, 2008: 2).

Geography will play an evermore important role in analyses of the international political economy. The fact that Susan Strange failed to adequately address its importance as an IPE structure is a definite fault in her theory. The IPE structure must include considerations of geography because geography decides who has access to hydrocarbon resources, which are intimately connected to all the other structures of the IPE. The international structure, it will be shown, both enables and constrains the actions of Russia (through its affect on Russia's domestic political economy). In the past Russia has been at the mercy of the capricious swings of the international structure. The country's ability to

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<sup>24</sup> The Hubbert-curve is a theoretical prediction that charts the possible peak of oil production. It is based on known reserves and the rate of discovery of new reserves. It is shaped like an inverted-U. Once production reaches the crest of this inverted-U oil production goes into terminal decline.

affect the structure itself has been limited. However, if current developments continue as many predict (with oil production peaking and a move to alternative sources of energy – of which natural gas will be an important one) then an increase in Russia's structural power can be expected. This makes an analysis of the affects of hydrocarbons on Russia's foreign policy an important issue for IPE analysts.

University Of Cape Town

## Hydrocarbons - blessing and curse

*“Men of a fat and fertile soil are most commonly effeminate and cowards; whereas contrariwise a barren country make men temperate by necessity, and by consequence careful, vigilant, and industrious” - Jean Bodin 1576<sup>25</sup>*

Innocents of economic theory may believe that the possession of valuable resources could be nothing but a blessing. However, the relationship between the possession of resources, economic growth and the development of political institutions is anything but simple. Although Sachs and Warner (1997) highlighted this phenomenon in their influential 1997 paper, they were not the first to theorise upon the link between natural resource abundance and poor economic growth (as the quote above shows). Their model of the Dutch disease<sup>26</sup> problem showed that when natural resources were discovered, or the terms-of-trade for them improved, the manufacturing sector shrinks and the non-traded goods sector expands (Sachs and Warner, 1997: 6). The ‘disease’ is due to this shrinkage of manufacturing, which has knock-on effects throughout the economy (backward and forward linkages) and affects vital externalities for sustained growth (such as learning-by-doing, etc) (Sachs and Warner, 1997: 6).

Sachs and Warner noted theories that could explain the phenomenon, which included: a lack of incentive for skills improvement, declining terms-of-trade for primary goods in the international economy (as predicted by Raul Prebisch and Hans Singer), rent<sup>27</sup>

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<sup>25</sup> From (Sachs and Warner, 1997: 4).

<sup>26</sup> Named thus due to the de-industrialisation effects noted after the Netherlands discovered the natural gas reserves of the Groningen field in the 1960s. Increased income from natural gas exports led to increased spending on imports and the shrinking of the Dutch manufacturing sector. It also led to increased unemployment and more people taking advantage of generous welfare programmes (Ellman, 2006: 4).

<sup>27</sup> Gaddy and Ickes define **rents** as: “the revenue received from sale of the resources minus the cost of production. By this definition, rent is equal to economic profit, that is, revenues minus economic opportunity costs (including depreciation of fixed assets and a “normal” return on capital)” (2005: 560).

seeking by interest groups (as theorised by Alan Gelb), the volatility of world market prices for primary goods, and, finally, the wasteful allocation of windfall revenue by the government (Sachs and Warner, 1997: 7-10). Their cross-country regression analysis supported the conclusion that resource abundance is correlated not only with poor economic growth, but also with explanatory variables such as poor institutional quality (measures of rule of law and bureaucratic efficiency) and restrictive trade policies (e.g. import-substitution policies – tariffs). However, they found no correlation with measures of human and physical capital accumulation or savings rates (Sachs and Warner, 1997: 25).

Natural resource abundance is classified in terms of the percentage of a country's GDP that is derived from the export of the natural resource (Sachs and Warner, 1997: 11). This classification strikes one as rather arbitrary. It is a widely known fact that poor countries are dependent on their primary sector (especially agriculture). Thus, studies that classify resource abundance as above and then conclude that resource abundance leads to low growth are making the simplistic argument that poor countries don't grow as much as industrialised countries. Sachs and Warner consider other measurements in their analysis (such as the percentage of mineral production to GDP, the log of land per capita and the share of primary exports to total exports) and find an inverse correlation between these variables and growth too, but don't regress the other factors on them (Sachs and Warner, 1997: 15). The rationale behind their choice of variable is based on data availability and the fact that this variable better captures the wealth effects of resource exports (which is important in analysing the labour force employed in the non-tradeables sector which is central to their Dutch disease model).

This is not the place to debate the merits and demerits of Sachs' and Warner's analysis<sup>28</sup>. The faults with their analysis are simply the faults of all large-sample, cross-country econometric regression analyses. Tompson states that the problem with such analyses is that they treat political, governance and institutional factors as intervening variables, which causes them to infer causation from correlation and makes them unable to explain the actual linkage between the economic and political structures (Tompson, 2006: 190).

Although such analyses have benefits, such as formulating general hypotheses that can be studied in more in-depth comparative and case study analyses, this thesis will focus on analyses with a broader focus that encompass political institutional development and social issues..

A more focused comparative analysis on the political economic affects of oil was conducted by Eifert et al (2002) at the World Bank. They employed comparative institutionalist political theory and found that "strong, mature, democratic traditions have advantages in managing oil rents well because of their ability to reach consensus, their educated and informed electorates, and a high level of transparency that facilitates clear decisions on how to use rents over a long horizon" (Eifert et al, 2002: intro). However, they stressed that even these countries struggled to control the effects of oil rents (Eifert et al, 2002: intro).

On the opposite end of the comparison, countries characterised by factionalism, autocracy, and personalised politics were less able to translate oil rents into economic

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<sup>28</sup> For a critique focusing on the role of institutions see H. Mehlum, K. Moene and R. Torvik. 2006. "Institutions and the Resource Curse". The Economic Journal. Vol. 116, (January), pp. 1-20.

development through consensus building and progressive policies (like stabilisation funds) (Eifert et al, 2002: intro). Their conclusions support the common sense assumption that politics affects economics (through the allocation/distribution of rents) and oil affects politics (through the moulding of social and political institutions – ‘rentier states’) (Eifert et al, 2002: 1). Their analysis is more realistic than that of Sachs and Warner as it situates the effects of oil in a broader social and political-economic environment. One of their insights - that of the affect of political and institutional development on the time-horizons of economic policy - is especially pertinent to the Russian case (as shown by Gaddy and Ickes later in this section). Unfortunately, they didn’t include Russia as one of their cases. Luckily, others have done case studies on Russia and it is to these that we now turn.

Firstly, we must establish whether Russia is a resource-based economy. In 2000 fuels and metals accounted for 65 percent of value added to Russian industry (Tompson, 2006: 191). 76 percent of total exports were attributed to metals, hydrocarbons, and other natural resources, in 2003 this amounted to 31.5 percent of GDP (Gross Domestic Product). Thus, according to most definitions of resource abundant countries, Russia is certainly a typical case. However, Tompson states that this should not lead us to conclude that Russia is a petro-state (in the mould of, say, Saudi Arabia). His proof is that in 2003 taxes on consumption (29.5 percent), value-added tax (35.8 percent in **2004** – no amount given for 2003) and social taxes (22.2 percent) accounted for more than taxes on export duties for oil and gas (20 percent) with regards to revenue (Tompson, 2006: 195)<sup>29</sup>. This claim of Tompson’s is disputed by the likes of Gaddy and Ickes who show that such measures don’t account for informal taxes levied on the sector (this will be shown below). There is no doubt that the Putin regime has made great strides with regards to

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<sup>29</sup> Lucas claims that hydrocarbons account for around half of government revenues (Lucas, 2008: 114).

taxation, but this is not the full picture. Russia is not quite a petro-state<sup>30</sup>, but it does share some of the symptoms thereof.

Tompson states that, unlike most countries examined in the literature, Russia is relatively well developed (high levels of education, developed industrial base etc) and thus bears comparison to countries like the Netherlands, the United Kingdom and Norway, rather than, say, Nigeria or Venezuela (2006: 191). It must also be remembered that Russia is a transition economy with fragile, nascent political and market institutions (rule of law, taxation etc), this also sets it apart from other cases.

Furthermore, it is important to take note of the nature of oil and gas as the natural resource under consideration. These are point resources, which means that they can be easily monopolised by capturing the source (unlike with fisheries, for example) (Tompson, 2006: 192). Oil and gas industries are also capital intensive, which leads to fewer, larger firms (Tompson, 2006: 193). These firms may grow so large as to threaten the power of the states in which they operate (a consequence of which will be picked up by Gaddy and Ickes later in this section). To secure their monopolistic position, and the rents they are able to gain from it, these companies need the state's protection. It will be argued below that in countries with weak regulatory institutions this may have deleterious affects on development.

Hoff and Stiglitz focus their analysis on the obstacles to the development of the rule of law<sup>31</sup> in post-communist countries. They state that the rationale of the 'big bang'

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<sup>30</sup> According to Moses Naim **petro-states** "are oil-rich countries plagued by weak institutions, a poorly functioning public sector, and a high concentration of power and wealth. Their population is chronically frustrated by the lack of proportion between their nation's oil wealth and their widespread poverty" (Naim, 2004).

economic reform programmes of the 1990s was to create property rights (through privatisation) so as to incentivise citizens to lobby government for the enforcement of laws<sup>32</sup>. However, in Russia there remains only a weak demand for such enforcement and thus the rule of law is not as established as it needs to be for the proper functioning of a market economy.

Their model identifies six factors that suppress the demand for law:

- (1) lack of knowledge of a market economy prior to communism,
- (2) open capital markets,
- (3) corruption in the privatisation process,
- (4) a legacy of corruption,
- (5) the hyperinflation of 1992-1993 (that weakened support for the free market),
- (6) abundant natural resources (Hoff and Stiglitz, 2004: 754).

There is a novel approach that looks at the rule of law from a demand perspective rather than the usual supply perspective offered by theorists of rent-seeking in resource abundant countries (e.g. Gelb's theory) (Hoff and Stiglitz, 2004: 761). Guriev and Sonin (2007) have also done an analysis of the demand for property rights, however, theirs focuses on the demand from oligarchs. It would seem logical that those with most to lose from weak property rights (the very rich) would put pressure on the government to provide such rights. And given that the oligarchs were so powerful during Yeltsin's tenure, it seems strange that not more was done to develop institutions that would protect the oligarch's property. Guriev and Sonin explain this phenomenon using the idea of coordination problems. Simply, although the collective of oligarchs would benefit from

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<sup>31</sup> Rule of law: "well-defined and enforced property rights, broad access to those rights, and predictable rules, uniformly enforced, for resolving property rights disputes" (Hoff and Stiglitz, 2004: 755-756).

<sup>32</sup> This interpretation differs from analysts like Anders Aslund, who state that the shock therapy approach was adopted for primarily political reasons. Simply, Yeltsin had to get his harsh reforms through quickly so that they wouldn't be threatened by a popular backlash. This will be put in context later in the section on Yeltsin. However, it is important to note that the two interpretations are not necessarily contradictory and that both reasons may have supported calls for shock therapy.

the enforcement of property rights, each individual oligarch finds it optimal to deviate, thus stymieing attempts to develop these rights (Guriev and Sonin, 2007: 2).

The following table from Stiglitz and Hoff's paper shows just how poorly Russia has performed with respect to the development of the rule of law and property rights in comparison to other post-communist countries. Clearly visible is the correlation between resource abundance and poor record of the rule of law in Russia. For instance, compare Russia with Slovenia or Hungary (Hoff and Stiglitz, 2004: 760).

**Table 2: Natural resource abundance and rule of law**

Country	Measure of natural resource abundance			Performance measures		
	Fuel and mineral exports / total exports (%)	Fuel and mineral exports / GDP (%)	Year	2000 GDP / 1989 GDP (%)	% believe legal system will not "uphold my contract and property rights in business disputes"	Wall Street Journal rule of law index
Moldova	3.80	0.69	1994	33	74	4.7
Slovenia	4.36	1.65	1994	114	26	8.4
Hungary	7.00	1.70	1994	104	29	8.7
Slovak Republic	8.04	3.13	1994	103	36	6.4
Czech Republic	8.48	2.43	1994	98	55	8.3
Estonia	9.18	3.68	1995	83	23	8.5
Average	6.81	2.21		89	46	7.5
Croatia	11.02	3.16	1994	80	34	7.0
Romania	13.63	2.81	1994	77	43	5.6
Bulgaria	16.17	6.72	1996	71	43	5.9
Poland	16.98	2.82	1994	127	25	8.3
Lithuania	18.32	5.96	1994	65	65	7.2
Average	15.22	4.29		84	42	6.9
Kyrgyz Republic	23.63	2.93	1995	66	71	4.4
Kazakhstan	48.86	12.87	1995	69	59	4.5
Russia	53.16	14.44	1996	63	73	3.7
Average	41.88	10.08		66	68	4.2

Note: Countries are listed in order of increasing natural resource abundance, as measured in column 1.

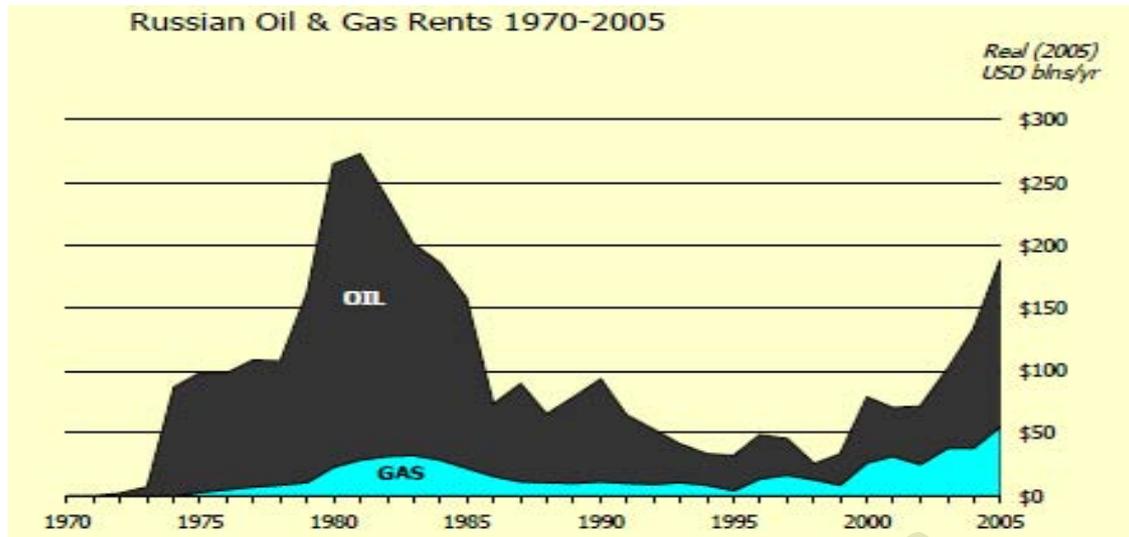
Gaddy and Ickes state that Russia's political economy, in the modern era, has always centred on the distribution of value from its resources to other parts of the economy (2005: 559). This allowed the Soviets to "impose a costly economic structure" and is still a factor today (Gaddy and Ickes, 2005: 559). Although the opacity of the Soviet era has somewhat lifted due to new institutional structures (taxation and accounting practices), the overwhelming amount of value generated in the resource sector means that much of it is still distributed by non-transparent means (subsidies, corruption etc) (Gaddy and Ickes, 2005: 559).

The magnitude of oil and gas rents as a percentage of GDP gives us a clear picture of Russia's economy and what is 'up for grabs'. In 2005, an estimated 25 percent of GDP<sup>33</sup> (in dollar terms) was attributed to these rents (Gaddy and Ickes, 2005: 562). But just as these rents can peak (as they did in 1981 and 2005), they can also fall. Between 1981 and 1998 oil and gas rents dropped steadily from a high of \$250 billion to just \$25 billion (adjusted to 2005 dollars) (Gaddy and Ickes, 2005: 562). The following graph shows these trends in oil and gas rents from 1970 to 2005 (Gaddy and Ickes, 2005: 562). Please note the growing importance of natural gas rents in the later years of the graph.

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<sup>33</sup> At their height in 1981 oil and gas rents accounted for 40 percent of Russia's GDP (Gaddy and Ickes, 2005: 562).

**Graph 1: Russian oil and gas rents (1970-2005)**



Putin's regime has done a commendable job in ensuring that a larger proportion of these rents find their way back into the system through official means (i.e. formal taxation). In 2004, all oil companies (whether state owned or private) were paying roughly ten times more in taxes compared to the level in 1999 (Gaddy and Ickes, 2005: 564). But Gaddy and Ickes argue that this is only half the story and that the more important story relates to the persistence of informal and indirect rents. These rents help sustain the economy and society but aren't captured in official statistics (Russia's 'virtual economy'). Thus, claims that the new, reformed Russia would be able to endure another oil price drop (thanks to the government's oil stabilisation fund) without succumbing to the devastating economic and social effects that characterised earlier drops are fallacious (Gaddy and Ickes, 2005: 565).

These informal rents come in the form of:

(1) **price subsidies** (that keep the local price of oil and gas well below international market prices<sup>34</sup>);

<sup>34</sup> The local oil price has been between 31 and 46 percent of the world price (Gaddy and Ickes, 2005: 565).

(2) **bribes** (estimates are that the volume of bribes increased more than ninefold between 2001 and 2004);

(3) **excess costs** (the inefficient and costly methods used in extraction and transportation<sup>35</sup>) (Gaddy and Ickes, 2005: 566)

The persistence of these informal rents in the economic structure means that today's Russian economy is more like the Soviet economy than the Kremlin would like to admit. In short, Russia is still addicted to oil and, increasingly, natural gas. In the Soviet era an inefficient system was made viable due to the exploitation of resource rents. A vicious circle developed in which the more the resources could be exploited the more inefficient the system could become, and thus the more the resources needed to be exploited (Gaddy and Ickes, 2005: 568). The 1970s saw this system take off with the oil boom out of Western Siberia and the effects of the oil price shocks brought about by OPEC. Gaddy and Ickes state that OPEC's actions had a two-pronged effect. Firstly, the international price of oil sky-rocketed - meaning huge windfalls for Russia. Secondly, the OPEC countries could afford to splash out on new military goods and the Soviet Union was their supplier of choice (Gaddy and Ickes, 2005: 569). The windfall led to irresponsible spending on:

- a) the expansion of heavy industry,
- b) building up of a giant arms industry,
- c) foreign 'adventures' like Afghanistan and the sponsoring of client states,
- d) subsidies to COMECON countries.

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<sup>35</sup> Some have hypothesised that this inefficiency is not incompetence but rather a conscious decision. For example, rail is sometimes used to transport oil rather than pipeline in order to keep the industries that produce railway freight cars in business (Gaddy and Ickes, 2005: 566).

When the oil price began to fall in 1985 Russia was addicted and it was too late to act. Gaddy and Ickes believe that Russia faces a similar addiction today and the strides towards reform and transparency, although impressive, have not dealt with this fact. The 'virtual economy', which informally distributes rents, is central in understanding modern Russia's political economy. The inability of the state to effectively distribute oil and gas rents (formally) means that it is reliant on the private sector to do so (informally). In essence, the state acts as a racketeer, it allows companies to operate as long as they share their rents (profits) with the local economy/society. If they don't cooperate, the government threatens to appropriate their property (as they did with Yukos in the Khodorkovsky affair, detailed later). Weak property rights and rule of law (as illustrated by Hoff and Stiglitz) allow this system to continue.

Putin's ascendancy signalled a change in the rules of the game. Under Yeltsin, oligarchs were courted and essentially given free reign. Putin inherited this system but wanted to centralise power and send a clear signal to the oligarchs that he was now in charge. Putin, however, was not trying to reform the system of informal rent distribution, he merely wanted to centralise the control thereof (Gaddy and Ickes, 2005: 571). Gaddy and Ickes identify three problems with this system:

- (1) It is inefficient and leads to generally lower levels of utility throughout society,
- (2) the tax burden on oil and gas companies (both formal and informal) are punitive and lead to lower levels of investment, thus hurting future productivity in the sector,
- (3) and property rights are systematically weakened, thus the time horizons of the owners of capital are shortened (due to the ever-present threat of expropriation) which leads to skewed and irrational use of capital that endangers future

productivity in the sector (Gaddy and Ickes, 2005: 571). Lucas notes that after the attacks on Yukos, modernisation in the oil industry halted and oil extraction fell (Lucas, 2008: 18)

These effects are being felt in Russia's oil and gas sectors today. There are generally low levels of investment in new fields and oil that should have reached the market when prices were highest (in order to optimise profits) was sold in a hurry due to foreshortened time horizons by companies (Gaddy and Ickes, 2005: 572). All this is due to the insecurity of property rights and the insecurity of property rights is a function of (a) the low demand for the rule of law (as shown by Hoff and Stiglitz above), and (b) the addiction to oil and gas rents and the perpetuation of the 'virtual economy' (shown by Gaddy and Ickes).

However, the weakness of Russia's regulatory institutions, especially in the 1990s, was not just a result of the effects of hydrocarbons. As will be shown in more detail later, the traumatic effect of the sudden adoption of neoliberal economic policies meant that Russia was left with an institutional framework it was unaccustomed to (this is Hoff and Stiglitz first point mentioned above). Kuznetsova and Kuznetsova state that "The logic of political struggle against the threat of restoration of communism undermined the administrative capacity of central authorities and their ability to provide an institutional framework in a time of systemic changes" (2003: 919). The presence of hydrocarbons did affect the ability of effective regulatory institutions to develop, but we must not forget that the political atmosphere at the time also played an important role.

So far, the relationship between weak institutions and resource abundance has been investigated and the deleterious effects of this relationship on the Russian economy and society in general have been noted. Tompson takes this analysis further by employing a Tillyian theoretical perspective (based on the theory of Charles Tilly 1992). This perspective shows that a development strategy centred on the state's control of natural resources is incentivised more than the development of institutions to regulate the political and economic spheres (Tompson, 2006: 205). This in turn leads to the stifling of civil society, rule of law, security of property rights, and investment in human and physical capital – which are all effects noted by the theories above (Tompson, 2006: 205). What Tompson's analysis highlights is that these factors add to the incentive for the state to nationalise the resource sector outright (Tompson, 2006: 206).

Getting back to the Russian case, Tompson shows evidence of just such a strategy. Putin regularly made proclamations to the effect that Russia's development and resurgence as a 'great power' geopolitically were to be based on hydrocarbon wealth (Tompson, 2006: 206). Putin sought to bring the oil sector (which had largely been privatised) under tighter government control<sup>36</sup> and to deploy loyal people (like Dmitri Medvedev, before he became president) at the helm of the state-controlled gas monopoly Gazprom in order to implement his development strategy. In the section on Putin this renationalisation policy will be dealt with in detail.

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<sup>36</sup> “By late 2005, around 15 percent of oil production had shifted, or was in the process of shifting, from private to state hands, and there was every likelihood that, when the onslaught against Yukos was finally over, the state would have raised the share of oil production directly under its control from around 17 percent in 2003 to perhaps 45 percent” (Tompson, 2006: 207).

## **Chapter 6: Russia's foreign policy in historical perspective**

*"I cannot forecast to you the action of Russia. It is a riddle, wrapped in a mystery, inside an enigma....The only key is the national interest of Russia" - Winston Churchill 1940.*

The division of Russia's post-communist history into the Yeltsin and Putin periods is not an arbitrary dichotomy. Yeltsin's rule took place under very different international and domestic circumstances. During his tenure, oil prices (and thus gas prices as they are related) were low and the Russian economy was struggling through a traumatic structural reform process. It was a time when the state was in retreat, both internationally (globalisation and the pushing of the neoliberal agenda) and domestically (due to the reforms, especially privatisation, and the weakness of new governance institutions).

With Putin's period we see the return of high oil prices. Russia's economy begins to grow and the people of Russia welcome the return of strong leadership (after Yeltsin's feckless rule at the mercy of various interest groups). We also see the return of the state internationally due to the 9/11 terrorist attacks and the resurgence of realist doctrine. The East Asian financial crisis draws attention to the defects of neoliberal economic policy and once again economists are theorising as to the proper role of the state in the market. The return of the state in Russia is shown by the willingness of Putin to take on the oligarchs as well as by the development of regulatory and administrative institutions (such as better taxation), and greater state ownership of the hydrocarbons industry.

As it is the interplay between the domestic and international that this thesis aims to tease out (through the role of hydrocarbons in both), it is important to make the distinction between these two periods.

The focus on the specific roles of Yeltsin and Putin as individuals is also not arbitrary. According to the Russian constitution adopted in 1993, Articles 80 and 86, the president has power to exercise “leadership of the foreign policy of the Russian Federation”, although this power is bound to the constitution and laws of the country (Donaldson and Noguee, 2005: 140). In an address to the CIS in March 1997 Yeltsin made this clear and said: “I want to stress that Russia’s foreign policy, including that with regard to the other CIS countries, is determined by the President....I beg you to proceed from this fact. It goes without saying that we could raise the issue of the unpleasant remarks made by parliamentarians, governors, politicians, and bureaucratic officials.....We know behind whose words the policy of the state is” (Yeltsin quoted in Donaldson and Noguee, 2005: 171). Russian leaders tend to identify themselves with the state in a fashion reminiscent of Louis XIV when he stated “L’Etat, c’est moi” (Shevtsova, 2003: 106).

However, individuals are incapable of running the domestic and foreign policies of their states by themselves. Thus, this thesis will attempt to give an account of the prominent groups that influenced policy (the oligarchs in the Yeltsin period and the *siloviki*<sup>37</sup> in Putin’s).

Before the post-communist era is addressed we must first recognise the legacy of Russia’s past and its geographic position, so as to contextualise these recent developments.

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<sup>37</sup> Siloviki is a Russian term referring to those in the power structures (FSB, ex-KGB).

## **Background**

*“Foreign policy with us does not proceed from the directions and priorities of a developed statehood. On the contrary, the practice of our foreign policy will help Russia become Russia” - Sergei Stankevich 1992.*

Sergei Stankevich’s words are telling. The fact is that Russia had never been a nation-state in the modern Westphalian sense until the dissolution of the Soviet Union. As Noguee and Donaldson have stated, “during both the tsarist and Soviet periods it had been a multinational empire with messianic ambitions” (2005: 124). This, however, doesn’t necessarily mean that there is no precedent on which to base an analysis. Although there was no state in the modern sense, there has always been a power centre and the geopolitical facts on which that centre based its foreign policies have remained relatively unchanged.

It is almost a cliché to wonder at the geographic scale of the Russian state. It has a territory of 6,592,850 square miles, which is about twice the size of Canada (the world’s second largest country), 6,000 miles of land lie between its Western border and the Pacific Ocean in the east (11 time zones), while from north to south lie 2,800 miles (Donaldson and Noguee, 2005: 17). Along its extensive borders lie volatile and powerful countries: China and North Korea in the east; Iran, Georgia and Azerbaijan in the south; and transition countries like Ukraine and Latvia to the west. Securing those borders is an unenviable task. Geopolitically<sup>38</sup>, Russia lies in the heart of Mackinder’s ‘Heartland’ (or pivot-area).

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<sup>38</sup> A geopolitical analysis of Russia seems like a fruitful course in a foreign policy analysis. However, its deterministic reasoning and ahistorical view clash with the analysis presented here. That said it is not wholly ignored and its insights are valuable.

With a telescopic view of Russian history, Lovell states that the early imperial powers of Russia – the Mongols of the 13<sup>th</sup> and 14<sup>th</sup> centuries – taught Russian rulers a lesson they could not forget; “given the size and openness of the Eurasian landmass, a strong centralised state was imperative for survival” (Lovell, 2006: 7). This logic has been translated down the years in many ideological guises. What it amounts to is the need for iron-fisted leaders at the head of a patrimonial system that is able to extract resources (rents) from the population (Lovell, 2006: 7). Modern-day incarnations of this logic are evident in Yeltsin’s method of hiring and firing underlings in order to cement his authority and in Putin’s idea of the ‘vertical of power’.

Russia’s straddling of the Europe-Asia divide has meant that it has something of a perpetual identity crisis – is it European or Eurasian? Russian identity has been at the heart of many important foreign policy analyses. Smith identified a number of conceptions of Russian geopolitical identity and concluded that the orthodoxy can be summed up in ‘democratic statism’ (*gosudarstvenniki*) or ‘the official Eurasianism’ (1999: 486). This view draws upon Western liberalism and neonationalism and produces what Smith refers to as a “syncretic geopolitical discourse” (Smith, 1999: 486).

What this amounts to is an acceptance of Russian distinctiveness with regard to culture and geopolitical security concerns and interests. According to Smith, Russia is seen as a “Eurasian power whose role is to organise and stabilise the Eurasian heartland, so operating as a bridge between Europe and Asia” (1999: 486). This is in contrast to Gorbachev’s slogan of “Europe our common home” pronounced in 1985 at the start of *perestroika* and *glasnost*, and reiterated by the early formulators of Russian policy in the Yeltsin period and by Putin’s early foreign policy during his first term (Tsygankov, 2006:

56, Stuermer, 2008: 13). Thus, indications are that the perpetual to-ing and fro-ing between “Slavo-philes” and “Westward-lookers” continues.

The issue of identity will be an important factor in the analysis of the changing foreign policy perspectives during both the Yeltsin and Putin periods. At the start of Yeltsin’s presidency, the liberal internationalists were firmly in control and Russian policy can be described as Westward-leaning. However, after the disastrous economic reforms and the growing nationalistic opposition they caused, Yeltsin needed to change tack and adopt a more Eurasian stance, emphasising Russia’s importance in the region, in order to stay in power. At the start of Putin’s rule he too could be described as Westward-leaning (especially after his response to the 9/11 terrorist attacks and helping of the US coalition). However, as the oil price rose and Russia was more able to flex its diplomatic muscle, Putin’s perspective morphed into one that emphasised Russia’s position as a ‘great power’ in the international system, but with its own Eurasian identity and values (at odds with Western values).

Russian geopolitics and the debates around identity are relatively stable factors in the determination of Russian action, and thus their influence on the modern period can be viewed in light of their influence on earlier periods. More recent historical events have had a more immediate affect on recent Russian history, and it is to these events that our background must now turn.

The demise of the Soviet Union puzzled observers and embarrassed sovietologist predictors who found themselves just as surprised as ‘the man in the street’. That it was largely unpredicted adds weight to the claim made in the philosophy of (social) science

section at the beginning of this thesis, which posited the essentially unpredictable nature of social interaction. Since the Soviet Union's end, however, theoreticians have attempted to explain the causes of the collapse. Although many interpretations<sup>39</sup> may be valid for the demise, one seems to have 'greater explanatory power' and fits with the approach taken in this thesis. This interpretation sees the collapse of the Soviet Union as being analogous to other imperial collapses in history.

Mandelbaum states that: "The Soviet Union was the last great multinational empire, the sole surviving member of the family of empires that once held sway over much of the planet and that, in the 20<sup>th</sup> century, were weakened, then destroyed, by war" (Mandelbaum, 1998: 2). For him, the best comparison of imperial collapse in the case of the Soviet Union (in the 20<sup>th</sup> century) is between the USSR and the Ottoman and Austro-Hungarian empires, as they were land-based empires rather than scattered colonial empires in the mould of Britain and France (Mandelbaum, 1998: 2-3).

Stuermer states that the implosion of the Soviet empire was due to imperial overstretch<sup>40</sup> and that this overstretch was funded by the oil price booms in the 1970s (Stuermer, 2008: 82-83). Thus, when prices began to tumble in the mid-1980s the Soviet empire became bankrupt. Oil prices shot up in 1973-1974 due to the Arab oil boycott (first oil crisis), at the same time oil fields in Western Siberia came on-line meaning that the Soviets were

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<sup>39</sup> Strange has forwarded a theory based on the fact that Soviet consumers became more aware of their relative deprivation due to the spread of information that occurred with the process of globalisation. She says that "information about what others enjoyed in the West could not altogether be kept from people even in the Soviet Union, let alone in Central Europe. The revolution in communications, and thus in the whole global knowledge structure, helped to reveal the widening gap between standards of living for similar social groups under global capitalism and under socialism (Strange, 2000: 63). This led to general disaffection with the system and the mounting calls for change. Such an interpretation is useful and valid and is in no-way discounted by the other one offered here. They are complementary not competitive interpretations.

<sup>40</sup> **Imperial overstretch** idea is often associated with Paul Kennedy's thesis that "hegemons decline because they make costly global commitments in excess of their ability to fulfil them" (Kegley and Wittkopf, 2004: 317).

benefitting from both high prices and an envious supply (Gaddy and Ickes, 2005: 569). As noted earlier (in the section on hydrocarbons and political economy) this led to reckless spending and an economic addiction to oil.

There was a second oil price hike in 1978 due to the Ayatollah Khomeini's return to Iran and the subsequent 'Mullah Revolution' (Stuermer, 2008: 89). This led the Soviet leaders to believe that an era of constantly high oil prices had been ushered in and so they planned and acted accordingly. Their engagement in Afghanistan in 1979 embroiled them in a war that drained revenues, fermented discontent at home (especially when injured and dead soldiers began to return), and showed the weaknesses of the army due to their technological backwardness when compared to the arms supplied to the Afghans by the Americans (Stuermer, 2008: 89).

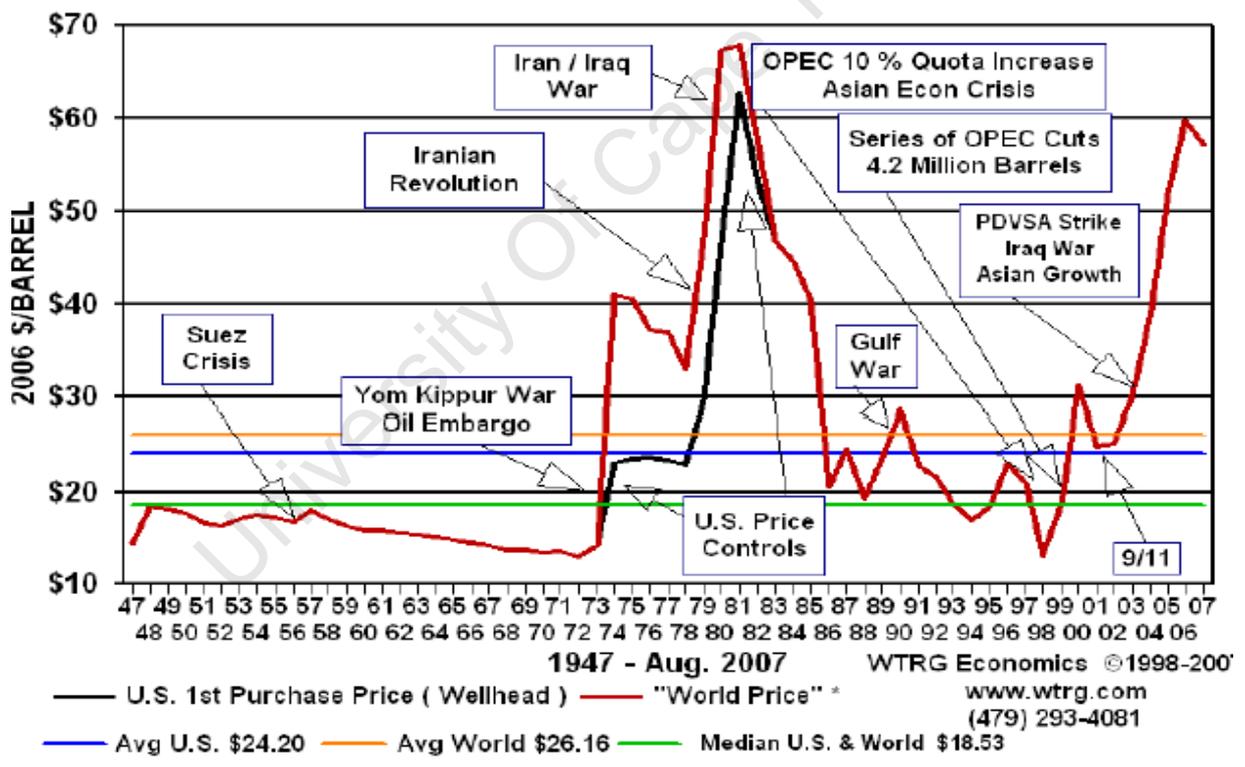
The mid-1980s were a harsh reality check. There are many versions explaining why the oil price fell in 1985:

1. The Saudi's, in alliance with the United States and the Iraqis against the Iranians, decided to increase oil production in order to price the Iranians out of the war (Stuermer, 2008: 148);
2. Thatcher and Reagan lobbied King Fahd to increase oil production with the express purpose of targeting their Cold War rival. This version is backed up by the fact that Thatcher let the price of North Sea oil fluctuate at this time, thus also depressing the prices (Morgan, 2003: 78);
3. Saudi Arabia was targeting other OPEC countries (like Kuwait) due to their cheating on their oil quotas. Therefore, they made a deal with Aramco to lock-in a certain price (Aramco received \$2 per barrel no

matter what the international market price did), thus incentivising the oil company to refine at full capacity, which flooded the market. The Saudis, in this interpretation were trying to teach the other OPEC members a lesson by stamping their authority on the international oil system (Yergin, 1991: 748-749).

The following graph summarise past moves in international oil prices and their causes, one can see how dramatically the oil price fell at the beginning of the 1980s (the oil price is in 2006 US dollars) (Gaddy and Ickes, 2005: 559).

**Graph 2: Oil price and international political developments**



Whatever the truth is, the oil price plummeted from \$30 per barrel to \$10 per barrel (some producers were selling oil for \$6 per barrel) (Morgan, 2003, 78). And to make

matters worse, Soviet oil production peaked due to a lack of investment in new fields and began to fall too (Sachs, 2005: 131-132). Sachs states that in the second half of the 1980s “the Soviet economy was caught in scissors of falling oil export earnings and rising external debt” (Sachs, 2005: 132). In 1985 oil earnings had exceeded net foreign debt (\$22 billion versus \$18 billion), but in 1989 this debt had ballooned to \$44 billion<sup>41</sup> while oil revenues were a relatively meagre \$13 billion (Sachs, 2005: 132).

This episode is a clear illustration of actor-structure interaction. The structure (international political economy) enables Russia to act so as to take advantage of the high oil prices in the 1970s. High oil prices affect the way individuals that make up the Russian state (policy-makers), at this time dominated by the military, act domestically (perpetuation of inefficient economic system and ballooning of the defence industry) and internationally (invasion of Afghanistan). Then, the actions of other actors (Saudi Arabia and the United States) change the structure so that oil prices plummet. Thus again affecting the choices open to Russia. Such a period could not be accurately accounted for without taking into consideration this dynamic interaction.

The Soviet economy, with its chronic inefficiencies and crippling reliance on oil, led to Gorbachev’s *perestroika* which attempted to reform it in a gradualist manner (by introducing some pricing mechanisms and some forms of property rights). This in turn led to the colossal concealed inflation (referred to as the inflation overhang) which essentially made the Soviet economy a joke. As Lovell recounts in a popular example of the absurdities of the system: “A tonne of crude oil fetched 30 roubles in the official system of Soviet wholesale trade; on the unofficial market, that amount of money could

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<sup>41</sup> Debt would reach \$57 billion in 1991 (Sachs, 2005: 132).

buy precisely one packet of Marlboro cigarettes” (Lovell, 2006: 91). The system was primed for implosion, and it would be up to Yeltsin and his liberal reformers to pick up the pieces and bring some sort of coherence to the economy.

This background has addressed two issues. The first is the geopolitical and identity issues that mould Russian views of themselves and their domestic and international actions. The second has been a brief sketch of the fall of the Soviet system, which highlights the role of hydrocarbons therein. It is much too short to offer a comprehensive picture of these two issues, but works as a launching pad into recent history and the factors that shaped it.

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## **Chapter 7: The Yeltsin years - the rise of the market**

The Yeltsin period is not one characterised by a formal and coherent foreign policy vision, and hydrocarbons only played an indirect role. It is a period that was defined by economic hardships and the political ferment that these hardships created in Russia's domestic politics. From the start Yeltsin had to fight to keep power. The domestic politics of Russia and the policies that they brought about were a direct result of the constraints placed upon Russia by the international political economy. During the 1990s oil prices were low and the Russian state, with its weak institutions (especially taxation, property rights and rule of law) and reliance on hydrocarbons, was unable to get the revenues necessary in order to develop. The reform process succeeded only in bringing to power a group of politically connected oligarchs that the Kremlin, and more specifically Yeltsin, would need to ingratiate themselves with in order to keep power. Russia's foreign policy during this period shifts from concerns over security and power (in the international context) to a focus on domestic economic stability.

The incoherence that came to be the hallmark of Russian foreign policy in this period is due to the fact that the state was weakened and that Yeltsin had to rely on the oligarchs. Thus, it was the oligarchs' economic interests that would come to dominate foreign policy decisions (their interests, access to Western capital, became Russia's interests). However, as McFauls has highlighted, the oligarchs were not interested in foreign policy issues that did not directly affect their economic interests (namely security issues like START II) and so these were decided by other interested parties (the military-industrial complex in this case) (McFaul, 1997: 25). This meant that foreign policy would often

shift from attempts to attract the West, to strong anti-Western rhetoric, and it is this constant shifting that caused the incoherence in foreign policy.

Although foreign policy was largely incoherent, two periods can be discerned. The first period (1991-1996) is when the liberal internationalists (Gaidar, Kozyrev etc) steered foreign policy towards integration with the West. The second period (1996-1999) sees Yeltsin conceding to nationalist sentiment at home and placating these forces by appointing Yevgeny Primakov as foreign minister. Foreign policy thus becomes more pragmatic, whilst stressing Russia's importance in its sphere of influence (the 'Near Abroad'). Due to constraints brought about by the failing economy, however, the change is more one of tone and rhetoric than substance.

#### **The liberal internationalist period (1991-1996)**

At first, Yeltsin's foreign policy followed in the footsteps of the *New Thinking*<sup>42</sup> laid down by Gorbachev's doctrine. This doctrine meant that Russia sought integration into the West and drew the line under the communist era (Adomeit, 1995: 44; Shevtsova, 2003: 61; Mandelbaum, 1998: 4). Adomeit states that the aims were the "devolution of empire, eradication of regional military preponderance, abandonment of military-strategic parity, pursuit of broad political cooperation with newly found partners in the UN Security Council, full participation in international economic institutions such as GATT, the IMF and the G7, and even membership of NATO" (Adomeit, 1995: 44). With hindsight, one could state that such aims were too ambitious and that the liberal reformers

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<sup>42</sup> Gorbachev's **New Thinking** according to Donaldson and Noguee: "Essentially a variant of liberal internationalism, Gorbachev's foreign policy ideas centred on interdependence, mutual security, cooperative solutions to international problems, the primacy of nonclass values, and an understanding of capitalism that rejected the notion of its inherent militarism and the inevitability of war" (2005: 123).

clustered around Yeltsin were naïve in thinking they could achieve all of these goals. However, at the time Yeltsin had massive support, following his August 1991 coup attempt, and the opposition (communists, conservatives and nationalists) were discredited and demoralised (Adomeit, 1995: 44).

This political capital was soon spent. As the effects of the liberal economic reforms began to bite and the economy went into deep recession, the opposition began to grow and by 1992 a crisis was developing. Centrist, moderate and right-wing groups united against Yeltsin. They were disgruntled by his unwillingness to compromise and his favouring of certain groups and ideas in his clique (Arbatov, 1993: 18). Arbatov has identified four groups that emerged in the 1991-1993 period. Each of these groups had a specific vision for Russia's foreign policy. They were:

- 1) **Pro-Western Group:** headed by foreign minister Andrei Kozyrev (liberal internationalist). This group concentrated on domestic and economic affairs and was not interested in security or geopolitical matters. It was supported by Yeltsin and liberal reformers like Yegor Gaidar (Arbatov, 1993: 7). According to Arbatov, "The most urgent goal of the Kozyrev group [had] been political and economic integration of Russia into the West" (1993: 8).
- 2) **Moderate Liberals:** this group was from the governmental, political and academic stratum of society. It had a more realistic and pragmatic view of Russia, the West, and world at large. A strong proponent was the ambassador to the US at the time, Vladimir Lukin (Arbatov, 1993: 10). This group had many supporters among the younger generals of the military and placed most emphasis on Russian relations with the former Soviet republics. They believed in stable relations with the West, but wanted the foreign policy to be focussed on Russian interests and

did not believe that it was necessary to align themselves completely with the interests of the US (Arbatov, 1993: 11). Furthermore, they were sceptical of US and Western aid<sup>43</sup>.

- 3) **Centrist and Moderate Conservatives:** these were represented by the likes of Vice President Alexander Rutskoi and Ruslan Khasbulatov, the Speaker of the Supreme Soviet. They were closely linked with those high up in the military as well as the industrial managers (Arbatov, 1993: 12). According to Arbatov, “These people [could not] reconcile themselves to the demise of the Soviet Union, although they [did] not advocate reunification by military force” (1993: 13).
- 4) **Neo-communists and Nationalists:** these included the right-wing groups and fascists, like Dmitri Vasiliev, who were not taken very seriously in politics (Arbatov, 1993: 13). These groups included “Russian Unity” and the notorious “Front of National Salvation”. According to Arbatov, they were “devoted to the goal of the revival of the Russian empire and Russia’s superpower role, not on the premise of communism, but on those of Great-Russian nationalism, a fundamentalist version of the Russian Orthodox religion, anti-semitism, and a vigorously anti-Western political crusade” (1993: 14).

The coalition of forces led by Rutskoi and Khasbulatov challenged Yeltsin’s authority, which led to Yeltsin taking drastic action (period: September-October 1993) by dissolving the Congress of People’s Deputies and the Supreme Soviet. The Supreme Soviet, in turn, tried to impeach Yeltsin and took up arms against him (Lovell, 2006: 164). The matter was finally settled by Yeltsin using extreme force and firing on the

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<sup>43</sup> As we shall see later, this group has much in common with those that would come to dominate in Putin’s second term in office when he begins to emphasise his “great state pragmatism”.

White House (former parliamentary buildings) with tanks and ordering the arrest of Khasbulatov and Rutskoi<sup>44</sup>.

This is the political background to the period under which Russia's new foreign policy doctrine was debated. By this time, a clear line distinguished the 'internationalists' (Andrei Kozyrev and his group) and the 'neopatriots' or '*derzhavniks*'<sup>45</sup> (Sergei Stankevich and his group) (Aron, 1998: 24). The neopatriots were ashamed of what they derisively came to call the 'diplomacy of smiles' and the 'policy of yes' (Arbatov, 1993: 21). They felt Russia, a great state, should not have to concede on every point to the West and they were mortified by Russia going cap-in-hand to Western nations and international financial institutions (such as the IMF) for aid (Arbatov, 1993: 21).

In December 1992 it seemed that the *derzhavniks* were triumphant. At the CSCE (Conference for Security and Cooperation in Europe) meeting in Stockholm Kozyrev shocked the audience by denouncing Western influence in the Baltic states, he demanded the end of UN sanctions against Serbia and declared that the territory of the former Soviet Union was off-limits to outside influence and would be defended with all of Russia's military and economic might (Adomeit, 1995: 45). However, shortly after making these pronouncements, he stated that it was all an elaborate hoax in order to illustrate to those present what they could expect if Yeltsin was ousted by the growing opposition to him and his liberalising ways (Adomeit, 1995: 45).

However, in the wrangling over foreign and defence policy between the neopatriots and the internationalists something approaching a compromise was born which looked much

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<sup>44</sup> They were later released in a surprising show of tolerance by Yeltsin.

<sup>45</sup> *Derzhavniks* means 'great state', which is how they wanted Russia to act.

like Kozyrev's joke. Concessions to the old guard, those that put defence and military matters at the heart of policy, were required during this turbulent time, but Yeltsin was also in the process of consolidating his power. In 1992 he created the Russian army and Defence Ministry (whilst putting himself in charge as acting minister), but he made it clear that the Ministry of Foreign Affairs (with Kozyrev at the helm) was to play the leading role in the formulation of foreign policy (Donaldson and Noguee, 2005: 147).

The policy that was adopted by Yeltsin in 1993, called the *Concept* (Konzeptzia)<sup>46</sup>, "formalised a revolutionary shift in Russia's national security priorities that occurred between 1987 and 1993" (Aron, 1998: 25). This document made explicit the sea change in policy from the Soviet era. Domestic and economic issues were now prime rather than security and defence concerns (Aron, 1998: 25). The key objectives of foreign policy were to ensure economic development and democratic stability. The Russian state was effectively 'decoupled' from the Russian empire (Aron, 1998: 25). The messianic motivations ("Third-Rome", "pan-Slavism", and "world socialism") that had characterised Russian policy for four centuries were abandoned (Aron, 1998: 25). The new policy portrayed a tripartite vision of Russia as:

- (1) A regional superpower,
- (2) A great power in the world,
- (3) And a nuclear superpower (Aron, 1998: 27).

Smith states that the new policy reflected a more nationalistic stance as a reaction to the general discontentment with the earlier, more Western-oriented policy (Gorbachev's *New*

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<sup>46</sup> Full Russian name: *Osnovnye polozhenia konceptzii vneshnei politiki Rossiiskoy Federatzii*.

*Thinking*) (Smith, 1999: 481). Thus, in 1993 and 1994 Kozyrev reiterated the statements he had made at the CSCE meeting in 1992, but no longer in jest (Adomeit, 1995: 45)<sup>47</sup>.

A staple of Russian rhetoric during this time was the assertion that Russia was once again a ‘great power’. However, as Adomeit was quick to point out, “true greatness, whether among men or among nations, does not need advertising. It should be evident” (Adomeit, 1995: 35). This posturing only managed to show how low Russia had fallen in such a short space of time.

The cause of Russia’s weakness was its ailing economy, and the cause of Russia’s ailing economy was the neoliberal reforms process. At the beginning of the reform process Russia had a choice between taking a ‘gradualist’ approach, which would involve the sequencing of reforms over time, or the ‘shock-therapy’ approach, which, as the name suggests, would aim to push reforms through quickly and all at once. Russia chose the latter and it will forever remain a matter of speculation how different things would have been if they had chosen the former.

In 1992 prices were freed to find their own level (price liberalisation). The result was an immediate surge in inflation that wiped out savings (Stiglitz, 2002: 142)<sup>48</sup>. Not all prices were freed, however, the price of oil (and other natural resources) were kept artificially low by the government (Stiglitz, 2002: 142). This was an open invitation for exploitation. Quick-witted entrepreneurs took advantage and started selling oil to the West for

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<sup>47</sup> Examples of this new edgier thinking were evident in relations with Japan (Yeltsin cancels trips in May 1992 to talk about resolving issues over the Kurile islands) and a more pro-Serbian stance with regards to the conflict in the former Yugoslavia (Adomeit, 1995: 46).

<sup>48</sup> In 1992 inflation reached 2,500 percent (Lovell, 2006: 93).

enormous profits. The international price for oil, although relatively low in this period, was ten times higher than that in Russia (Lovell, 2006: 96).

After liberalisation and stabilisation, the next step was privatisation. But liberalisation had managed to wipe out savings, so the only people that were able to buy the newly privatised companies were those that were already relatively wealthy – or those who were making large profits off the resale of oil and other natural resources to the West (Stiglitz, 2002: 143). Even if one could afford to buy a newly privatised company, it would have been difficult to finance its operations when interest rates were high and there was a lack of financial institutions to provide capital (Stiglitz, 2002: 143). The result of the shock-therapy approach (instantaneous liberalisation-stabilisation-privatisation) was not wealth creation but asset stripping. Those who could get their hands on assets made money quickly and sent it overseas just as quickly.

This was only the first round of privatisation. At this point the state still retained ownership of land and sensitive industries like oil, gas, medical supplies, and weapons production (Lovell, 2006: 93). But, as will be shown, when Yeltsin needed support, much of the oil industry would be privatised too.

The effects of the reforms and subsequent depression on Russian society were catastrophic. Life expectancy for men dropped from 64.2 years in 1989 to 57.6 years in 1994; contagious diseases that had been eliminated under Soviet rule came back, and the state of schools was in shambles (Shevtsova, 2003: 8). Furthermore, crime and lawlessness became a fact of everyday life. Economically, the loss in GDP was worse than had been suffered during the Second World War (Stiglitz, 2002: 143). During the

war (1940-1946) industrial production fell by 24 percent, between 1990 and 1999 it fell by 60 percent (Stiglitz, 2002: 143). The two years between 1991 and 1993 alone saw a drop in industrial production of around 40 percent (Lovell, 2006: 105). During 1992-1993 a tenth of the work force was cut and those that kept their jobs would often have to wait months to get paid (Lovell, 2006: 105). In a climate like this it paid to have friends in high places. Gazprom was able to lobby government for enormous tax breaks which, according to Lovell, amounted to 3-4 percent of GDP in 1994 – which goes to show the power these corporations had gained (2006, 106).

It is not surprising that in this period Yeltsin met with strong opposition. It was important for him to secure his position of power, and he did so by vesting the presidency with extensive powers in the 1993 constitution. Although the constitution allows for the formation of parties and interest groups, it also gives the president the powers to determine the guidelines of domestic and foreign policy; to serve as commander-in-chief (thus allowing him to appoint and dismiss the top commanders of the armed forces); to approve military doctrine; to declare martial law and states of emergency (with the approval of the Federal Council – upper house of parliament); and to make binding decrees and directives (as long as they're in line with the constitution or federal law) (Donaldson and Noguee, 2005: 141).

Yeltsin's opponents were those with close ties to the military-industrial complex. Thus, given his domestic and foreign policy goals (focussed on economic development) and the fact that his opponents came from this sector, it is not surprising that military spending dropped precipitously during the Yeltsin years. Russian defence expenditure dropped from around 15 to 25 percent of GNP (Gross National Product) in 1992 to less than 5

percent of GNP in 1995 (Aron, 1998: 43). In absolute terms this is a decrease of at least 45 percent (Aron, 1998: 43). Troop numbers were cut from around 3.8 million in 1992 to around 2.5 million in 1996 (a 34 percent reduction) (Aron, 1998: 43). Thus, the Russian army, once a source of pride, became a pale spectre of that now distant superpower. Although it still retained its nuclear arsenal, its conventional forces were in a poor state, as the first Chechen war would highlight.

The decline of the military can in part be explained by the economic crisis, but this would ignore the fact that Yeltsin actively targeted spending on the military (below 3.5 percent of GDP) (Donaldson and Noguee, 2005: 161). Donaldson and Noguee state that the military would often not even receive the meagre amount budgeted (Donaldson and Noguee, 2005: 161). This is indicative of the change in power in Russia. The Yeltsin years see the decline of defence-industrialists and the rise of financial-industrial groups (Donaldson and Noguee, 2005: 173).

November and December 1995 saw the auctioning off of Russia's largest and most profitable companies. Among them were large companies in the oil, gas and metals sectors (Lovell, 2006: 99). Foreign investors and all other outsiders were not allowed to bid and the tycoons that had profited off earlier rounds of privatisation benefited once again. This process became known as the 'loans for shares' scheme and, as Lovell puts it, it "was simply the most outrageous case of insider dealing in history" (Lovell, 2006: 99). By 1997, 50 percent of Russia's economy was controlled by seven oligarchs (Lovell, 2006: 99). Sachs estimates that around \$100 billion of oil, gas and other commodities were transferred into private hands during the privatisations, with the state treasury taking just \$1 billion in privatisation receipts (Sachs, 2005: 144).

It may seem odd that a state should be so willing to part so cheaply with so much, especially since Yeltsin's administration was unable to tax these companies effectively. However, Tompson makes sense of the event by saying that Yeltsin's time horizons at this juncture were relatively short (Tompson, 2006: 199). The sale of these companies had two major political benefits for Yeltsin:

- (1) It bought him the support of Russia's richest tycoons in the run up to the 1996 elections;
- (2) It ensured that if he were to fail to be re-elected in 1996 his opponents would find it very difficult to reverse the course of his economic policy (Tompson, 2006: 199).

Lovell takes a simpler view of these events and states that by this point Yeltsin's regime had become "massively and endemically corrupt" (Lovell, 2006: 31). In assessing the government's motives for this privatisation, however, it must be kept in mind that at the time the oil industry was not the profit-making centre it later became. Hill and Feel remind us that at this juncture oil production was basically unprofitable, except perhaps with regard to refining. Between 1990-1995 oil demand had declined 40 percent in Russia due to the economic recession, causing a glut on the local market, while the country's pipelines lacked the capacity to export the excess volumes (Hill and Feel, 2002: 4). Due to lack of capacity in export pipelines, low local demand, and minimal access to capital for investment, production of oil between 1988-1998 fell by almost 50 percent (from 11mbpd<sup>49</sup> to 6mbpd) (Hill and Feel, 2002: 4).

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<sup>49</sup> Million barrels per day (mbpd)

### **The pragmatic, patriotic period (1996-1999)**

From 1995 onwards we see the “complete interpenetration of political and economic elites” (Lovell, 2006: 31). From here on out we also see the rise of ‘The Family’, a clique of oligarchs (including Abramovich and Berezovsky) and hangers-on surrounding Yeltsin and his now powerful daughter, Tatyana Dyachenko, who would take on a prominent role during the period of his ill health and alcoholism (Shevtsova, 2003: 27). It is important to note that these oligarchs came primarily from the banking sector, although the ‘loans for shares’ privatisations meant that many now also had connections to the hydrocarbons industry. Because he was able to create a powerful group of loyal oligarchs, with media and business ties, Yeltsin was able to hang on to power despite vociferous opposition. In 1996 he was re-elected president, but the economy went from bad to worse.

On the foreign policy front, the run-up to the 1996 presidential election saw the liberal internationalist Kozyrev replaced with the seasoned, Eurasian-oriented, Yevgeny Primakov as foreign minister. This move was meant to appease the growing nationalist opposition in the Duma, and it indicated a fundamental shift in Russia’s foreign policy. Under Kozyrev, Russia had been humiliated over its inability to play a bigger role in the Yugoslav conflict with NATO in 1994<sup>50</sup>. Although Russia had made ultimatums and threatened military action, at the end of the conflict it was obvious that Russia had no control over what it believed to be its ‘backyard’. The appointment of Primakov was meant to help strengthen Russian diplomatic efforts and ensure that Russia’s national interests were represented in international affairs.

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<sup>50</sup> Lynch, however, indicates that the Russian ultimatum achieved its desired effect of forestalling NATO air raids (Lynch, 2001: 14). Yet, it can hardly be claimed that the whole exercise was a foreign policy success.

Primakov's view was that Russia needed to strive to become an independent power in a multipolar world, that it should stop its efforts to integrate with the West, and that it should be motivated by its great power interests (Tsygankov, 2006: 154). His plan to achieve this was to have Russia enter alliances with non-Western states (China and India in particular), to modernise the economy, and to gain greater control over the former Soviet space (Tsygankov, 2006: 154). According to Mankoff, (2006: 6), Primakov's ascent ushered in a non-ideological, pragmatic approach to foreign policy that was able to cater to politicians across the political spectrum. It also signalled the return to emphasis on Russia's role in the 'Near Abroad'.

In 1997 the state coffers were effectively empty, wages could not be paid and the East Asia financial crisis caused world demand for oil to drop - the price of oil quickly followed suite (Stuermer, 2008: 26). China's economic rise in the early 1990s meant that oil prices would follow its economy closely, and if demand slackened even slightly oil prices would fall (Stuermer, 2008: 26).

It became evident that Russia would have to start making overtures to the Chinese. In the spring of 1997 Yeltsin signed a joint declaration with Jiang Zemin in support of the creation of a Multipolar World, it stated: "The Cold War has ended. The bipolar system has disappeared. Positive trends toward the formation of a multipolar world are developing at an accelerated pace, and relations are changing among the major states, including former Cold War adversaries" (Donaldson and Noguee, 2005: 8). The economic rise of China and India is important for Russia as they understand that these countries

will be essential markets for their hydrocarbons in the years to come, as became evident during Putin's reign.

At around the same time, May 1997, we see the end of the Russo-Chechen War. Many observers believe that the end of the war was brought about by the successful lobbying of Lukoil, the large oil company controlled by the oligarch Vagit Alekperov (Aron, 1998: 46). Lukoil needed the conflict to be resolved so that it could secure the flow of oil across Chechnya from their Caspian oil fields to their terminals in the port of Novorossisk on the Russian Black Sea (Aron, 1998: 46). Lukoil was in partnership with Mobil and Chevron in the development of a pipeline from the Tengiz oil field in Kazakhstan, the holding companies were the Caspian Pipeline Consortium and the Azerbaijani International Operating Company (AIOC) (Aron, 1998: 46). What is important about this is the fact that a private oil company in partnership with foreign oil majors was able to affect Russian domestic policy on such a sensitive issue as Chechnya.

Furthermore, in July of 1997 Yeltsin signed a profit-sharing decree that permitted foreign investment in oil and gas (along with iron, coal and gold) in exchange for a percentage of future resources extracted. It was also now legal for foreign investors to own up to 25 percent of major privatised companies (Aron, 1998: 46). These developments are a sign of the state's weakness at this time and many of these developments (the privatisation of the oil industry, the courting of foreign oil companies, and the power of the likes of Lukoil to influence policy) would be reversed when Putin came to power and international oil prices rose.

It is interesting to note the mood that had taken hold at this point and how the views of oil executives and politicians differed. A survey was conducted in the summer of 1997 which interviewed 65 oil executives and 30 politicians about their views on political and economic policy, the results are shown in the table below (Lane, 2000, 496-496):

**Table 3: Survey of attitudes to political and economic reforms**

<b>Question 1: As a result of the political and economic reforms which have taken place since 1993, the present political system is:</b>	Oil executives (% response)	Politicians (% response)
1. Effective and almost no need for change.	4.5	0
2. Effective but needing some reforms.	27.7	10
3. In general not effective but significant reforms could be carried out under present system.	52.3	40
4. Completely ineffective and complete change is necessary.	13.8	50
No response	1.5	0
<b>Question 2: The present economic system in the Russian Federation is:</b>		
1. Effective and almost no need for change.	1.5	0
2. Effective but needing some reforms.	32.3	10
3. In general not effective but significant reforms could be carried out under present system.	53.8	36.7
4. Completely ineffective and complete change is necessary.	7.7	50
No response	4.6	3.3

What this survey indicated was that both groups, the politicians and the oil executives, felt that the system at the time was in need of reform. However, it is important to note that the politicians were more in favour of wholesale change (50 percent called for wholesale change in both questions, while for the oil executives it was 13.8 percent and 7.7 percent, respectively). This is due to the fact that the weak regulatory system at the time was favouring the oil executives and making it difficult for the political elite to exercise power over the economic actors. The 1998 financial crisis would highlight the problems with economic policy and weaken the position of the economic elite, and Putin's rule would shift the political reality.

The central bank governor, up to and during the crisis, Dubinin, recalled in an interview with Padma Desai the dilemmas that faced the central bank in the years approaching the crisis:

“The joint decision of the government and the central bank was that we must continue our anti-inflationary monetary policy, and move forward on budgetary policy and structural reform. But every year we saw that progress in the latter sphere was missing. The gap became wider and wider... The problem of the budget was lagging tax collection rather than cutting expenditures... and there were a number of mistakes. For example, the government tried to handle the tax situation by trying to push the tax code, a massive document, in the Duma. It required a lot of time, months to get approved. We needed changes in the tax system and the appropriate legislation in perhaps two months. The government worked on the tax code rather than on the concrete problems of taxation” (Desai, 2005: 99).

The issue of reforming taxation would become one of Putin's primary economic goals during his first term as president. As mentioned before, the weakness of Russia's economic institutions was the main reason for the state's reliance on the oligarchs, and thus the inability of Yeltsin to follow an independent foreign policy.

McFaul states that those with economic interests in the big corporations needed the government to stay friendly with international sources of funds (IMF, EBRD, Paris Club, World Bank, etc) as this meant that they did not have to pay as much in taxes to fund government activities: According to McFaul, “A billion dollars from the IMF to help close the budget deficit is a billion dollars that Gazprom does not have to pay in taxes” (1997: 25).

The 1998 financial crisis once again tested the resolve of the Russian people. In the first six months of 1998 oil prices fell by 40 percent due to the ongoing East Asia financial crisis that suppressed demand (Stiglitz, 2002: 145). The strains of debt at higher interest rates, the low oil price, and the overvalued ruble (which incidentally favoured the wealthy oligarchs who sent their money overseas) led to the Russians once again to seek help from the IMF (a loan of \$4.8 billion was given in July, more was given in instalments) (Stiglitz, 2002: 147).

The IMF convinced Russia to take out more dollar-denominated loans, in order to capitalise on the lower interest rate offered in dollars than in rubles, and to maintain the ruble at its overvalued level (Stiglitz, 2002: 147-148). But investors overseas could see which way events were headed and continued to speculate against the ruble. Eventually, on 17 August 1998, Russia had to default on its debts, the ruble collapsed (between July 1998 and January 1999 it lost 45 percent of its value) and a run on the banks ensued (Stiglitz, 2002: 149; Lovell, 2006: 100; Stuermer, 2008: 30). Many banks which had invested in government promissory notes (known as GKO) folded. And, not surprisingly, billions of dollars originating from the IMF loans showed up in Cypriot and

Swiss bank accounts – the oligarchs and politically connected were evidently prepared for such an eventuality (Stiglitz, 2002: 150).

Once again Russia was saddled with debt and the economy was in recession, but at least the ruble's decline helped to revive local manufacturing and industry that had been languishing under the overvalued currency (Stiglitz, 2002: 151). Soon things would change, the oil price was about to rise and a new chapter in Russia's post-communist era would begin.

It is ironic that the financial crisis hit only months after Russia was accepted as an equal member of the G-7 (at the May 1998 conference in Birmingham) – at the point when it seemed as though Yeltsin's foreign policy dreams were finally coming true, economic reality stepped in to deny Russia once again. Yeltsin's reign as president saw the retreat of the state. A vicious cycle formed in which a state that was unable to collect revenues (weak tax system) needed to rely on powerful financial actors (the banks) who themselves were the beneficiaries of the state's privatisation programme and deficit financing (the sale of bonds called GKO's) (Robinson, 1999: 557). The state and the market fed off each other in a symbiotic relationship that left the Russian people as the main losers.

The cause of this was firstly the nature of the reforms and secondly the prevailing international situation (with oil prices low). There was simply no positive input from the international structure. Loans from the international financial institutions ended up in Cypriot or Swiss bank accounts and made no qualitative difference to the system (Robinson, 1999: 557). The onset of the 1998 crisis saw many banks collapse and their

stranglehold on the state slacken. The government was left with two options to change the status quo: (1) strengthen the taxation system, and (2) gain greater control over the oil and gas industries in order to get revenues – in order to do either the state would have to take on the oligarchs (Robinson, 1999: 558). Prime Minister Kiriyenko attempted to make progress on both counts by reducing Gazprom's authority and making it channel some of its enormous profits towards paying back-taxes (Donaldson and Noguee, 2005: 176).

In 1999 oil prices began to rise and with them hopes of a new chapter for Russia. Good news was, however, followed by bad as Chechen rebels, led by Rasayev, looked to step up the conflict once more (Stuermer, 2008: 36). Rasayev promised to cut Russia off from the Caspian, and to the Kremlin this meant access to one of their most important oil pipelines (Stuermer, 2008: 36). Onto this stage stepped Vladimir Putin, a relative unknown from Saint Petersburg. Many took little notice of him, even when he was elected prime minister. After all, under Yeltsin prime ministers had come and gone with alarming regularity - in eight years he had had seven and Putin was the fifth in less than a year (Shevtsova, 2003: 18, Lucas, 2008: 25) - it was Yeltsin's way of consolidating his power. Donaldson and Noguee state that this internecine approach to the consolidation of his power was a major contributing factor to the lack of coherence in Yeltsin's foreign policy (2005: 178).

The appointment of Putin as prime minister can be seen as the continuation of a trend in Yeltsin's appointments. His last three Security Council<sup>51</sup> appointments had been

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<sup>51</sup> The Security Council had become something of a shadow cabinet under Yeltsin, virtually a state within a state where many important decisions on internal security and counter intelligence were taken (Donaldson

members of the security services (Borduzha, Putin and Ivanov) and his last three prime ministers (Primakov, Stepashin, and Putin) had also spent part of their careers in the intelligence or security services (Donaldson and Noguee, 2005: 167). Putin was also a favourite of 'The Family' who trusted that he would not challenge their interests.

Putin's role in the Second Chechen War<sup>52</sup> and the leadership he showed made him very popular with the people. At the presidential elections in March 2000 he won convincingly with 52.6 percent of the vote (Stuermer, 2008: 38). At the end of the Yeltsin years not much had been resolved with regards to the economy or Russia's foreign policy. Donaldson and Noguee state that much of the problems Yeltsin had inherited from the Soviets were passed on unchanged (2005: 178).

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and Noguee, 2005: 145). "It was during Putin's brief tenure in the Security Council that the drafting of the new National Security Concept was begun" (Donaldson and Noguee, 2005: 145).

<sup>52</sup> The possible role of the FSB (which was headed by Putin) in the supposed terrorist attacks on apartments in Moscow remains an enduring conspiracy theory in Russia. A group of intelligence officers were caught placing sugar bags full of explosives in the basement of a Moscow apartment. They stated that they were running an exercise to see how the public would react. The case was never fully investigated (Stuermer, 2008: 37).

## **Chapter 8: The Putin period - the return of the state**

*“The year One in the modern Russian calendar is when the oil price began to rise; when the ruble came back to life and mutated into a convertible hard currency; when, after a calamitous pause, pensions and salaries began to be paid” (Stuermer, 2008: 199).*

Sachs makes the point that the reform process and subsequent economic crises of the 1990s had turned the optimism of the early days of the post-communist era into cynicism and support for a “strong leader with centralised power” (Sachs, 2005: 143). As will be shown, key to Putin’s idea of leadership is what has been termed the ‘vertical of authority’ (or power, depending on the author), “a term coined by Russian elites to describe a top-down system of governance based on subordination and a domineering role for the executive branch” (Shevtsova, 2003: 7). Such a system has always been a feature of Russian governance, but under Yeltsin it had been almost impossible to execute (hence, the capricious hiring and firing and dependence on the oligarchs).

To simplify the changes that occurred in Russian society so far in the post-communist era we can use Strange’s four values (freedom, wealth, justice, and security) and their hierarchical ordering as a guide. After the end of the Cold War and collapse of the Soviet Union the Russian people sought wealth (to achieve what the West had) and freedom. Justice and security had in effect been demoted. But with the reform process causing havoc and strife throughout the 1990s and the Chechen wars and terrorist attacks, the situation was quite different at the start of Putin’s reign. Wealth was still a priority, but security and stability (both economic and political) trumped both freedom and justice<sup>53</sup>.

Prioritising wealth and security is a recipe for economic nationalism, but how could a

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<sup>53</sup> The demotion of freedom and justice became all too clear under Putin, who systematically sought to push back media freedoms and used the judiciary as a political tool against his rivals (as will become clear in the Khodorkovsky affair).

country in the dire straights of economic depression follow such a path? This is where the role of hydrocarbons becomes key. As we saw in the Yeltsin years, the lack of revenue had caused a weak state that needed to rely on powerful market players to survive, market players that themselves had been created due to the weakness of the state (the vicious cycle described by Robinson). In 1999 oil prices (an exogenous input from the IPE structure) caused the fundamental nature of Russian politics and policies to change. As Strange would put it, the bargains that structured the domestic politics of the actor had changed. What we see is the return of the state and the subjugation of the 'foreign' neoliberal market. This section will show how this developed and what impact it had on the Russian political economy and foreign policy.

Foreign policy would not be consistent in Putin's time either, yet the changes in policy were not capricious and contradictory (as under Yeltsin) but rather the result of growing confidence and a growing sense that Russia should reclaim its place amongst the great powers of international politics. Stent states that during Putin's rule it became difficult to understand how foreign policy was made (2008: 1092). In crucial decisions - such as aiding the US in setting up military bases in Central Asia after 9/11 and cutting off gas supplies to the Ukraine in 2006 - Putin seems to have been the decision maker. While on other, less important issues, the foreign minister would take charge. According to Stent this illustrated that the 'vertical of power' was the centre of foreign policy decision making (2008: 1092).

The ruling elite got mixed messages from the start of Putin's rule. In the first week after his inauguration Putin targeted the powerful media tycoon Vladimir Gusinsky, whose support for Putin's opponents (Primakov, Luzhkov and Yavlinsky) in the 2000 election

had made him a threat (Shevtsova, 2003:93). The headquarters of his company, Media-Most, which owned the popular television station NTV was raided and his bank, Most-Bank, was taken over by the government (Gazprom would eventually get control of NTV) (Shevtsova, 2003: 94). His arrest was the first politically motivated one since Yeltsin had had Khasbulatov and Ruskoi arrested after their failed coup attempt in 1993.

Boris Berezovsky, one of Yeltsin's most loyal oligarchs and a former ally of Putin, was also targeted and forced into exile. However, other members of the elite and 'The Family' were kept in power. Mikhail Kasianov<sup>54</sup>, who was closely associated with 'The Family', was named Putin's first prime minister and Alexander Voloshin, who was Yeltsin's chief of presidential staff, remained Putin's chief of presidential staff (Shevtsova, 2003: 85).

Less ambiguous was Putin's stance towards the regional leaders, who had under Yeltsin run their regions like personal fiefdoms. He immediately promulgated a decree calling for the creation of seven federal *okrugs* to oversee the 89 federal republics (Shevtsova, 2003: 91). He then deployed loyal subjects to five of the seven *okrugs*, thus ensuring that those in charge of the system obeyed his rules and could not be influenced by the oligarchs. This is a clear example of the centralisation of power that would come to be the defining trait of his rule.

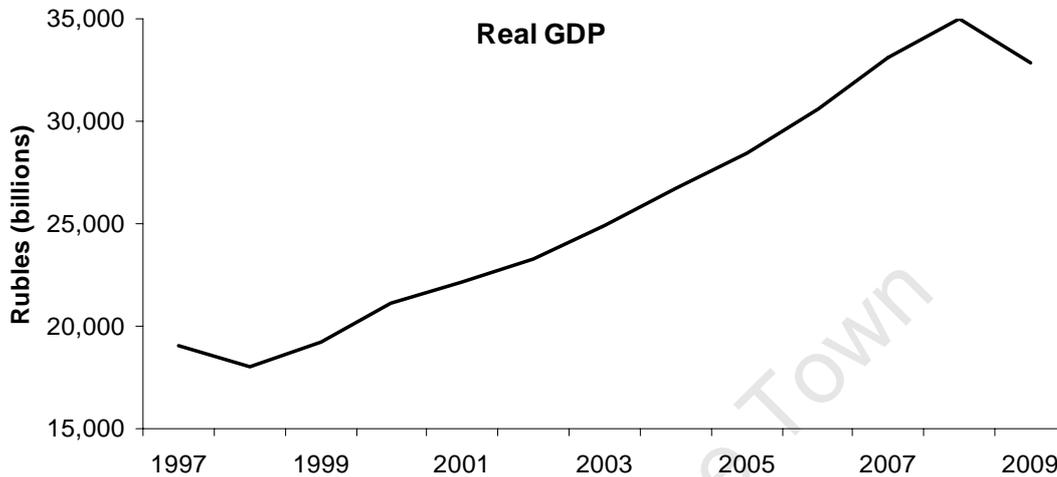
From 1999 the price of oil rose steadily, and by 2000 inflation was under control at just between 0.7 and 0.8 percent (Shevtsova, 2003: 77). Production had recovered by 11 percent from the year before and the budget was showing a surplus (Shevtsova, 2003: 77). As time passed the economic situation only improved, between Putin's nomination

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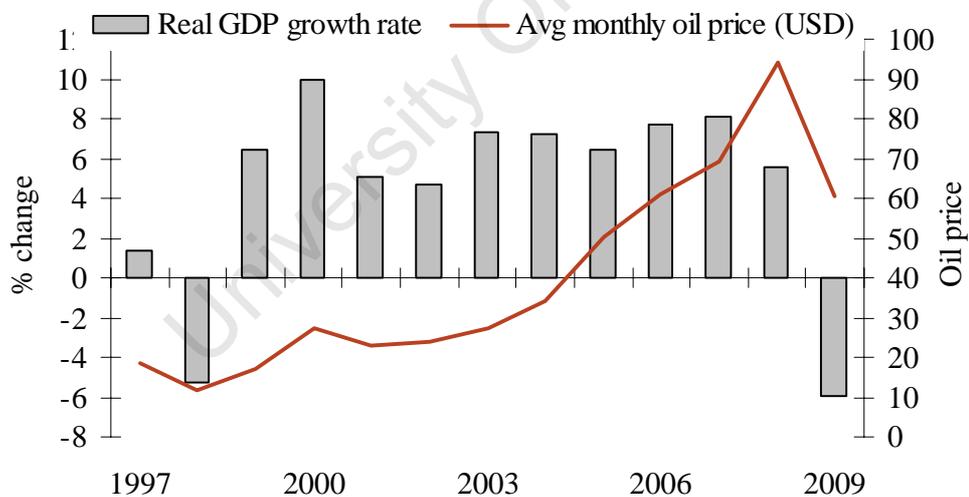
<sup>54</sup> Kasianov would only be kept until 2004, thereafter the influence of Yeltsin's clique will have faded and Putin's elite (*siloviki*) would be at the reins.

as prime minister and the end of his second term. The following graphs illustrate the precipitous rise in real GDP and oil prices (Urals oil prices yearly averages) over this period (Data: IMF 2009, EIA 2010)

**Graph 3: Real GDP (1997-2009)**



**Graph 4: Real GDP growth rate and oil price (1997-2009)**



With the improvement in the economy and the weakening of the oligarchs' influence we see the rise of a new faction in Russia's domestic politics. The infiltration of former-KGB-connected (*siloviki*) people into the highest ranks of Russian politics and business that began under Yeltsin accelerated under Putin. According to Stuermer, 75 percent of

senior Russian officials in 2008 had KGB or other security backgrounds (Stuermer, 2008: 73). Stuermer has identified two groups at the helm of Russian politics, they are the old and new Saint Petersburg clans – all served either in the KGB or with Putin in the Saint Petersburg administration (Stuermer, 2008: 72). The fact that the process started under Yeltsin indicates that Putin was at first a product of this process, but it is clear that he sought to entrench this development (Stuermer, 2008: 76). Furthermore, Stuermer states that the FSB (the Federal Security Bureau) has become the state itself, with the Duma and government unable or unwilling to challenge the Kremlin's power (Stuermer, 2008: 77).

The improvement in the economic situation and rise of this new elite sees the focus of Russian domestic and international politics shift, from the need to attract Western aid and capital to policies aimed at strengthening the state and the state's position in the international political economy. The next section will present how Putin's regime sought to reform the domestic sphere through:

- I. improving the tax system,
- II. breaking the stranglehold of the oligarchs and,
- III. increasing its control over the hydrocarbons industry.

This will be followed by a closer look at what these domestic reforms meant for Russia's foreign policy and how Putin's foreign policy shifted through three distinct phases.

### **(I) Tax system:**

With regards to taxation, the Putin government succeeded in increasing both the relative and absolute amount of rent collected (Gaddy and Ickes, 2005: 564). Oil companies, specifically, paid about ten times more in taxes in 2004 when compared to 1999 (Gaddy and Ickes, 2005: 564). Until 2003, many Russian firms used loopholes in the judicial system to run a scheme called 'transfer pricing' in order to avoid taxation of energy (Larsson, 2006: 34). This scheme involved transferring profits made in the industrial sector to the trading sector by selling the product below market price to a trading company in an 'internal offshore' (usually one of the regions of Mordovia, Kalmykia, or Chukotka). The company that received the product was also owned by the producing company (and often existed only on paper). The trading company would then resell the product (oil) without having to pay taxes for it (Larsson, 2006: 34). Changes to the law in 2004, however, brought this practice to an end.

The revenues collected from the improved taxation system have bought Russia vast foreign currency and gold reserves (\$420 billion in 2007), the third largest in the world, and allowed them to put money aside in a stabilisation fund (\$120 billion in 2007) (Goldman, 2008: 361).

The non-economic side of taxation has been that it has been used as an excuse to target the oligarchs who profited from lax regulation in the 1990s for political reasons (as will be shown with regards to the Yukos and Khodorkovsky affairs). Taxation was also used as a reason to attack foreigners in the hydrocarbons sector. TNK-BP was accused in 2005 of having not paid \$1 billion in taxes (Larsson, 2006: 110). The merger between TNK and BP (which owns 50 percent of the company) was the largest foreign investment in

Russia and was at first supported by Putin (Larsson, 2006: 28). However, TNK-BP tried to increase its gas business, which brought it into conflict with the state-owned monopoly Gazprom (later we shall see how Gazprom successfully wrested control of TNK-BP's gas fields in Siberia). The 2005 allegations were interpreted as a warning to stay out of Gazprom's business. It also sent the message that foreign investors are not beyond the grasp of the Kremlin and that their ownership of Russian resources is unwanted and vulnerable (Larsson, 2006: 110).

Furthermore, taxation has been used as a tool to force private domestically-owned companies to sell out to the government. Hanson states that the titanium firm VSMPO-Avisma was forced to sell to the government when threatened with prosecution over tax issues. While the private oil company Russneft was targeted with allegations involving tax in order to halt its acquisitions in the industry (Hanson, 2007: 877). There are two methods the state can employ in this regard: the first is to trump up charges of tax evasion (as was the case with Yukos) and then force the company into bankruptcy and selling; the second is to claim that ownership has been transferred with intent to defraud (Lucas, 2008: 119).

## **(II) War on the oligarchs:**

Putin's intentions to go after the oligarchs were evident after he forced Berezovsky and Gusinsky into exile early in his tenure. It has been alleged that after coming to power in 2000 Putin made a deal with the oligarchs - he told them that if they stayed out of politics and started to pay taxes he would ignore their misdeeds of the 1990s<sup>55</sup> (Larsson, 2006:

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<sup>55</sup> Such a 'deal' is analogous to Strange's idea of bargains that need to be constantly renegotiated in light of developments. Changes in bargains point to the dynamism of the actor-structure relationship.

89-90). By 2003 Putin had decided that some were not abiding by this arrangement. This represents a shift in the bargains the state had with these private companies.

Khodorkovsky (the owner of the Yukos oil company and Russia's richest man at the time) was arrested along with Platon Lebedev and ten others for tax evasion amounting to \$3.27 billion (Larsson, 2006: 93). The Yukos and Khodorkovsky affairs should be analysed separately as it seems that the Kremlin's motivations were different with regards to each (the Yukos issue will be dealt with in the next section). Khodorkovsky was targeted by Putin specifically because he was meddling in politics and, apparently, had ambitions to become president (although this is hard to prove)<sup>56</sup>. His political meddling amounted to his support for the Yabloko party (a liberal democratic party), but this party was so weak at the time that this could not have been the main reason to target him. It is more likely that Khodorkovsky was targeted because he was trying to buy seats in the Duma in order to influence the new tax legislation (Larsson, 2006: 97).

In 2005 he and his co-accused were sentenced to nine years in a Siberian prison camp, on appeal Khodorkovsky's sentence was brought down to eight years (Larsson, 2006: 93). The apparent war on the oligarchs should not be overstated. Putin did not attempt to rid Russia of powerful, and often corrupt, businessmen, but rather sought to bring them under the Kremlin's control or replace them with his own oligarchs. Thus, Chernomyrdin was replaced by Dmitri Medvedev (a long-time friend and colleague of Putin's the from Saint Petersburg administration) as chairman of the Gazprom Overseeing Board, while Rem Viakhirev was replaced by Aleksei Miller as CEO (Goldman, 2008: 363). Roman Abramovich remains a powerful oligarch even though he was intimately connected with

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<sup>56</sup> According to some, Khodorkovsky was planning to run in the Duma fill-in election in 2005.

the Yeltsin regime. He was able to survive by ingratiating himself with Putin by selling part of Sibneft to Gazprom. Interestingly, Sibneft and Yukos were set to merge before the Kremlin arrested Khodorkovsky. The merger had been approved by the anti-monopoly commission in August 2003, almost exactly a year later Khodorkovsky was standing trial (Land, 2004: 70).

### **(III) Controlling the hydrocarbons industry:**

Putin's doctoral thesis (1997) and the contents thereof are the source of much speculation, and will remain so because it is not publicly available. It is unlikely that Putin wrote the thesis himself as he was a senior official at the time<sup>57</sup>, but he had to have approved it, and thus we can consider the views held therein to mirror his own<sup>58</sup>. Russian analysts, Olcott and Balzer<sup>59</sup> were given an abstract to translate and interpret and it is from their analysis that we are able to gain an understanding of the views held by Putin.

In short, his thesis is that the government should play a leading role in the oil industry and set the priorities thereof (Larsson, 2006: 55). Russia needs to diversify its economy away from its reliance on the hydrocarbons industry in order to promote a better standard of living for its citizens and become an economic power in the world. According to his thesis, this means that the state needs to work closely with large industrial and financial corporations so as to compete with Western corporations (Larsson, 2006: 55).

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<sup>57</sup> Getting a thesis written on your behalf when you are in a leadership position was a common practice in the Soviet era.

<sup>58</sup> When asked at a press conference Putin stated that there was a correlation between the ideas in his thesis and the subsequent policy under his rule.

<sup>59</sup> Unfortunately I was unable to get their original work as it is available to the subscribers of the publishers only.

When questioned about this approach at a press conference in February 2006, Putin compared Russia with Norway, where: “the oil-and-gas sector is completely monopolised by the state” (Putin quoted in Larsson, 2006: 59). Critics, however, were quick to point out that in Norway there exist two competing firms, whereas in Russia there is, would be, only one – Gazprom.

The process of renationalising the hydrocarbons industry has been obvious for anyone to see. In a 2007 interview with the business newspaper *Kommersant* Oleg Shvartsman, the head of a venture capitalist group called Finansgroup, stated that:

“We are closely connected to the structures of political power, including some political characters, and we administer their assets. We are also linked to the presidential administration, with its security structures. We own large assets in oil resources. I am president of a company called Russian Oil Group... The holders of power are not involved, but their family members, members of the administration. They are FSB people, people from internal intelligence” (Shvartsman in Stuermer, 2008: 68).

Russian Oil Group is allied with Lukoil, TNK and Rosneft oil companies. The aim of this complex group that spans the private and public spheres is ‘velvet reprivatisation’. Shvartsman named Igor Sechin as the man in charge of the operation. Sechin, a colleague of Putin’s from the Saint Petersburg days, was the head of the presidential administration and sat on the board of Rosneft (state-owned oil company). He is known to be a ‘hardliner’ who has openly called for greater state control of the oil sector. Furthermore, he is also considered to be the man that called for the arrest of Khodorkovsky (the two had had a personal falling out).

After Khodorkovsky was sentenced, Yukos was split and its production half (Yuganskneftegaz) was bought by the Baikal Finance Group - which was a shell corporation for Surgutneftegaz, which in turn has been linked to the Kremlin and to Putin

himself (Larsson, 2006: 95). Finally, it was sold to Rosneft and effectively nationalised (Larsson, 2006: 95).

Mankoff (2006: 14) highlights that there was also a foreign policy dimension to the nationalisation of Yukos. Khodorkovsky had been lobbying the Kremlin over a route for a vital oil pipeline from Siberia to East Asia and had been in negotiations to sell Yukos' oil rights in this regard to Exxon-Mobil. The state's seizure of Yukos ensured that they would have control over the route of the oil pipeline and that foreign companies would be kept out of the strategic initiative (Mankoff, 2006: 14). The 2000 National Security Concept (drawn up by the Ministry of Foreign Affairs to guide foreign policy) is explicit in its emphasis on the need to keep strategic industries out of foreign hands. It states that: "It is necessary to enhance the role of the state in regulating the activities of foreign banking, insurance and investment companies and to introduce definite and justified restrictions on the transfer of exploitation of deposits of *strategic natural resources*, telecommunications, and transport and *commodity-distribution networks* to foreign companies" (italics my emphasis, Concept, 2000).

The arrest of Khodorkovsky and seizure of Yugansneftgaz can be interpreted as a Kremlin strategy on three fronts: firstly, to put an end to Khodorkovsky's domestic political ambitions and send a signal to other powerful oligarchs; secondly, as an example of the Kremlin's new renationalisation policy; and thirdly, from a foreign policy perspective, as a means for the Kremlin to dictate the route of oil pipelines and wrest control over the export of hydrocarbons.

Nationalisation by stealth has meant that the Russian government has increased its voting shares in the country's 20 largest companies from 11 percent in 2004 to 39 percent in 2008 (Lucas, 2008: 119).

It is not only local firms that have been targeted under the Kremlin's new renationalisation strategy; Shell and BP also had their operations affected. In 2006 Shell had to sell a majority stake in its Sakhalin II gas project to Gazprom after the government sued them for \$30 billion in environmental damages. Shell received \$7.5 billion in a mixture of cash and shares for their stake – much lower than the project's true value (Lucas, 2008: 126). Hanson notes that although the legal grounds for suing Shell for environmental infringements appeared legitimate, the state seemingly lost interest in environmental issues once Gazprom was in charge (Hanson, 2007: 876-877). Meanwhile, BP's Russian subsidiary, TNK, had a licence to develop the Kovykta gas field in Siberia, which it aimed to use to sell gas to the Chinese (around 75 percent of production would go to China). However, Gazprom blocked the deal and BP was compelled to sell its 63 percent stake, according to Lucas worth many billions of dollars, for around \$800 million (Lucas, 2008: 126-127). A gas pipeline to China is one of Russia's main aims with regard to international energy politics, thus it seems it is too important a project to be left in the hands of a British oil major – just as with the oil licence to supply the East Asian pipeline Exxon-Mobil was attempting to gain from Yukos. In July 2006, Putin promulgated a law making Gazprom the only company legally able to export gas from Russia.

That the government would want to nationalise the oil industry in an attempt to further its economic development is itself not surprising. As Tompson showed, in the section on Russia's hydrocarbon political economy, such actions are expected. However, there

seems to be an inherent conflict between the goal of economic diversification and the practice of installing Kremlin power-players at the top of these hydrocarbon corporations. It is difficult to believe that the *siloviki* that are now in charge of massive wealth will support economic policies that take power away from the hydrocarbon industry – and effectively from them.

The question is: what do these developments mean with regard to Russia's foreign policy? If we take Susan Strange's argument that in a globalised world macroeconomic and industrial policy **are** in effect foreign policy, and we combine this with the fact that the Russian state is hostile to private ownership of these resources (by locals and especially by foreigners) we can sum up Russia's foreign policy as being mercantilist (economic nationalism) and isolationist. Indeed, the political doctrine that became popular in this period, the sovereign democracy model, explicitly states that the Russian state needs to protect itself from the effects of the globalised international system and assert its sovereignty, hydrocarbons are an important component in such a strategy.

In the atmosphere created by the creeping renationalisation, oil companies have found that they have to actively promote the interests of the state in order to remain in favour, and that this role extends to promoting Russia's foreign policy objectives. In 2001 Vagit Alekperov, president of LUKoil, made this position explicit when he stated that investments by the Russian oil industry in neighbouring states of the former Soviet Union and Eastern Europe had strengthened political ties between the states. He was quoted as saying "As an example, I am certain that Bulgaria, whose oil sector is almost entirely owned by Russian companies, will not conduct an anti-Russian foreign policy in the foreseeable future" (Hill and Feel, 2002: 20).

The role of Russia's giant hydrocarbons industry in foreign policy has not been a simple case of its use as a tool for forwarding the state's interests. As will be shown later in the section on Gazprom, the economic realities of Russia have meant that, while these companies have given the state immense structural power, they have also caused interdependence between Russia and its customers. Below, the three distinct eras of Putin's foreign policy are discussed, thereafter the thesis will focus on the specific role of Gazprom in Russia's domestic economy and foreign policy.

**1999-2003 Domestic consolidation:** During his first years in office, Putin sought to convey that Russia would be a team player and could be counted on to cooperate. Even before his election he had tried to make this clear. In 1999 he invited Lord George Robertson (Secretary General of NATO) to Moscow and also invited Tony Blair (UK prime minister) to Saint Petersburg to assure them that Russia was seeking warmer relations with the West (Shevtsova, 2003: 97). Sergei Lavrov, Putin's new foreign minister, made it clear that cooperation with the US and NATO was Russia's policy and that Russia sought a strategic partnership with the EU.

When he was inaugurated, Putin once again invited Robertson to Russia, even though the move was unpopular with many generals given the stand-off between Russia and NATO over the bombing of Kosovo just a year earlier. However, the meeting between the two led to the restoration of Russian relations with NATO and can be seen as the first step towards the setting up of the NATO-Russia Council in May 2002 – which sought to institutionalise relations between the two (Mankoff, 2006: 22)..

When the 9/11 terrorist attacks occurred Putin was the first foreign leader to speak to President Bush. He offered his condolences and dispatched a telegram expressing “anger and indignation” at the “series of barbaric terrorist attacks” (O’Loughlin et al, 2004: 3). He backed-up his sentiment by offering to aid the US-led coalition in Afghanistan. Russia supplied intelligence and made Russian airspace available for “through-flights of planes carrying humanitarian cargo to the area of the anti-terrorist operation” (O’Loughlin et al, 2004: 3). The significance of this was not lost on geopoliticians in Russia and the West. Russia was inviting the Americans to establish a military base in the ‘heartland’. Tsygankov attributed this early, Westward-leaning phase to Putin’s belief that the West and Russia shared a common threat in the guise of Islamic extremism (2006: 56). Thus, as with Yeltsin, Putin began his tenure in favour of Russia’s integration into the West and made references to Russia as a European nation with a European culture (Legvold, 2001: 65).

The emphasis during this period was on portraying Russia as a ‘normal’ member of the international community, rather than the villain it was cast as during the Cold War or as the feckless state it had become during the 1990s. In this period, Russia also cemented its relations with China. In July 2001 Russia and China signed a treaty calling for increased sales from Russia’s oil, gas, nuclear and armaments (Hill and Feel, 2002: 18). Meanwhile, the economy was steadily recovering as oil prices improved, yet Russia was still in debt to Western international financial institutions.

**2004-2006 Regional focus:** On 1 July, 2005, Russia paid off its debt to the IMF (three years ahead of schedule) and in 2006 the government was able to repay the Paris Club its \$23 billion debt (Gaddy, 2008: 124). As Gaddy put it, with financial sovereignty came

the concept of 'sovereign democracy' – a political doctrine conceptualised by Putin's deputy chief of staff, Vladislav Surkov, that calls for Russia to pursue its own path separate from the Western model and to protect itself from the need to compromise due to the pressures of globalisation (Gaddy, 2008: 124, Stent, 2008: 1091). By 2004 and the start of Putin's second term in office, Russia's foreign policy had changed from one that sought integration into the West, into one that saw Russia as distinct from the West and as a regional power once again.

During this period Russia focused on its role as a regional power and its interests in the 'Near Abroad'. An example of Russia's new confidence and need to assert itself internationally is the case of engagement with Iran. During this time Russia opposed sanctions against Iran in the UN Security Council and sold arms and nuclear power to the country (this stands in juxtaposition to Yeltsin's deal with the US in 1995 not to sell arms to Tehran) (Aron, 2008: 3). Aron states that the motivation behind Russia's approach to Iran was not one of economic interest, but rather as a signal to the international community that the country had returned as a player with consequence in international affairs (2008: 3). What Aron fails to note, however, is that Iran and Russia, both sharing a border on the Caspian Sea, together hold around half the world's proven natural gas reserves (Hill and Feel, 2002: 14). The countries cooperate closely in the industry (with rumours of a cartel forming) and plan to build a pipeline to South Asia for distribution (Hill and Feel, 2002: 16). Thus, the motivation behind siding with Iran is more strategic than merely signalling Russia's re-emergence in the international system.

Russia also regained influence over Uzbekistan in this period<sup>60</sup>, after the 2005 riots that caused hundreds of deaths drew condemnation from the West Putin supported the actions of President Karimov, and the two have since worked closely on energy matters (Hill and Feel, 2002: 16). Putin's efforts in Central Asia were amongst his most successful foreign policy initiatives in this period. He was able to lock-in Turkmen, Uzbek and Kazakh gas supplies for the foreseeable future and deny the US and EU pipelines that would bypass Russia (Stent, 2008: 1102)<sup>61</sup>.

However, not all went Russia's way, Ukraine's "Orange Revolution" showed that the country could not control the actions of its erstwhile Soviet allies, while the Beslan terrorist attacks highlighted problems at home. Due to these two issues, creeping pro-democracy revolutions and continued terrorist/separatist activity, Putin felt the need to step-up anti-Western (especially anti-American) rhetoric in order to garner greater unity at home by projecting an outside threat. In his public statement after the Beslan massacre Putin stated that: "Some want to tear off a big chunk of our country and others are helping them. They are helping them in the belief that Russia, as one of the greatest nuclear powers of the world, still poses a threat to them and, therefore, this threat has to be eliminated. Terrorism is their only tool" (Tsygankov, 2006: 159). This statement, and dredging up of old Cold War references, was directed mainly to a domestic audience with the aim of increasing unity at home.

An important point to note is that military spending in this period increased dramatically.

Thanks to its new wealth from the soaring oil price, and new impetus on portraying itself

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<sup>60</sup> Uzbekistan had allowed the US to set up a military base in order to coordinate its war efforts in Afghanistan.

<sup>61</sup> BP, with the help of the US, was able to establish the Baku–Tbilisi–Ceyhan oil pipeline that opened in 2006, but it is unlikely that with the agreement mentioned between Kazakhstan, Turkmenistan and Russia that further pipelines will be established in the near future (Stent, 2008: 1094).

as an independent, significant international power, Russian military spending increased 27 percent between 2004 and 2005, and increased a further 22 percent between 2005 and 2006 (Mankoff, 2006: 13). The revival in military spending is one of the obvious differences between the Putin and Yeltsin periods. Under Yeltsin, as has been mentioned, the armed forces were reduced to an emaciated spectre of their former glory. Yeltsin had cut spending firstly as a backlash against the military-industrial complex – who were on the opposite end of the politico-ideological spectrum from his liberal allies in the financial-industrial complex; and secondly, because the economy was in crisis. With Putin, however, the economy had rebounded impressively, the security-minded *siloviki* were largely in charge of the Kremlin, and Russia's more forceful and ambitious foreign policy was gaining ground.

Putin justified the ramping-up of military expenditure in his address to the Munich Security Conference in February 2007. He stated that the ambition of the Americans to install an anti-missile shield in Europe had changed the international security equation<sup>62</sup> that had formed during the Cold War (the balance of power through mutually assured destruction) (Putin, 2007). As the Russians could not afford to build a multi-billion dollar anti-missile shield of their own, Putin felt he was justified in accumulating and developing offensive conventional weaponry – for the sake of international security/balance.

The 2006 G-8 summit in St Petersburg capped off this period. Although rightly regarded as a foreign policy success for Putin, he could not have been deaf to the criticisms in the Western media and think-tanks that asked why a relatively poor and undemocratic

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<sup>62</sup> In his address Putin said “the system of international relations is just like mathematics” (Putin, 2007). A clear example indicating that Cold War realism is alive and well in Russian foreign policy thinking.

country was part of the elite international organisation (the killing of journalist Politkovskaya and spy Litvenenko in the same year had brought Russia's reputation to new lows during the Putin years).

**2007- Global ambitions:** Many analysts have claimed that Putin's speech at the Munich Security Conference in February 2007 was a turning point in Russian foreign policy. At the conference Putin decried the US's use of military force and stated that they were overstepping their borders in everyway (economically, culturally, politically and even educationally) (Putin, 2007). While it is true that 2007 marked a definite change in tone out of Moscow, the themes of Putin's speech were not new. Yeltsin, along with Chinese premier Jiang Zemin, had made similar pronouncements in 1997 on the need for a new multipolar<sup>63</sup> world (Donaldson and Noguee, 2005: 8). The 2000 Security Concept also stated that "Russia will help shape the ideology behind the rise of a multipolar.world" and decried the "attempts to create an international relations structure based on domination by developed Western countries in the international community, under US leadership and designed for unilateral solutions (primarily by the use of military force) to key issues in world politics in circumvention of the fundamental rules of international law" (Concept, 2000).

Meanwhile, the emphasis on respect for state sovereignty had been a growing theme under Surkov's doctrine of sovereign democracy since Putin's first term. Lukyanov states that the only substantial difference between this speech and the one Putin gave in the German Bundestag in September 2001, is that in the latter he had asked for the US and

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<sup>63</sup> The emphasis on multipolarity in 1997 was a result of Primakov's foreign policy of 'competitive pragmatism'. During Putin's first term in office he discarded this approach for the normalisation of foreign engagement (Sakwa, 2008: 244). Thus, here we see a return to the Primakov-inspired policies of the 1990s (distinct, Eurasian identity and competitive pragmatism).

EU to address security issues with Russia, while in 2007 he admonished them for not doing so (2009: 119). Thus, the speech should not be interpreted as a complete break with previous policies, but rather as a renewed emphasis on, and clarification of, how Russia would like to be perceived in international affairs.

Like his statement after the Beslan massacre, the speech can also be seen as Putin's need to speak to a domestic audience, influenced by growing nationalist sentiment and discord due to the continued terrorist threat. His party's (United Russia) 2007 campaign brochure (entitled *Putin's Plan*) also gives us an insight into the perception Putin tried to create domestically. The brochure stated: "This means victory in the competitive battle of leading world powers. The result of this victory will be a dignified place for Russia in the international division of labour and distribution of assets... The victory of Russia is a new architecture of the world in which our country can influence global politics for the benefit of security and well being of its citizens" (Brochure quoted in Gaddy, 2008: 125). The emphasis on an outside threat, and victory over it, is part of the sovereign democracy doctrine which can be viewed as Russia's brand of neoconservatism. As in the US brand of neoconservatism, promoted in the writings of Samuel Huntington and in the Bush regime, domestic unity in a culturally diverse, secular state requires the projection of an outside threat. The doctrines also frame world politics in terms of contestation between different, incompatible civilisations<sup>64</sup>.

Putin had another motive in promoting a more aggressive foreign policy towards the end of his tenure, which was to drum-up support for his chosen successor Dmitri Medvedev. I believe, although I have not found corroboration from academic analyses, that the

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<sup>64</sup> Further reading showed that Lukyanov drew the same comparison between this new doctrine and the US's neoconservatism.

invasion of Georgia in the summer of 2008 can be interpreted primarily in light of the need to cement Medvedev (who entered office in March 2008) as a strong leader capable of executing 'Putin's Plan' for the future. Other interpretations include the desire to establish a gas pipeline in the region, the protection of Russians living in the area (although they were only relatively recently given passports by Russia and were not ethnic Russians), self-defence, and retaliation against the US-backed 'Rose Revolution that brought President Saakashvili to power. It may be that in invading Georgia the Russians sought to gain on many fronts, however the most plausible, in light of the sovereign democracy doctrine and aim for greater unity at home, is that it was mainly to promote Medvedev to the Russian people.

## **Chapter 9: Focus on Gazprom**

What makes an analysis of this state-controlled company interesting in the context of this thesis is the role it plays in both foreign policy formation and the domestic political economy. Gazprom can be viewed as the Russian state in miniature - in fact, in the 1990s there was a joke that said that Gazprom was not a state within a state, but rather that Russia was a state within Gazprom (Hill and Feel, 2002: 17). The company is so closely linked with Russia's political economy, political elites and foreign policy ambitions that any foreign policy analysis of Russia would be deficient without mentioning its role.

First, it is important to appreciate the scale of the company. Russia has the world's largest reserves of natural gas and Gazprom controls 94 percent of Russia's gas<sup>65</sup>. This translates into Gazprom controlling 25 percent of the world's known natural gas reserves (Hill and Feel, 2002: 8). Furthermore, by law<sup>66</sup>, Gazprom is the only company that can export gas from Russia (Larsson, 2006: 30; Stuermer, 2008: 133). This makes Gazprom Russia's biggest company and also one of the biggest companies in the world, in any industry<sup>67</sup>.

There are a number of international developments that are set to make Gazprom's place in the international political economy even more important. The first is the move to cleaner forms of power due to fears of global warming. Gas, although still a source of CO<sub>2</sub>, is far cleaner than oil and coal as a fuel source for both power generation and transportation. The second is the phenomenal growth in energy demand in the emerging

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<sup>65</sup> The statistics are impressive. Gazprom has access to 27 percent of the world's gas production, 38 percent of estimated reserves, and 15 percent of the global gas transport network (Donaldson and Noguee, 2005: 174).

<sup>66</sup> In July 2006 Putin signed a law ensuring Gazprom retained its position as the only exporter of Russian gas.

<sup>67</sup> Gazprom has a capitalised value of over \$ 300 billion, making it the world's third largest company after Exxon and General Electric (Goldman, 2008: 369).

economies (especially India and China) that is set to keep demand for hydrocarbons strong for years to come. Although China currently uses coal, in which it is self-sufficient, for much of its power generation, the Chinese government has stated that it will increase its use for natural gas going forward (this was stated in their 2002 five year plan, but it is likely that the logic remains the same today) (Hill and Feel, 2002: 10). The third factor is the fact that the traditional source of European gas, the North Sea fields, are in terminal decline. This will mean that Europe, already dependent on Russia for much of its gas, will become more dependent in future. The final factor, the development of the international market for Liquefied Natural Gas (LNG), will have a mixed affect on Gazprom – as will be shown later – but could ultimately boost the company’s position internationally.

### **Gazprom in the domestic political economy**

Before addressing the international role of Gazprom it is important to note its domestic importance. Gazprom, which is 50.01 percent state-owned,<sup>68</sup> is Russia’s largest earner of foreign currency, contributes 7 percent to GDP, and its tax payments account for 25 percent of tax revenues (Hill and Feel, 2002: 8). The company also owns a network of companies in other sectors, including: Gazprombank, Gazprom-Media (the recipients of Guzinski’s Media-Most company), Sogaz (insurance), and the St. Petersburg football team Zenith (Paillard, 2007: 9).

Gas in Russia is by far the cheapest in the world. In 2007 1,000 cubic metres cost \$15, compared to \$110 in Georgia, \$159 in Finland, \$735 in Denmark, and an average of \$200

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<sup>68</sup> The government increased its stake from 38 percent to 50.01 percent in 2005 (Paillard, 2007, 9; Hill and Feel, 2002: 17).

in the EU (Paillard, 2007: 19). The cheapness of gas means that Russian's are not compelled to use the resource sparingly, which puts a drain on the amount the company is able to export and a dampener on profits that could be used for reinvestment. The price is kept low for political and economic reasons. Uncompetitive/inefficient companies are able to lower their production costs thanks to the price; while, because of the local climate, if prices for heating were to rise they would account for a substantial proportion of the average family's monthly costs. Thus, Paillard states that the government uses the gas price as a "social shock absorber" and would find it extremely difficult to reform the current situation (2007: 19).

This wastefulness has broader implications for Gazprom and its use as a foreign policy tool. Paillard states that between 2010 and 2012 Russian gas production should be between 555-645bcm (billion cubic metres) (2007: 6). Local demand is expected to reach between 440-480bcm, while the EU has contracts assuring them at least 169bcm, Ukraine 40-45bcm, China 15bcm, Turkey 15bcm, and other markets 20bcm (Paillard, 2007: 6). Paillard estimates that the most optimistic assessment is a shortfall of 63bcm, while the most pessimistic scenario points to a deficit of almost 200bcm (2007: 7).

When we add to this equation the fact that 70 percent of Gazprom's profits come from the EU alone and the statistics showing the company's importance to the Russian economy as a whole, we can get a clearer picture of the critical choices facing the Russian government. Either they raise prices and/or improve efficiency domestically (meaning that they will have to risk unpopular revolt at home), or they disappoint their international clients (causing them to find alternative sources and diminishing the country's relational power with regard to energy). The other option is to increase

investment in untapped fields and increase production. However, according to Jonathan Stern of the Oxford Institute for Energy Studies, major new explorations are not economically viable given the current, low domestic price (Stern in Paillard, 2007: 11). Estimates show that in order to meet its obligations to EU countries, Gazprom will need to build 26,000km of pipelines and 137 new compressor stations by 2020. Altogether, the cost for improving exploration, production, product conversion (to LNG), and transportation (boats and pipelines) before 2020 amounts to between \$173-203 billion (Paillard, 2007: 12). Meanwhile, the company's debts to the state and various banks run into the tens of billions of dollars (\$29.7 billion in 2007) (Paillard, 2007: 13).

Gazprom does afford Russia structural power within the IPE, but given domestic factors and the dependence the company has on the EU in particular, we can see that the company, as with Russia's hydrocarbons industry in general, also makes Russia vulnerable and forces it into international interdependencies. Much of the financial constraints currently facing the industry could be overcome if the government allowed greater international participation. But, even if the government were to make a U-turn on its current policy of nationalising the hydrocarbons industry and antipathy towards international companies, it is unlikely that international companies would be willing to take the risk of investing given the recent history of government meddling and expropriation. These issues, however, are a matter for the future, the rest of this section will focus on the present situation.

### **Gazprom – a source of power and cause of interdependence**

Europe is becoming evermore reliant on Gazprom as a supplier of natural gas due to the fact that reserves in the North Sea (where most of Western Europe's gas originates at

present) have peaked and are in steep decline. In total, Europe receives 23 percent of its natural gas from Gazprom (Goldman, 2008: 365).

The following table summarises the statistics on reliance (Goldman, 2008: 366):

**Table 4: European reliance on Russian gas**

<b>Country</b>	<b>% of imports from Russia 2005</b>
Germany	42
Italy	32
Turkey	66
France	20
Poland	66
Hungary	73
Czech Republic	76
Slovakia	100
Finland	100
Estonia	100
Bulgaria	100

When Russia cut-off the supply of gas to the Ukraine in 2006 many thought that it was the beginning of Russia's use of gas as a foreign policy tool. However, many analysts (like Roland Gotz, a prominent energy analyst at the Institute for International and Security Affairs in Germany) insist that as a supplier the Russians have been a reliable source for 30 years (Larsson, 2006: 13-14). Jonathan Stern of the Oxford Institute for Energy Studies also holds this opinion. He states that security analysts over-emphasise the risk of dependence on Russia and there is no empirical evidence to back-up any argument for concern (Larsson, 2006: 13-14).

At a press conference with the Valdai Club<sup>69</sup> in 2005 Putin commented on energy relations with the West, he said: "We are happy with the situation. Even in the worst of

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<sup>69</sup> Every year Putin meets with members of the Western media and Russian analysts to outline his policies and give his views on matters. Over the years it has become known as the Valdai Club. The fact that Putin

times Russia has never allowed interruptions to take place” (Putin in Stuermer, 2008: 47-48). By this he was referring to the strange Cold War paradox of the 1980s when the Soviet Union had its nuclear-tipped medium-ranged missiles, the SS20, trained on Western Europe (Stuermer, 2008: 47-48). Even under these heightened security conditions the Germans and the Soviets were able to conclude a gas pipeline deal and gas continued to flow (Stuermer, 2008: 47-48).

However, it is not absolutely true that the Soviet Union was always a reliable supplier. It is only that they used gas and petroleum as a policy tool against non-Western European countries. In 1948 the USSR suspended shipments to Tito’s Yugoslavia, in 1956 they did the same to Israel in retaliation to the Sinai invasion, and in 1967 they stopped supplying China due to the Sino-Soviet split (Goldman, 2008: 362).

In the Russian era, gas was cut-off to Belarus in 2004, to the Ukraine in 1992 and 1993, and to Moldova and Georgia in the same years (Goldman, 2008: 362). The motivation for these cut-offs was either to raise prices or because of non-payment of debts (Goldman, 2008: 362). There have been politically motivated cut-offs too, as in 2007 when gas supplies to Estonia and Lithuania were stopped<sup>70</sup> (Goldman, 2008: 362). Russia also cut-back gas supplies to the Czech Republic in 2008 due to the country signing a deal with the US to host their missile defence shield. The Russians stated that they were having technical difficulties with their supply lines, an excuse they also used with regard to Lithuania (Lucas, 2008: 13).

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holds such meetings with the Western media is interesting in itself and shows, or rather projects, a certain amount of openness.

<sup>70</sup> This was due to policies against ethnic Russians in these countries and the tearing down of Soviet monuments.

There are two possible reasons why gas has not been used as a political tool as much as some would expect. The first is that in the 1990s Russia was almost insolvent, thus they would be hurt by such cut-offs as much as the country they were targeting. The other is that until recently the North Sea reserves have been large enough to fill in for Russia if ever they chose to start pursuing such a strategy (Goldman, 2008: 362). With Russia now the third largest holder of foreign currency and gold reserves in the world and with the North Sea gas reserves in terminal decline, it is obvious that the rules of the game are changing once again.

International relations issues with regard to gas are not only issues between supplier and end-user, but also involve the transit countries through which pipelines and gas flow. To overcome the interference caused by these transit countries, Gazprom has used the debt these countries have accumulated as a means to gain ownership of their pipelines, and thus gain full control of supply (Goldman, 2008: 363). This approach has been taken in Belarus, Ukraine, Moldova, and Armenia (Goldman, 2008: 363). When the North European Gas Pipeline (NEPG), which connects Russia to Germany via a pipeline under the Baltic Sea, is up and running in 2013, the transit countries in Eastern Europe will lose all strategic advantage (Goldman, 2008: 363).

The tables are reversed with regards to gas-producing countries that use Gazprom to transport their gas to the Western European market (Turkmenistan, Uzbekistan, and Kazakhstan), here Gazprom acts as the transit country and is able to negotiate prices well below the world market price (Goldman, 2008: 364). In 2006 Gazprom was able to get control of Armenia's gas pipelines, thus giving it control over Iranian gas flowing to the West (Goldman, 2008: 364).

It can be argued that Gazprom has acted aggressively in order to cement its position as the main supplier of gas to Europe for years to come, but in doing so it has acted much as one would expect any market-driven multinational would. The fact that it has been headed by powerful politicians (Chernomyrdin, Medvedev and Miller) in the past has meant that at the same time it has sought to forward Russia's interests. However, if we look at the company in light of Russia's domestic political economy we can see that the appointment of Kremlin insiders at the helm of Gazprom could have more to do with directing rents to the state rather than forwarding a foreign strategy. Of course, the two motivations (forwarding Russia's international agenda and directing rents) are not mutually exclusive and it makes sense to see the deployment of insiders as a dual strategy. To focus too narrowly on the international agenda would give us a skewed perspective. As the analysts cited above have stated, there is very little empirical evidence that Russia is an unreliable supplier of gas that uses it as a political weapon – at least to the West.

There have not been any direct threats made to cut-off gas supply to any Western European countries. This is because the Western European market is too important to Russia's economy and Russia understands that threatening one Western European country may cause the others to seek supply channels from elsewhere (Algeria and Tunisia for example). The relationship between Russia and Western Europe is essentially one of interdependence with regard to energy. Although Russia is able to strike deals with EU countries independently (divide and rule), it also understands that to threaten the energy security of one of them may cause a backlash by all. It is the opinion of this thesis that commentators like Stuermer and Goldman have focussed too narrowly on the divide

and rule aspect, and have not adequately considered the fact that when threatened the EU countries would more than likely act in unison. The overriding sense is that the Russians, represented by Gazprom, have acted pragmatically (forwarding a mercantilist strategy), which is in keeping with Putin's foreign policy approach as a whole.

### **LNG – changing the rules of the game**

The gas industry differs in an important respect to the oil industry. Gas is transported almost exclusively in pipelines that are costly to build, thus making it economically unattractive to duplicate lines of supply (Goldman, 2008: 361). This means that once a supplier is established, they in effect have their customer locked-in. A monopolistic system can result without the need to develop cartel structures like OPEC. However, LNG is a technology that would allow the gas industry to move away from its reliance on pipelines and thus free up customers to find alternative suppliers. At present this is an expensive operation and Russia has not mastered the technology.

The development of Liquefied Natural Gas (LNG) will certainly change the equation for every participant. At present Gazprom has structural power over Europe (the ability to dictate the rules of the game), but if other countries with substantial gas reserves (such as Qatar and Iran) develop and exploit LNG technology, then a truly open market may develop. According to Strahan, Iran and Qatar together hold one-third of global proved gas reserves (2007: 143). The Qataris, unlike the Russians, have welcomed foreign involvement in the exploitation of their resources and have thus been able to get the technology and know-how they need. Qatar represents one of Gazprom's biggest threats with regard to its monopoly over gas supplies to Europe. The country, which holds 14% of the world's proven gas reserves, already has a well developed LNG programme and

should by 2015 have the necessary industrial tools and transport infrastructure to challenge Gazprom in the European market .(Lucas, 2008: 20). What's more, Qatar has so far rebuked Putin's overtures to join his proposed gas OPEC.

Despite their conflict in 2006, Gazprom has struck a deal with Royal Dutch Shell that gives Shell 25 percent of the Sakhalin II field and 50 percent of Zapolyarnove-Neocomian field in return for helping them gain experience in LNG technology (Stuermer, 2008: 135). Thus, it is obvious that the development of LNG has caused the gas giant to humble itself to foreign firms due to its lack of technological know-how.

Although LNG represents a threat to Russia's monopoly position in Europe, it is also a major opportunity for them to find new customers. The prospect of LNG technology and Russia's new-found international ambitions have seen the gas giant expand its operations globally. In 2008 alone, Gazprom signed deals with Nigeria, Bolivia, Vietnam, and Venezuela to purchase large shares (and in the case of Nigeria the 100%) in their gas industries. (Lucas, 2008: 13). Another possible development is a pipeline to China. Putin has already promised a pipeline to the Chinese from Western Siberia (Goldman, 2008: 367). When this is operational the Russians could play the Europeans and Chinese off each other in order to get the best deal possible, but LNG would make such a strategy more difficult.

At the beginning of this section it was posited that Gazprom can be seen as the Russian state in miniature. Most of the themes touched on in this case study are distilled in the case of the gas giant. The Russian economy's dependence on hydrocarbons and the constraining effects this dependency has on the formation of foreign policy. The idea that

hydrocarbons afford Russia a certain amount of structural power, and yet also draw Russia into the web of international dependencies that characterise the globalised world. On the domestic front the company illustrates the strategic placing of Kremlin insiders into all of Russia's important positions. While Putin's hands-on approach to the strategy of the company indicates how centralised decision making is in his vertical of power – which is equally present in foreign policy decision making.

Looking forward we can also speculate that the opportunities and threats that face the company are similar to those that face the state. Will Gazprom continue to become an international player in hydrocarbons? Or will the company's inability to adopt and develop innovative technology (LNG), attract foreign investment, and forge international alliances (either through a cartel or good relations with customers) see the company's presence diminish as it fails to compete? What is certain is that due to the size of its reserves and the growing importance of natural gas in the international economy, Gazprom and Russia will be impossible actors to ignore.

### **Part 3: A Picture of Points**

The sheer scope of the preceding analysis - encompassing two decades, employing an approach that requires one to address domestic and international factors and to do so using political and economic tools – may leave the reader overwhelmed by the detail, and wondering how it all fits together. Like a pointillist picture, up close such an analysis appears to be naught but disconnected dots. This brief section aims to give the reader the perspective to see the picture as a unified whole.

In the theory section it was stated that the scientific method can be thought of in terms of a three-phase schema: (1) a phenomenon, or range of phenomena, is identified; (2) explanations for the phenomenon are constructed and empirically tested; (3) a generative mechanism is identified and itself becomes subject of explanation and testing (Bhaskar, 1979: 15). Thus the process begins again and continues in a dialectic manner.

Applying this to the above analysis one can see that the phenomenon that was identified was the affect of hydrocarbons on Russian foreign policy. To explain this phenomenon, the analysis posited that the affect was due to the way the resources affected the relationship between the actor and the structure. This explanation occurred through an analysis of the role of hydrocarbons in the structure (international political economy) and the actor (Russia's domestic political economy). The dynamics within both the international political economy and the political economy of the Russian state were shown to be quite similar – power/security in either requires access to the resources. In testing this explanation empirically, the analysis offered a case study of two periods in Russia's post-communist era.

The insight gained from the first period (1991-1999) was that when the value of hydrocarbons was diminished, due to prevailing conditions in the structure, the ability of the state to act independently was also diminished. This did not occur through outside force or sanction, but was a result of internal political-economic dynamics. The state, unable to reap the benefits from hydrocarbon rents, becomes beholden to the market in order to retain influence over the polity. In turn, the market, and the interests of the powerful market players (the oligarchs) determine the actor's relation to the structure (foreign policy). This is well illustrated in the prevailing foreign policy during the Yeltsin years that saw Russia careful not to displease the West, which was seen as a source of capital to prop-up the state (budgetary support from the IMF, World Bank and other sources) and to keep the state from expropriating rents through either taxation or renationalisation. After the state defaulted on its debt in 1998, causing the market to collapse once again, this situation became difficult to maintain. The collapse of the market sees the grip of the market players weaken. However, without the exogenous input of rising oil prices that occurred thereafter, it is unlikely that the situation would have altered too drastically. Indeed, Putin was not elected to office by popular revolt against the status quo, he was placed there by the influential market elite.

The second period (1999-2008) shows that when conditions in the structure are such that they enable the state to regain supremacy over the market domestically, the state is able to act in a more coherent manner in international affairs (i.e. better able to promote its own interests<sup>71</sup>). At the beginning of this period (for most of Putin's first term) it was not certain that the positive input from the structure (higher oil prices) would be sustained.

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<sup>71</sup> Obviously, the idea of the "state's interests" begs the question who decides what these interests are. Here I am simply referring to the traditional idea of state interests as greater power, security, prestige and wealth in relation to other states.

Thus, at first Putin retains the careful policy towards the West and the state does not completely exert its influence over the market. By his second term, however, the state is in a position to fully dominate the market, this ushers in a period of renationalisation and the subjugation of oligarchs that threaten the power of the centre (Putin's vertical of power). Russia is also able to repay its Western debtors and free itself from such obligations that would constrain its approach. The state, thus enabled by the structure, begins to act so as to affect the structure itself. Russia in this period is assertive and in possession of what Strange defined as structural power. Examples of this power are evident in Russia's relations with states in the near abroad (Turkmenistan, Uzbekistan and Kazakhstan), Iran, the Ukraine (gas cut off) and to a certain extent the EU. Russia makes pronouncements to the effect that the international structure should change from unipolarity to multipolarity.

In focussing the analysis on the subject of Gazprom, we were able to discover that the power afforded Russia through hydrocarbons is not one-dimensional. Although Russia gains structural power through its position with regard to natural gas, the domestic political economy, and its reliance on the hydrocarbons industry, means that Russia has become entwined in the web of economic and political interdependencies that have come to characterise the international political economy. The fact that Russia has been careful not to jeopardise its relations with its main customer with regard to gas, the EU, illustrates the dual effect of hydrocarbons on Russia's behaviour. Thus we get the seemingly paradoxical relationship between power and dependency which characterises Russia's foreign policy in the era of globalisation.

There is yet another thread that has woven itself through the narrative of the case study, that of Russia's identity. It may be thought that such an abstract (ideational) factor as a state's identity would be separate from concerns of political economy and foreign policy. Yet, in the words of Sergei Stankevich quoted earlier in the thesis, "Foreign policy with [Russia] does not proceed from the directions and priorities of a developed statehood. On the contrary, the practice of [Russia's] foreign policy will help Russia become Russia" (Stankevich 1992). The sovereign democracy doctrine, Putin's speech in Munich in 2007, his comments after Beslan, and multiple other examples, are clear evidence that much of the motivation behind Russian foreign policy is inwardly focused at shaping the view Russians have of themselves in relation to the international system. We can also recognise the pattern of official pronouncements on Russia's identity and its correlation with the relative dependency the state had on the West at the time. At the beginning of Yeltsin's tenure Russian 'official' identity was Western; when Yeltsin needed to appease the nationalist forces in the Duma ahead of the 1996 election the identity shifted towards Eurasian; again, when Putin comes to power and the West and Russia share a radical Islamic threat the identity shifts back to Western; only to swing once again to an identity emphasising Russia's distinctiveness from the West when the economy is performing well and unity at home requires it.

The final step in the scientific method is the identification of the generative mechanisms, which themselves become the subject of further analysis in the dialectical march towards grander truths. The generative mechanisms that have been identified are: state-market interaction, actor-structure interaction, power-interdependency, and state identity-foreign policy interaction. These have been addressed to some extent in this analysis, but each could become the topic of their own substantial analysis in future.

## **Conclusion**

This case study has sought to compare two periods in Russia's post-communist era, one when international oil prices were generally low (the Yeltsin years) and one when international oil prices reached historic peaks (the Putin period). The aim has been to discern the affects of hydrocarbons on Russian foreign policy.

The theory employed is based on a constructivist meta-theory which approaches social scientific phenomena using the actor-structure problem. This meta-theory stresses that actor and structure are mutually constitutive (codetermined) and thus continually interact to create the present reality (dialectical interaction). Neither is taken as given (as would be the case in realism when the actor (state) is taken to be a given, unitary entity; or structuralism, where the superstructure determines the actor's path). This approach required that the analysis address domestic political-economic issues to a degree that is still unusual in traditional foreign policy analysis.

To focus the analysis, Susan Strange's approach to IPE was employed. This theory was adopted because it fits with the meta-theory, and because it spans the artificial divides that separated different schools within the social sciences for much of the 20<sup>th</sup> century. The theory offers us two useful definitions of power (structural and relational), a framework of four international structures (production, security, financial, and knowledge) and a methodology that urges us to look at the bargains that have been created and ask 'who benefits' in order to discern where the power lies in the situation. It also gave us four values that we can use to judge the priorities of a society (wealth, security, justice, and freedom). With regard to foreign policy, Strange gave us the insight

that in the globalised era, industrial and macroeconomic policies must be considered along with traditional issues of security and power in our analyses.

Strange's approach, however, was found to be deficient on two counts: Firstly, her claim that the power of states in the IPE has been circumscribed by the emergence of powerful multinational corporations was found to be too strong. Although this point was not argued at length, the subsequent case study showed that the Russian state was openly hostile to foreign multinationals and that other states have been equally circumspect with regard to the hosting of Gazprom. Strange's point is not rejected outright, but it does require qualification. The second, and more fundamental deficiency, was that Strange failed to recognise the importance of geography as a structure in the IPE. It was argued that the issue of hydrocarbons highlighted this deficiency in her approach and that the addition of geography to her model would be a fruitful theoretical initiative.

Following the outlining of the theory to be used, the thesis analysed the importance of hydrocarbons in both the international structure and in Russia's domestic political economy. With regard to the international structure, the importance of hydrocarbons in Strange's four structures of the international political economy was outlined. There after, the role of hydrocarbons in Russia's domestic political economy and their affect on the development of institutions was analysed.

The analysis then turned to a historic narrative of the two periods under study. In the Yeltsin years, it was shown that low international oil prices constrained the ability of the state to act, both locally and internationally. Furthermore, foreign policy applied in an ad hoc manner with the interests of the oligarchs being forwarded on certain issues, and

those of the military-industrial complex on others. This led to incoherence, but also to the favouring of relations with the West on most pertinent issues. The period was divided into two halves (liberal internationalist and Primakov's pragmatism) representing the shift that occurred with the appointment of Primakov.

In the Putin period three domestic issues, pertinent to the hydrocarbons industry and Russia's political economy, were addressed (taxation, subjugation of oligarchs, and renationalisation). Thereafter, the three phases of Putin's foreign policy were outlined. These three periods showed an increasing confidence on the international stage as the economy moved from strength to strength on the back of higher international oil prices. The state in this period had returned, both in the domestic sphere and on the international stage. The aim of the analysis was to show how hydrocarbons aided and incentivised this process.

The thesis then focused on the role of Gazprom in Russia's foreign policy, showing that the gas giant had a dual role of affording the state great structural power, while at the same time tying it to the interdependent globalised system. The case of Gazprom was offered as the Russian case in miniature, and many of the themes of the foregoing analysis were reflected in and illuminated by the case.

Finally, the thesis sought to gain perspective and present the "big picture" that had formed through the analysis of seemingly disconnected phenomena. This section (A Picture of Points) summarised the argument of the thesis and tied the different threads of the analysis together. As such, the final section performed many of the duties of a traditional conclusion. Thus the argument need not be rehashed here.

As Odell noted in the section on case studies, such studies have as one of their strengths the ability to inspire future work and further analysis. Future research topics that have been inspired by this analysis include a more formal comparative analysis of the two periods analysed here, perhaps employing econometric tools and the formation of explanatory political-economic models. A theoretical work marrying Susan Strange's IPE theory with geography, using the role of hydrocarbons in the IPE structure as an important case. A cross-country comparative analysis of the same period comparing the affect of hydrocarbons on the foreign policies of a number of states, in order to discern which factors are particular to the various cases.

The truth is that the Russian period that has been addressed in this thesis is likely to keep analysts busy for many years to come. Russia in the present is also a fascinating case, as the recent financial crisis shows what has changed in recent years and what factors remain the same. What is certain is that Russia can no longer be ignored, either by the academic world or actors in the international political economy.

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